Buttonwood Partners, Inc.

May 1, 2019
Q2

Investment Thoughts

Dear Client,

Rules of thumb come into being because they are guidelines that work well "on average." They select a set of the most common assumptions and discover what works well under those circumstances. The simple fact that they do work means that there is an underlying truth supporting them. They also tend to be easy to remember, and to apply, and therefore have widespread appeal. There is comfort in numbers, which makes us more willing to accept something that has apparently worked well for so many before us. The word is spread until they become ingrained in our common knowledge.

Yet there is a contradiction at work here. In a world where we vigorously defend that which makes us unique, why are we so willing to embrace statements or planning techniques that treat us as one of the masses? Remember the saying that warns us of the dangers of relying on assumptions…

Broad-based assumptions have their usefulness, but their value tends to be limited to generalizations. When you attempt to apply them to specific cases or unique circumstances, the result is too often an avoidable mistake. For example…

A quick Google search reveals that the average temperature for May in Madison is roughly 58 degrees, with about 9 days of rain during the month. But are you willing to choose your wardrobe in the morning based on this information alone? What if I added that this figure was calculated by combining the average high (70 degrees) with the average low (45 degrees) of the day? Or that the data points were recorded on UW-Madison's campus?

And we haven't even factored in our personal preference. How often have you been bundled up in a winter coat and hat, only to drive by middle schoolers waiting for the bus in shorts and a sweatshirt? Or seen someone sprint inside at the first snowflake while others race to get outdoors in the middle of a blizzard? Since we tailor our decisions to our tastes, even knowing the "average" tells us little – our personal behavior will likely bear little resemblance to that "average" response.

Rules of thumb tend to be static; real life most certainly is not. I might make tentative plans based on the 10-day forecast, but I know better than to cancel them more than a day or two before – or even a few hours! The general outlook of rain during the day could be correct, while the 2-hour window I care about is filled with bright sunshine. Too much can change in a short period of time, and it is the specifics that matter – not the broad summary.

Personally, I pay closer attention to the hourly forecast, along with a check of the radar. I know that the weather can change dramatically between morning and night,

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Inside this issue

Special points of interest

- Not able to make an appointment during the work day? The sidebar on page 2 has alternative times to see Greg and Jodie.
- A list of essential estate planning documents appears on page 6.
- We can help you with more than just fund allocation. See our list of other services on page 7.

Need an After Hours Appointment?

Upcoming opportunities:

Greg
Wednesday Evenings

Available 4 pm, 4:45 pm, 5:30 pm and 6:15 pm

May 15
June 19
July 24
August 14

Jodie
Saturday Mornings

Available 9 am, 10 am and 11am

June 22

Office Closures

Buttonwood Partners Inc. will be closed on the dates below to allow our employees to celebrate with their families.

Monday, May 27
Labor Day

Wednesday, July 3 at Noon
Independence Day

Thursday, July 4
Independence Day

Monday, September 2
Labor Day

Investment Thoughts cont.

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and that the seemingly small distance between Middleton and Stoughton (both technically suburbs of Madison) can mean a large difference in my weather experience. Averages can be a useful place to start, but can also be treacherous when used as the sole basis for a decision.

With that in mind, in this issue, we are featuring an article that focuses on one of the greatest rules of thumb in the financial planning industry: the "4% Distribution Rule." It is a thoughtful, academically tested response to the question, "How much can I plan to live on in retirement?" But it was also designed to calculate a static answer to a specific scenario using a very strict set of assumptions. (There's that word again! A few of the key ones in play here are highlighted at the end of this note.) Of course, this should bring you to the next logical question: What if you don't fit exactly into that particular mold? "Well, you should be OK…"

To borrow from the current AT&T ad campaign, "Just OK is not OK." You can do better. We can do better together. Yes, it will require a little extra thought, time and energy, but isn't something as important as your financial future worth it?

Subsequent academic research has led to the conclusion that advice and a flexible plan can lead to a better outcome namely, successful withdrawal rates above the rule of thumb's 4% standard. Setting money aside ahead of time? Adds value. Choosing which asset class to take a withdrawal from, rather then selling proportionately from the entire portfolio? Adds value. Being willing to adjust spending rather than take an automatic inflation adjustment? Adds value. Almost every decision we actively make together is outside the set of assumptions that arrived at the 4% Rule, and therefore has the possibility of producing a better outcome. It's why you'll hear us talk about the "6% Rule" when discussing your retirement income.

