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WEALTH WATCH

FALL 2020

7 Psychological Traps

SOMETIMES, WHEN IT comes to investing, volatile markets aren't your worst enemy. You are. Unfortunately, our brains often play tricks on us, causing even the savviest of investors to make decisions that don't really make a lot of sense, such as panic selling or ignoring opportunities.

The problem of psychological investing traps is so pervasive, in fact, that there's a whole field dedicated to studying it called behavioral finance. Researchers in this discipline look at the way psychology affects how we make financial decisions. Knowing about these traps can help you avoid them and make you a better investor. Here are seven psychological traps to keep in mind.

> "Optimism is the only realism."
>
> Nick Murray

SUNK COSTS BIAS — The sunk costs bias has to do with the all-too-common tendency to stick with something, whether a bad boyfriend or a bad investment, long after it's clear that it's not worth it anymore. Still, because you've invested a certain amount of time or money, you're reluctant to give it up. In investing, you might end up hanging on to a stock long after you should sell it in the vain hope that you'll eventually come out ahead. But in these cases, it's better to cut your losses rather than to hang on to a loser.

FAMILIARITY BIAS — Most of us are biased toward what is familiar to us. We head to restaurants we've been to before and follow the same roads to work because we know what to expect. With investing, familiarity bias involves favoring investments that are familiar to you. You might prefer to invest in the company you work for or big-name businesses that are in the news. That could cause you to overlook important opportunities you don't know as much about.

ANCHORING — Anchoring is the process of getting attached to a particular reference point — such as the price you paid for a stock — and using that to guide future decisions. Or you might fixate on a stock's previous high, even though that price was an anomaly. Anchoring is why buyers think they got a

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Retirement-Planning Assumptions

TO ENJOY YOUR retirement without financial worries, make sure you have enough money saved when you retire. However, that calculation can be a daunting task, since a variety of factors affect your answer, and inaccurate estimates for any factor can leave you with way too little in savings. Some of the more significant factors include:

WHAT PERCENTAGE OF YOUR PRERETIREMENT INCOME WILL YOU NEED? You can find various rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income. On the surface, it seems like you should need less than 100% of your income. After all, you won't have any work-related

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Retirement-Planning Assumptions

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expenses, such as clothing, lunch, or commuting costs. But look carefully at your current expenses and how much you plan to spend in retirement before deciding how much you'll need.

When will you retire? You want to make sure your retirement savings and other income sources, such as Social Security and pension benefits, will support you for what could be a very lengthy retirement. Even extending your retirement age by a couple of years can significantly affect the ultimate amount you'll need.

How long will you live? Today, the average life expectancy of a 65-year-old man is 81 and of a 65-year-old woman is 84 (Source: Social Security Administration). Most people look at average life expectancies when estimating, but average life expectancy means you have a 50% chance of living beyond that age and a 50% chance of dying before that age. Since you can't be sure which will apply to you, it's typically better to assume you'll live at least a few years past that age.

What long-term rate of return do you expect to earn on investments? A few years ago, many retirement plans were calculated using fairly high rates of return. Those high returns don't look so assured now. At a minimum, make sure your expectations are based on average returns over a very long period. You might even want to be more conservative, assuming a rate of return lower than long-term averages suggest. Even a small difference in your estimated and actual rate of return can make a big difference in your savings.

Have you considered inflation? Even modest levels of inflation can significantly impact the purchasing power of your money over long time periods. For instance, after 30 years of just 2% inflation, your portfolio's purchasing power will decline by 45%. When estimating an inflation figure, don't just look at the historically low inflation rates of the recent past. Also consider long-term inflation rates, since your retirement could last for decades.

What tax rate do you expect to pay during retirement? Especially if you save significant amounts in tax-deferred investments that will be taxable when withdrawn, your tax rate can significantly affect the amount you'll have available for spending. You may find your tax rate is the same or higher after retirement.

Once you've estimated these factors, you can calculate how much you'll need for retirement. Please call if you'd like help with this calculation. ✔✔✔

Financial Tips for the Sandwich Generation

If you are caring for young children and aging parents, you are part of the sandwich generation. Developing a financial plan for your parents, your children, and yourself will help you navigate the challenges you face.

A Retirement Income Plan for Your Parents — In addition to understanding their wishes for medical treatment and long-term care, you should also understand if your parents have adequate retirement income.

Research Long-Term Care Options — You should research ways to pay for long-term care if your parents need it. If your parents are in good health and still relatively young, they may want to consider purchasing a policy.

Prepare an Estate Plan — If your parents do not have an estate plan, it's time to create one so that their wishes are met. Help them through this process, or find someone who can, including establishing a will, trust, advanced healthcare directives, and medical and durable powers of attorney.

Inventory Assets — Help get your parents' financial assets in order by locating all important documents.

Develop a College Savings Plan — As you switch the financial focus from your parents to your children, start by planning for their largest expense: their college educations. In addition to college savings, you should help your children plan for their life after high school. Engage your children in this process by having them research scholarships, grants, and work-study programs to assist with college expenses.

Your Turn — Because you are sandwiched between your parents and children and taking care of their needs, you may not have developed your own financial plan. It is important that you take the time to put yourself first and get your own financial house in order. Creating a financial plan with long- and short-term goals will give you peace of mind that your own financial life is on track. Once it is created, it will give you more time for the other competing priorities in your life. Please call if you'd like to discuss this in more detail. ✔✔✔

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Your Risk Tolerance and Retirement

To gain a better understanding of how we're affected by risk when building a retirement portfolio, it's important to learn about risk tolerance and what it means for you as an investor.

What Is Risk Tolerance?

