

## The Opportunity is Now: The Perfect Storm for Retirement Planning Continues into 2023

Although the recent passage of the SECURE 2.0 Act will make it easier for more Americans to save for retirement, inflation, increased market volatility and a changing but likely rising tax environment are factors creating a perfect retirement storm for many. That's why it has never been more critical to review clients' financial and retirement plans.

### SECURE 2.0 Act of 2022

On December 29, 2022, the SECURE 2.0 Act was signed into law. Some notable provisions of this legislation include:

- Raising the Required Minimum Distribution (RMD) age to 73 starting in 2023 and 75 in 2033.
- Increase Catch-Up Contributions to \$10,000 for those ages 60 to 63 beginning in 2024.
- Roth contributions for SIMPLE and SEP IRAs.
- Require Catch-Up contributions for those with income exceeding \$145,000 to be designated as Roth beginning in 2024.
- Eliminate RMDs for Roth 401(k) accounts beginning in 2024.
- Beginning in 2024, beneficiaries of 529 plans may roll over up to \$35,000 during their lifetime to a Roth IRA. The rollovers will be subject to annual contribution limits and the 529 plan must have been open for more than 15 years.
- Beginning in 2024, employers can establish an emergency savings account where employees can save up to \$2,500 in a Roth-style account.
- In case of financial hardship, up to \$1,000 may be withdrawn per year, penalty-free, from a 401(k) or IRA beginning in 2024.
- Beginning in 2024, student loan payments will be treated as Employee Elective Deferral for purposes of matching contributions.
- Up to \$200,000 can be contributed into a Qualified Longevity Annuity Contract. The prior 25% of account balance limit is eliminated.
- Reduced excise tax for failure to take RMDs from 50% to 25%.
- Removal of barriers to the use of annuities in qualified plans by exempting certain annuity features from actuarial tests that would otherwise prohibit their use.
- Create a retirement savings lost and found.

The SECURE 2.0 Act expands upon the original SECURE Act passed at the end of 2019. The primary purpose of both pieces of legislation is to encourage more businesses to offer a retirement plan to their employees and to encourage employees to save more for their own

retirement. Although this should help more Americans prepare for retirement, they will need help to navigate common risks while retired including inflation, market volatility and taxes.

## **Inflation**

Inflation has now become a much greater threat to retiree's income. For the past 30 years, up to last year, inflation has been modest fluctuating between 2 and 3%. 2022, however, was a different story, as inflation reached its highest level in 40 years.<sup>1</sup> The peak was 9.1% in June, but the inflation rate continues to remain elevated and is currently 6.5%.<sup>2</sup>

Unfortunately, most clients do not fully understand the impact of inflation on their retirement income. Inflation reduces purchasing power over time. It's the chance that investment income won't be worth as much in the future. The longer one lives in retirement, the greater reduction in purchasing power. Even if inflation moderates, at 4% it will reduce purchasing power by 56% in 20 years. That means a dollar today will be worth 44 cents in 2042.

One way to hedge against this risk is through equity exposure. The market historically outperforms inflation, often substantially.

## **Market Volatility**

While equities can help outpace inflation, the recent market volatility and uncertainty has caused a lot of concern for many investors, especially those who are in or nearing retirement. Market trends are the one of the most important factors to portfolio longevity, perhaps second only to the withdrawal rate. Investors typically spend decades saving for retirement.

Systematic investing in a fluctuating market coupled with historically rising trends has helped many Americans build sizable retirement accounts. However, when Americans retire and stop contributing to and start withdrawing from retirement accounts, they become much more susceptible to market risks.

Chances are most retirees will have to live through at least one bear market. In fact, the average retiree will face 3 to 5 such bear markets in retirement. Since 1945 there have been 26 market corrections of greater than 10% and 12 bear markets with losses that exceed 20%. The average bear market lasts 16 months with an average loss of 35%.<sup>3</sup> Assuming no withdrawals from retirement and an average annual return of 10%, it would take just over 3 years to recover from that average decline.<sup>3</sup> The timing of a bear market will also influence the longevity of a retirement portfolio. This is known as sequence or return risks. During the accumulation phase of retirement planning, the sequence of returns really don't matter - it's the average rate of returns that do. However, the sequence of returns matters greatly during the distribution phase of retirement planning. Withdrawals in the beginning of a bear market as opposed to a bull market will likely accelerate the depletion of retirement accounts.