We want you to be active participants in your financial planning, not to simply rely on general rules of thumb, and to involve us in the process. I'll reiterate a point made on page 7: nothing disappoints us more than learning about a financial decision we could have improved if consulted, or hearing someone say they didn't ask us a question because they didn't think it was "what we do." There is also that saying about "the only bad question…"

Thank you as always for your trust. We look forward to hearing from you – and hopefully being able to answer a question or two!

Sincerely,
Greg Rademacher, Jodie McLellan and Chris Bugg

Key Assumptions of the 4% Rule

- Limiting to a 10% chance of failure (running out of money) within a 30-yr timeframe
- Annual withdrawals set as a percentage of the beginning balance in the first year, adjusted by the inflation rate every year thereafter.
- A 60% stock, 40% bond portfolio, represented by the S&P 500 Index for stocks and Barclay's Aggregate Bond Index for fixed income. The portfolio is rebalanced back to these proportions annually.
- Annual withdrawals are taken at the beginning of the year, and are taken proportionately from each asset class.
- No adjustments to spending or inflation adjustments based on financial need or market conditions.

The 4% rule was originally developed by William Bengen. While we strive to provide the most accurate information possible, we do not accept any liability due to inaccuracies in the information above.

The Myth of Steady Retirement Spending and Why Reality May Cost Less

By Peter Finch **11/29/2018**

It's the question at the heart of so much retirement planning: How much money will I need in savings when I've stopped working?

To arrive at that number, many people start calculating an estimate of what they will need to live on each month. The figure they come up with often relies on a popular rule of thumb: the so-called 4 percent rule.

This rule holds that if you invest in a mix of roughly 60 percent stocks and 40 percent bonds, you can safely spend 4 percent of your savings annually over 30 years without fear of depleting your nest egg.

So if you retired at 65 with $1 million, you could withdraw $40,000 (adjusted each year for inflation) for living expenses until you run out of money at 95. Add this $40,000 to Social Security and any other income you may be collecting, and that's your annual spending budget in retirement. Need more than that? You'll either have to cut expenses or save more money before you're ready to retire.

There's a lot of research to suggest that following the 4 percent rule — or something close to 4 percent — is a good way to make your savings last. This approach is at the heart of many popular online retirement calculators.

But does retirement spending actually work that way? Do retirees really spend a fixed amount each year for the rest of their lives?

They do not, many financial advisers and academics say. "This is my 35th year in practice, and I can tell you none of my clients has ever spent on a straight line," said Neal Van Zutphen, a certified financial planner with the firm Intrinsic Wealth Counsel in Tempe, Ariz. "Your spending habits and your spending needs will change over time."

Here's one reason that's important: You may be closer to having enough money to retire than you think.

"The frustration for clients is they have to save this big bunch of money to produce this big number," Mr. Van Zutphen said. "Some of them hate their jobs, and they can't wait to get out. As a planner, you feel like you're torturing the client by making them stay longer and work harder. Instead, why don't we sit down and figure out what's really happening with them?"

Although his clients Rod and Jeannie Koleno didn't hate working in Mr. Koleno's dental practice in Eugene Ore., they hoped to sell it and retire in 2001, when he turned 59. Mr. Van Zutphen showed them that they had enough money to retire a year earlier if they wanted. Their reaction? "Yippee!" Ms. Koleno recalled.

"Do retirees really spend a fixed amount each year for the rest of their lives?"

Mr. Van Zutphen was counting on the Kolenos to spend more in their first years as retirees and less as they got older. Which is what has happened. Expenses that hit them hard in their early retired years — helping out their six children a bit and caring for their aging parents — have dropped away. Now they're living frugally and happily in Ketchum, Idaho.

Financial advisers have a few ways of describing the decline in retirement spending over time. One of the most popular, coined by the certified financial planner Michael K. Stein, is to view retirement as three stages: your Go-Go years, your Slow-Go years and, finally, your No-Go

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The Myth of Steady Retirement Spending Cont.

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years.

Data from the Bureau of Labor Statistics suggests the decline is true. The mean spending for households headed by 55- to 64-year-olds was $65,000 in 2017, according to its Consumer Expenditure Survey. Spending dropped to $55,000 between ages 65 and 74, and after that it fell to $42,000. Housing costs remained steady and health care expenses increased, but nearly every other category — transportation, entertainment, clothing, food and drink — declined sharply.
J. P. Morgan Asset Management has studied the spending patterns of its customers and witnessed the same trend. Spending drop-offs are even more pronounced among retirees with $1 million to $3 million in assets, said Katherine Roy, the firm's chief retirement strategist.

