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Back to the Investment Basics

Part 2: First Save, Then Invest

In our last piece, we wrote about how recency bias can damage your investments by causing current crises to loom large, while rewriting your memories of past challenges. Recency tricks us into overpaying during heady times, and bailing at bargain rates, when our confidence fades.

One of the best ways to combat recency bias is by focusing instead on the basics that have served investors well for centuries, if not millennia. In this series, we'll cover five of our favorites:

1. **You can't invest if you haven't saved.**
2. Markets are inspired by ingenuity, tempered by diversification.
3. The price you pay matters.
4. Patience is a virtue.
5. Investing is personal.

Today, let's talk about saving.

Saving is a Super Power

Before you can invest, you have to save. But knowing this is true doesn't always make it easy to do. Bottom line, saving is a sacrifice. When you set aside money for tomorrow, you don't get to spend it today. There's nothing fun about that.

Saving also isn't as "exciting" as investing. When you invest, the stakes can be high: Some strike it rich, others suffer calamitous loss, and either makes for dramatic headlines. In contrast, your basic savings account is unremarkable. It's unlikely to either grow wildly or vanish overnight. No wonder most people are far more attuned to their investment efforts than their saving strategies. There's never a lack of analysts covering the latest market news, or experts opining on what to do about it. Whether the coverage is good, bad, or ugly, there's always plenty of it.

When was the last time someone reminded you how incredibly powerful it can be to simply keep adding new money to your accounts, no matter what the market is doing? Saving is important throughout your life, and an absolute super power when you or your loved ones are younger, with time on your side. In fact, when we're in a bear market, as long as you have enough time before you need the money back (a decade or longer), it can be even more compelling to inject new money into your accounts. If you use fresh savings to add to your existing investments, you're effectively buying in at discounted rates.

Give Your Savings a Nudge

It's easy to cast our human biases as the bad guys when it comes to good investing. Letting recency bias skew your perspective is a prime example.

But our biases don't have to hurt us. In "Nudge: The Final Edition," Nobel Laureate Richard Thaler and Cass Sunstein describe scores of ways you can use your biases to nudge you toward making better decisions about your wealth, health, and well-being.

"A nudge . . . alters people's behavior in a predictable way without forbidding any options or significantly changing their economic incentives. To count as a mere nudge, the intervention must be easy and cheap to avoid. Nudges are not taxes, fines, subsidies, bans, or mandates. Putting the fruit at eye level counts as a nudge. Banning junk food does not."

Others can nudge you, as Thaler and Sunstein describe, or you can nudge yourself. For example, would you like to save more, but you're having a hard time shaking loose the change? Consider using status quo bias as a force for good.

The idea is, you're far more likely to save more effectively once you no longer have to make a choice, or take action to shift funds from your spendable coffers to your savings stash. For example, when your company auto-enrolls you in its 401(k) retirement plan, for heaven's sake, let them. Ditto if they have a formula for automatically increasing the percentage you contribute over time. You can also make a one-time choice to maximize the percentage you're contributing. After that, inertia will kick in, making it less likely you'll skip or skimp on saving for the future.

Self-Service Savings

You can set up similar, inertia-based saving habits by making a pledge to yourself that any "new" money coming your way will receive similar treatment.

For example, establish a rule that you'll always set aside 10%, 20%, or whatever works for you, whenever you receive a raise, bonus, or equity compensation from work. You can establish a savings account specifically for this purpose, like a bank-based "change jar."

Restorative Powers of Saving

So, have you been watching the markets bouncing up, down, and all around this year, wondering whether the pundits who are predicting doom and gloom are correct? Please remember, there's not much you can do to prevent market uncertainty. But you can save. You should save. You should keep saving. If you haven't been, we understand that change is hard. Thanks to our biases, going with the flow usually seems easier, even if we're dissatisfied with where it's taking us.

In our next installment, we'll take a look at our second investment basic: *Markets are inspired by ingenuity, tempered by diversification*.