Risk tolerance essentially refers to an investor's ability — both emotionally and financially — to deal with major upswings and downswings in the market. If a person is said to have high risk tolerance, he or she likely tends not to worry so much about the potential risk of certain stocks or having a large amount of stocks in a portfolio. Those with low risk tolerance are on the other end of spectrum, often too cautious to deal with volatile stocks or the market in general.

Risk Tolerance and Age

While plenty of factors must be taken into consideration when considering your own risk tolerance, age is one that can be seen as an important anchor to help risk-takers avoid getting in over their heads. This is especially true of those who are working towards building an effective retirement plan. When people are young, it makes more sense to take risks with investments than when they reach retirement age.

What's important to recognize is that risk tolerance *must* shift with age to avoid making costly mistakes at a time when it may be potentially too late to recover.

Adjusting Risk Tolerance

It may seem as if adjusting risk tolerance is challenging, but often it simply means taking a realistic approach to your investments. If you're nearing 60, for example, it's generally considered unwise for your portfolio to be comprised of 70% stocks — the number should be closer to 40%. Many successful investors find moving away from stocks to bonds is an effective later-in-life strategy.

The Importance of Working with a Financial Planner

The best way to get a better sense of what is a realistic risk tolerance for you at this point in life is to work closely with your financial planner. Please call if you'd like to discuss this in more detail. ✔✔✔

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great deal when buying a car for $50,000 when the initial price was $60,000, even though the car's really worth $40,000.

Whether buying stocks or cars, anchoring involves using a single piece of information to determine what a stock or other investment should be worth while also discounting more relevant information, such as a company's fundamentals or broader economic trends. Unfortunately, avoiding anchoring is difficult, but considering all available information before choosing an investment can help.

Focusing Too Much on the Recent Past — Recency bias is the tendency to make decisions or judgments based on relatively new or recent information. For example, during times when the market is up, people may ignore or discount the possibility of a market decline. Or, if a certain category of stocks has done poorly recently, people may conclude that those stocks *always* have negative returns, even if the dip is an anomaly. You can avoid this mistake by doing your best to consider the entire universe of information at your fingertips, not just what happened yesterday.

Following the Herd — While following trends might be fine for fashionistas, it's not always a smart investing move. Yet herd investing is an all-too-easy trap to fall into. If everyone is telling you that now's the time to get into a certain hot investment, you may feel you need to act fast so you don't miss out. But just because something is popular doesn't make it a good investment. Blindly following the herd without first consulting your own financial goals and plan doesn't make you a smart investor.

Overconfidence — Most of us like to think we're smarter than the average person. If you hit it big with a certain investment, you may overattribute that success to your skill rather than what it really is — luck. That can cause you to repeat the same behavior.

Panic — Investing isn't for the faint of heart. When the market takes a sudden dip, it's easy to panic, which can lead you to make bad decisions, such as selling at a big loss, rather than riding out the natural hills and valleys of investing. Making these emotionally driven choices costs you a lot of money. When making investing decisions, make sure they're based on evidence, not your initial gut reaction to the day's events. ✔✔✔

About Align Wealth Management

Align Wealth Management (Align) is a federally registered investment advisor with offices in Oklahoma City, Oklahoma and St. Petersburg, Florida. Our advisors are CERTIFIED FINANCIAL PLANNER™ professionals who can help you manage your investments, plan your retirement, reduce your taxes, minimize your risks, and leave a legacy to your loved ones. Recognized as one of America's best by Financial Times Top 300, Align has developed a solid reputation for its strong client-focused culture.

Our sole mission is to help you make the most of your one financial life. We believe in straight talk, good old-fashioned common sense, intense research, hard work on your behalf, and complete transparency.

Importantly, we serve one master — our valued clients. We don't work for (nor do we accept compensation from) any brokerage firm, insurance company, or financial company. We are a "fee-only" firm, and we never accept commissions for the sale of financial or insurance products. Every ounce of our allegiance flows directly to our clients and every penny of our compensation flows directly from our clients via fully disclosed fees. And speaking of fees, you'll find the total cost of our services to be among the most competitive in the industry.

Bottom line: We work to ensure our clients never run out of money in retirement and help them pass meaningful legacies to their loves ones. We're here to help. ✔✔✔

Thanks for taking a look!

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> "Choosing accounts with tax benefits, buying investments that are prone to a lower tax bite, and making strategic moves before year-end can help cut your tax bill."
>
> Source: Vanguard, *Managing Your Investment Taxes 2020*

Why Tax Planning Matters

When people neglect to plan for taxes over the course of their lifetimes, they typically end up paying more than necessary. Taking the time and effort to plan for taxes can help in these areas:

Short Term — Making a tax plan at the beginning of the year can help lower your tax bill by ensuring that you are taking advantage of as many tax strategies as possible. The best way to make sure you haven't missed anything is by going over your tax situation and strategies with an accountant or advisor.

Long Term — Most people do not make enough money in a single year to fund their long-term goals, like paying for their children's college, purchasing a house, or paying off all of their student loan debt. Therefore, some long-term tax planning is in order. Overall, the more you save on taxes, the more you have to put toward your financial goals.

Retirement — As you plan for your retirement and continue to contribute to your 401(k) plan or IRA, it is helpful to know that the amount you contribute can be deducted from your taxes. Even if you utilize a Roth IRA and cannot deduct the contributions today, you can access those funds tax-free in retirement. It takes a lot of money and careful planning to retire comfortably, and a tax plan is an essential part of the process.

Legacy — When you think about what you hope to leave behind for your heirs or your favorite charity, you might not initially consider the tax ramifications. Consider setting up part of your estate plan in a Roth IRA so your children can draw tax-free income from the account. You can also take advantage of the annual gift tax exclusion by transferring funds to your heirs while you are still alive. Donor-advised funds, life insurance, and various types of trusts can all offer other solutions to the tax aspect of your legacy. ✔✔✔