"It appears the more you have, the steeper the spending decline in real terms," she said.
Ms. Roy figures that traditional financial planning tools — ones that expect spending to keep pace with inflation for 30 years — "could overstate spending in late retirement by 30 percent or more."

One of her firm's studies grouped 613,000 JPMorgan Chase customers into profiles based on their spending patterns. These included homebodies, globe-trotters, health care spenders and foodies.

It's worth figuring out which profile matches your spending, said Wade Pfau, a professor at the American College of Financial Services and director of retirement research at McLean Asset Management. If you fall into one of the first three groups, you may be looking at spending increases throughout your retirement. But people in the biggest group — the 39 percent who spend more than others on food and drink — can reasonably expect the "Go-Go, Slow-Go, No-Go" progression.

"This is the group that tends to spend less as they age," Dr. Pfau said.

Even when it declines, retirement spending in today's dollars doesn't always follow a straight path. It often resembles a smile, according to a study by David Blanchett, head of retirement research at Morningstar. That is, it starts high, gradually declines, and then increases toward the end of a retiree's life. He based his study on real-life data from the Health and Retirement Study, a project of the National Institute on Aging and the University of Michigan.

Those later-year gains in spending are almost always related to health care, Dr. Blanchett said.

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Even with those increases, however, retirees in their 70s and 80s still tend to spend less than when they first quit working.

"The real change in annual spending through retirement is clearly negative," Dr. Blanchett said. This is something financial advisers should go over with their clients, he added. "They can say, 'The most common assumption is that you're going to increase your spending by inflation, but here's the

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The Myth of Steady Retirement Spending Cont.

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deal: The average person doesn't do that,'" he said.

Dr. Blanchett suggests running a separate retirement-spending projection that assumes your spending grows by 1 percentage point less than inflation.

"How does that change how you can spend your money?" he said. "One thing it can do is free up money when you can most enjoy it. Take that cruise when you're 65 or 70 because you're probably not going to be able to take it when you're 80."

Not every financial adviser thinks it's a great idea to count on lower spending in your later years. Michaela Herlihy, president of Beacon Financial Planning of Cape Cod in Hyannis, Mass., will happily create alternate spending projections for clients who request them, but her recommendation is to stick with the 4 percent rule.

"If clients are front-loading their spending because they're waiting to supplement it with Social Security or a pension later, I'd feel better about it," she said. "Otherwise, I would prefer they didn't."

One danger is that spending more in early retirement, combined with a sharp market downturn, could put your portfolio in a deep hole, jeopardizing your later years. Even without a market crash, it can be jarring to watch your investment account shrink.

"When you say, 'I'm going to retire,' and you turn on the spigot from your savings, the shift in psychology is so big," Ms. Herlihy said. "The people who are able to do it more healthily are the ones who see stability in their nest eggs. They go through their retirement years with less worry. The other ones are constantly asking, 'Are we going to be O.K.?'"

Planning your retirement around the "Go-Go, Slow-Go, No-Go" spending pattern does require a higher level of risk tolerance, advisers agree. It also takes some discipline. You can't just go on autopilot. You need to track carefully how much you're spending and be prepared to adjust if necessary.

This is exactly what Rod and Jeannie Koleno, now 77 and 74, do. They get quarterly updates from their financial adviser, Mr. Van Zutphen, and once a year they carefully plot their expenses for the next 12 months.

"We're spending less than we used to, but more on things like entertainment and vacations," Ms. Koleno said. "Not big splashy trips, just fun things with friends and family, things that fit our values."

Looking back, do they have any regrets about spending more freely in their early retirement? Not a chance, Ms. Koleno said. "I'm thrilled with the way things have turned out."

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A Note From Chris

The NY Times article you've just finished reading in this issue discusses topics we talk with you about every chance we get. Helping you to save for retirement, and later helping you determine how quickly you can spend. It is what we do. Many of you will recall my saying, "For retirement planning you're both going to live to be 114 years old. But for Estate Planning, neither of you will make it until 6 o'clock tonight." The hyperbole is intended to make an impression.

