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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Happy Summer, FF readers! Please enjoy this month's edition of The Financial Formula, and let me know if you have any questions...thanks!

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In This Issue

Inflation -- The Subtle Thief of Your Purchasing Power

American workers are laboring as diligently as ever, but they have little extra to show for their effort. Combine meager pay increases with the slow but steady effects of inflation, and it is easy to see how families are barely breaking even.

According to Department of Labor statistics, workers have been receiving, on average, 2% pay increases for the past few years.[1] But when you adjust that increase for inflation, what's left it negligible. In April of this year, for instance, inflation-adjusted earnings rose just 0.3% from the previous year. In April 2016, wages rose 1.2% annually after inflation, and in 2015 that figure was double -- at 2.4% -- thanks to near-zero increases in the cost of consumer goods and services at that time.[1]

Ramping Up?

While inflation rose 2.2% in April from a year earlier, policymakers at the Federal Reserve -- the nation's central bank and overseer of our monetary system -- expect price increases to level off at the Fed's annual inflation target of about 2%.[1] Still, with wages following a similar trajectory, workers are left feeling the squeeze in their wallets, despite bigger pay days.

Follow the CPI

The most common measure of inflation is the Consumer Price Index, or CPI. The CPI is based on a monthly survey by the U.S. Bureau of Labor Statistics. It compares current and past prices on a "basket" of common expense categories, including housing, transportation, food, and clothing.

While inflation has been a constant fact of life in the U.S. economy dating back several decades, it can be particularly damaging to retirees, many of whom are living on fixed incomes. For many, Social Security is the only retirement income that increases through cost-of-living adjustments (COLAs) to reflect any increase in the cost of living as measured by the CPI.

It may be easy to overlook inflation when preparing for your financial future. After all, an inflation rate of just 2% to 3% -- which we have been experiencing for the past several decades -- may not seem worth noting, until you consider the impact it can have on your purchasing power over the long term.

Consider that at just a 3% inflation rate, a $100,000 nest egg today would be worth only $73,742 in today's dollars 10 years from now, $54,379 in 20 years, and $40,101 in 30 years.

As you can see from this example, the further away you are from retirement, the more potential inflation has to erode your future purchasing power, and the more important it is for you to choose investments that can potentially help you stay ahead of inflation.

Talk with your financial advisor to learn more about managing the impact of inflation on your investments.

[1]*The Wall Street Journal, "Don't Feel That Pay Raise? Blame Inflation," May 12, 2017.*

IRAs: Who's Contributing Today?

When traditional IRAs were introduced more than four decades ago, the federal government sought to give individuals without access to an employer-sponsored retirement plan a way to save for retirement in a tax-advantaged manner. Fast-forward to today, and IRAs account for nearly half of all assets in private sector retirement plans, far exceeding monies held in defined benefit and defined contribution plans.[1]

Retirement Assets by Plan Type -- Q3 2016

Defined Benefit Plans	Defined Contribution Plans	IRAs
$3.3 trillion	$5.7 trillion	$7.8 trillion

Sources: The Center for Retirement Research at Boston College and the U.S. Board of Governors of the Federal Reserve Systems, *Flow of Funds Accounts* (2016).

Yet even though more than one third of American households -- some 43 million -- now own IRAs, just 14% of all U.S. households contributed to an IRA in 2015. Instead, the vast majority of assets held in IRAs come by way of rollovers from employer-sponsored retirement plans.

Who's Using IRAs?

With rollover assets dominating the IRA landscape, the real question becomes: Who is contributing to an IRA today? To help answer this question we turn to recent research published by The Center for Retirement Research at Boston College (CRR). The CRR compiled key demographic and financial data about IRA owners who contribute to their accounts versus those who do not.

Among other discoveries, the report revealed that IRA contributors are more likely to be white, college educated, married individuals in two-earner households. IRA contributors are also more likely to contribute to a 401(k) account (in addition to an IRA) and have higher household earnings that non-contributors.

Characteristics of IRA Owners by Contribution Status, 2011
(Ages 25-70)

Characteristic	Not Contributing	Contributing
Demographic		
White	68%	86%
College of more	33%	61%
Average age	45	47
Marital status		
Single	30%	26%
Married, one-earner	39%	35%
Married, two-earner	31%	39%
Employment and financial		
Currently participates in a 401(k)	30%	53%
Average household earnings	$70,197	$110,523
Self-employed	9%	14%

Sources: The Center for Retirement Research at Boston College. Authors' calculations from U.S. Census Bureau *Survey of Income and Program Participation*, 2008 panel.

Find Your Match

The researchers further broke down the data, creating three prominent subgroups within the IRA contributing population.

1. Dual-income super savers - married couples in two-income households that frequently also contribute to an employer-sponsored retirement plan. This group is motivated to save beyond their 401(k)s and is attracted by the tax benefits of IRAs.
2. Frugal breadwinners - either single individuals or one-earner married couples in the middle-income range that also tend to participate in an employer's retirement plan. This group could be described as thrifty and knowledgeable about the income requirements of retirement.
3. Successful entrepreneurs - higher-income, self-employed individuals who are not currently contributing to a 401(k). This group uses IRAs as an alternative vehicle to an employer plan to save for retirement.

Keep in mind that with just 14% of American households contributing to IRAs, these groups represent a very small minority of the population. As for IRAs, they continue to serve primarily as repositories for assets accumulated in employer-based plans - not as the tax-advantaged retirement savings vehicles intended for those individuals without access to a workplace plan.