Market volatility will often influence investor behavior which has a profound impact on portfolio performance. Investors are often influenced by their emotions. These emotions can include excitement, greed, euphoria, fear or panic and can disrupt a long-term investment

strategy. The foundation of behavioral finance is that investors treat losses different than they treat gains. Investors are affected more, almost twice as much<sup>4</sup>, from losses as they are from gains. An aversion to loss could affect the ability to stay in the market.

To benefit from any potential long-term market appreciation, the investor should remain invested through difficult times. Bear markets do not last forever and historically we have recovered from every past bear market. The key to such recovery is staying invested and not make irrational decisions based on emotion alone. There are products such as registered indexed-linked annuities and certain life insurance policies that allow the owner to participate in the market, with upside potential, sometimes unlimited, but provide downside protection in the form of floors or buffers. Such protection could help

## **The Tax Environment**

While the future tax environment is uncertain, most anticipate that taxes will likely increase. The question is when and by how much. The Tax Cut and Jobs Act will sunset at the end of 2025 increasing the top income tax rate to 39.6%. As a result, there are opportunities to take advantage of the current tax environment before it changes. For instance, the current market may make Roth conversions more appealing. Clients may want to convert now when the market is down to allow any subsequent recovery to be tax-free. Furthermore, a conversion now would help clients take advantage of the current low-tax environment and provide a hedge against the risk of higher taxes in the future.

A careful review of a client's investments may find, for example, that their overall portfolio isn't as tax-efficient as it could be. High-turnover portfolios can trigger excessive short-term capital gains taxable in the year they are incurred—even if the investor has experienced an overall loss in their investment portfolio, perhaps due to high market volatility. Of course, investors cannot eliminate all investment-related taxes, but they can control them and improve a portfolio's efficiency. The benefits of tax efficiency, tax diversification and tax deferral could be compelling for certain investors and consideration may be given to the tax benefits of life insurance and tax deferred annuities. These products may provide investors better control over taxes, tax-free portfolio rebalancing and the ability to tap the cash value of an insurance policy tax free\* or defer taxation on income from an annuity until the income is needed and at a time the retiree will likely be in a lower tax bracket.

## **Prudential is Here to Support You**

Thousands of Americans retire each day and by 2050, 20 percent of Americans will be over age 65.<sup>5</sup> Considering inflation compounded by ever increasing longevity, market volatility, and increasing taxes, today, more Americans than ever will need help in creating a secure retirement. Now is the time to act by helping clients plan.

For questions regarding retirement planning or any advanced concept or strategy, please contact Prudential's Advanced Planning team at 800-800-2738, option 4.

<sup>1</sup> June inflation soared 9.1%, a new 40-year high, amid spiking gas prices, Siegel, R. (July 13, 2022). Washington Post, <https://www.washingtonpost.com/business/2022/07/13/inflation-june-cpi/>.

<sup>2</sup> Here's the inflation breakdown for December 2022 – in one chart, Iacurci, G. (January 12, 2023). CNBC, <https://www.cnbc.com/2023/01/12/heres-the-inflation-breakdown-for-december-2022-in-one-chart.html#:~:text=The%20inflation%20rate%20fell%20again,to%20the%20consumer%20price%20index.>

<sup>3</sup> JP Morgan "Guide to the Markets<sup>®</sup>", 3Q 2022; based on market activity post-WWII. Does not include losses from the current (2022) bear market cycle. Recovery is calculated using this data, and then a hypothetical average annual return of 10% and no withdrawals.

<sup>4</sup> BehavioralEconomics.com, Accessed 7/2022, (Kahneman & Tversky 1979).

<sup>5</sup> [www.census.gov](http://www.census.gov), July 2022

\*Cash value can be accessed through policy loans and withdrawals. Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences

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