On the Estate Planning side, there are 2 huge but (fortunately) not difficult tasks. #1 is protecting your income. You can determine with considerable precision what you'll receive in Social Security benefits and (if you're among the lucky few) Pension Benefits. Until you have saved enough, the rest you make up with life insurance. If you're healthy, you don't smoke, and you're in your 30's or 40's, you can buy life insurance today – a policy that will last until you retire – for remarkably little. Do it. Talk to one of us and we can tell you where to go to get appropriate coverage. Your #2 task is putting the proper estate planning documents in place – wills, trusts, medical and financial powers of attorney. Not too tricky, but you have to make a few decisions and then, once again, Do It. Please do. We're here to help with your questions.

Estate Document List

Estate planning is not the most exciting way to spend your summer. It is definitely not a trip to the beach. It is, however, the most important gift you can leave your loved ones after you have passed. Below are some of the documents that we think are the most helpful.

Will—A will coordinates the distribution of your belongings after your death. It names your representative and allows that person to make decisions your behalf.

Trust—A legal entity that holds property that is controlled by a trustee. Items in a trust bypass probate after a death.

Letter of Explanation—If you are dividing assets unequally between heirs, you may want to leave a letter outlining your reasoning.

Powers of Attorney (POA) —A legal document naming the person who makes decisions on your behalf should you become incapacitated. You can name the same person for both healthcare and finances or a separate person for each.

Important Document List —Real estate records, tax returns, life insurance policies, summary of your financial accounts and beneficiaries.

Letter of Intent—A letter left to your personal representative that details your instructions either for items to be distributed to beneficiaries or your funeral arrangements or other special requests. It can also list where to find all of the information below.

Online Account Information—This includes a list of websites with password information as well as who you would like to manage your online presence after you are gone. You may want to leave specific instructions on how your data should be managed. This includes any photos, websites or files that are online.

List of Professional Contacts—This includes your financial advisor, CPA, lawyer, insurance agent but also your veterinarian for any pets left behind, hair stylist, massage therapist or any other professionals in your life that you may have appointments with or who care for your pets or home.

Final Wishes—This includes everything from funeral arrangements to organ donation, pet care, final donation requests.

Definitions compiled in part from fidelity.com and nvestopedia.com. While we strive to provide the most accurate information possible, we do not accept any liability due to inaccuracies in the information above.

Buttonwood Meeting FAQ

Below are some of the most frequently asked questions that we hear.

When should I call Buttonwood?

We want to hear from you whenever your life situation changes or when you have a financial question. Common life changes are:

- Getting married
- Having a child
- Having a grandchild
- Changing jobs
- Buying a house
- Starting school

We also want to hear from you if you are wondering:

- When can I retire and how much can I expect to live on?
- When should I begin taking Social Security?
- Is it better to contribute to my employer plan or a Roth IRA?
- How can I eliminate my credit card debt?
- What is the best way to pay for college tuition?
- How much life insurance should I have?
- What annuity/pension option should I take?
- Should I refinance my home?
- What is the best way to donate to charity?
- What is the best way to structure my estate for my heirs?
- How/when should I discuss money with my children?

What Should I Bring to a Meeting?

This varies from person to person, so we often answer that we want to know about everything you own and everything you owe. Below are some examples of what that includes:

- Account statements
- Social Security statements
- Details on home mortgage and car loans—how much do you owe and what is the interest rate?
- Pension plan statements
- Previous year tax return
- Credit card statements or balance and interest rate information

Who Should I Call?

We want you to feel comfortable talking to anyone on our team, but if you have an administrative or support question such as making an appointment, logging into your account, requesting a funds transfer or receiving a copy of a statement, please speak with Linda at 608-827-6415. If you have an investment or financial planning question, speak to your advisor. If your primary contact isn't available, don't hesitate to speak to one of the other two.

If you would like a large print or electronic version of this newsletter, please contact Andrea at andrea@btnwd.com or 608-827-6411

What Else Does Buttonwood Do?

Nothing makes Greg and Jodie sadder than hearing "I didn't know you did that" from a client. We're happy to provide help in the following areas:

Home and car financing advice.

Scanning of important documents

Shredding of documents you no longer need

Meeting with children and grandchildren to help start them on a healthy financial path

Provide recommendations for other professional services—CPAs, life insurance dealers, etc.

Social Security distribution timing recommendations

General estate planning conversations

Investment related tax planning

Life insurance needs analysis

Retirement planning income and replacement strategies

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"There's never enough time to do all the nothing you want." – Bill Waterson, Calvin & Hobbes