[1]*The Center for Retirement Research at Boston College, "Who Contributes to Individual Retirement Accounts?" April 2017, Number 17-8.*

Sick of Worrying About Health Care Costs?

With all the news about rising health care premiums, deductibles, and other out-of-pocket expenses, a majority of Americans are concerned about what the future may hold for health care expenses.

A new poll conducted by Bankrate.com found that 56% of respondents are worried that they might not have affordable health care in the future.

Fear of the Future

(Percentage of survey respondents who are concerned about future health care costs)

- Very worried = 35%
- Somewhat worried = 21%
- Not too worried = 17%
- Not at all worried = 24%

The same study found that about one-in-four Americans admit that they -- or a member of their family -- have skipped a visit to the doctor due to the expense. In terms of demographic groups, millennials (those age 18 to 36) are the most likely to forgo a medical appointment due to cost, while the Silent Generation (those age 72+) are the least likely to miss a medical visit.

Age Matters

(Percentage of survey respondents who said cost was a barrier to seeking medical care)

- Millennials (age 18 to 36) = 31%
- Generation X (age 37 to 52) = 25%
- Baby Boomers (age 53 to 71) = 23%
- Silent Generation (age 72+) = 8%

Certainly much of the concern expressed by Americans is justified. With the mantra of "repeal and replace the Affordable Care Act" echoing through the White House and the halls of Congress, the nation waits in limbo as the House's version of a replacement health care bill now rests in the hands of the Senate where it faces significant opposition and a very uncertain future.

Start Your "Sick Day" Fund

Instead of waiting, worrying, and compromising your physical health, consider starting a fund to help pay for the uncovered portions of medical expenses. You may already have a rainy day fund for unexpected home or car repairs, so starting a sick day fund may seem like a familiar exercise.

The following tips will help you start saving more right away.

Stick to Your Budget. Try to maintain financial discipline by avoiding unnecessary "impulse items" that aren't in your budget or on your shopping list.

Buy in Bulk. Instead of purchasing just one of anything you use regularly, you may be able to find the same item at a much lower "unit cost" when it is packaged and sold in bulk at a discount retailer or shoppers' club. While you'll spend more up front, the "economies of scale" may help improve your bottom line within a month or two.

Reduce the Cost of Debt. Every month, millions of Americans spend their hard-earned money on interest and finance charges that arise from carrying personal debt, such as credit card balances. Wherever possible, transfer any high-interest debt to a single, low-rate account. And needless to say, don't use credit to buy things you can't really afford.

Additionally, whenever you're expecting a tax refund, bonus, or other windfall, be sure to put it to good use. Paying off debt and saving for a "sick day" are almost always better strategies than spending without a plan.

[1] *Bankrate.com, "Worried sick about your health care? You're not alone," June 8, 2017.*

The DOL's Fiduciary Rule Takes Effect -- at Least for Now

For those following the fate of the Department of Labor's (DOL's) fiduciary rule, the road has been a long and winding one. But in late May 2017, the newly-appointed U.S. Labor Secretary, Alexander Acosta, announced that the DOL would honor the June 9 effective date for the rule, which expands the scope of what constitutes investment advice and defines the obligations of financial professionals who provide such advice to retirement plan participants, plan sponsors, and/or IRA owners.[1]

In an article published in *The Wall Street Journal* on May 22, Acosta wrote, "We…have found no principled legal basis to change the June 9 date while we seek public input."[2] Thus, the rule went into "partial" effect on June 9 with full implementation scheduled for January 1, 2018.

The Back Story

The so-called fiduciary rule was initially proposed under the Obama administration in 2010, but at that time it faced stiff opposition from the financial services industry. A revamped version of the proposed rule was issued in April 2015, and a year later the "final" rule -- which was revised to reflect input from consumer advocates, industry stakeholders, and others, was presented by the DOL.

The new regulations were expected to take effect in April of 2017. On February 3, 2017, President Trump issued a memorandum directing that the DOL's rule be reviewed to determine whether it may "adversely affect" retirement investors' ability to gain access to financial advice, and if it does, to move forward with "rescinding or revising" the rule.[3] In response, on March 2 the DOL announced that it was seeking a 60-day delay in the applicability of the new rule, from April 10, 2017 to June 9, 2017, which brings the timeline full circle.[4]

What's at Stake?

Supporters of the rule view it as a necessary and basic consumer protection that includes a number of measures aimed at protecting the interests of investors in and sponsors of retirement accounts.

According to Labor Secretary Acosta, the rule's critics believe "it would limit choice of investment advice, limit freedom of contract, and enforce these limits through new legal remedies that would likely be a boon to trial attorneys at the expense of investors." He went on to assert that, "Although courts have upheld this rule as consistent with Congress's delegated authority, the Fiduciary Rule as written may not align with President Trump's deregulatory goals. This administration presumes that Americans can be trusted to decide for themselves what is best for them."[2]

For now at least the fiduciary rule stands while the DOL continues to review it for possible changes or elimination.

[1]*United States Department of Labor, "FAQs About Conflicts of Interest Rulemaking."*

[2]*The Wall Street Journal*, "Deregulators Must Follow the Law, So Regulators Will Too," May 22, 2017.

[3]Forbes, "Under President Trump's Direction DOL Moves to Delay Fiduciary Rule," March 1, 2017.

[4]U.S. Department of Labor, Employee Benefits Security Administration, Field Assistance Bulletin No. 2017-02, May 22, 2017.