Until next time, no regrets!

Eric Hutchens
President & Chief Investment Officer

Headlines

- Allodium was named in the July issue of Financial Advisor Magazine RIA Survey and Ranking.
- Eric Hutchens was a speaker at the 5th Annual Private Wealth Great Plains Forum on July 26, 2023. His panel topic: "The Future of Wealth Management."
- Our office will be closed September 4, November 23 and 24 for company holidays.
- Allodium welcomed three new clients in the second quarter of 2023.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

Upcoming Webinar

Introduction to Financial Planning

Do you wonder if you are on the right track to meet your financial goals? Do you want to incorporate financial planning strategies to build a stronger foundation for your financial future? A financial plan has several components which can help you consolidate your debt, budget your spending, and manage your savings.

If you are interested in how to create a financial plan or improve your existing financial plan, save the date for our 2023 Allodium Fall Wealth Management webinar called Introduction to Financial Planning to be held Thursday, October 19, at 2:00 p.m.

Featured Speakers

Saul R. Baumann,
CPF®, AIF®
Investment Consultant

Derek Van Calligan,
CPF®, AIF®
Investment Consultant & Director of Investment Research

EVENTS

"Invest for the long haul. Don't get too greedy and don't get too scared."
— Shelby M.C. Davis

FINANCIAL PLANNING TIP

Guidance on Inherited IRAs

For Decedents Passing Away in 2020, 2021, or 2022

The rules for inherited IRAs changed with the Secure Act of 2019, which eliminated the "stretch" required minimum distribution (RMD) schedule for most non-spouse beneficiaries and replaced it with a 10-year distribution period. The new rule said that inherited IRAs had to be fully distributed by the end of the 10th year following the original owner's death, and the beneficiary could decide how much to take each year, including waiting until the 10th year to distribute all of it. This is where the confusion began.

Most CPAs and tax professionals interpreted the 10-year distribution rule to apply to all IRAs inherited from non-spouses. However, according to the IRS, that is not what the law intended. The IRS said that if the decedent was already taking RMDs when he or she died, then the beneficiaries would need to continue taking RMDs annually AND fully distribute everything within 10 years. This rule caught the tax professionals by surprise, and the IRS received a lot of push-back.

Due to the confusion, the IRS waived required RMDs in 2022 for those inheriting an IRA from someone who died in 2020 or 2021. In July 2023, the IRS again waived RMDs for those who inherited IRAs from someone who died in 2020, 2021 or 2022. [1] This is probably the last time the RMDs will be waived because clearer guidance from the IRS is coming by the end of 2023.

If you have an inherited IRA, this is what you need to know for your situation:

1. No change to the prior "stretch" distribution schedule for the following two situations:
   - Inherited IRA from someone who died before 2020
   - Inherited IRA from spouse
2. For an inherited IRA from someone other than a spouse, who died in 2020, 2021 or 2022 and who had *not begun* taking RMDs, you must take full distribution within 10 years of date of death using your preferred distribution schedule.
3. For an inherited IRA from someone other than a spouse, who died in 2020, 2021 or 2022 and who had *already begun* taking RMDS — you don't need to take an RMD this year. RMD will (most likely) be required in 2024 and you should watch for the IRS guidelines. You must still distribute everything from the account within 10 years from the date of death.

For those inheriting an IRA from someone who died in 2023 and had already started taking RMDs, the beneficiaries must take any remaining 2023 RMD on behalf of the decedent. The beneficiaries' own 10-year distribution period begins next year (2024) and the forthcoming IRS guidelines on the RMD amount each year will apply.

Please contact your advisor and/or your tax professional if you have any questions on this.

1. O'Brien, Elizabeth. (July 18, 2023). *Inherited IRAs Just Got New Rules Again. What You Need to Know.* Barron's. https://www.barrons.com/articles/rules-inherited-iras-retirement-irs-39ed5fa3

TIP

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3700 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

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