Rethinking your Savings

Our savings can stir a range of emotions. We can feel stressed when an unexpected bill arrives, feel proud when we reach a savings milestone, or feel confident when we see our financial plan working to benefit our family. Feelings about finances though can interfere with our ability to make rational decisions. Since 2008 the desire to understand "behavioral finance," has increased and a field that focuses on investor psychology and decision-making has emerged. Loss Aversion, Familiarity Tendencies, and Consensus Bias are a few theories in the field but one concept that can greatly impact the strategies we use to save is known as Mental Accounting. Mental Accounting is the idea that we treat money differently based on subjective criteria, such as where it came from or how we plan to use it.

In the context of savings, mental accounting can lead to irrational decisions, such as over or under saving, by mentally sorting money into rigid and inflexible categories or "accounts" instead of treating all your money as fungible. This type of thinking can cause us to overlook certain funds because they are considered off limits for a specific project, or to the other extreme, we might consider an inheritance or a tax refund as "found money" and then spend it lavishly. We need to start thinking of our savings differently. No matter how much you have accumulated or where you have invested it, your savings have one thing in common, they represent your hard-earned money. The sacrifices you have made over the years and responsible decisions to accumulate funds mean your savings should focus on working best for you.

The first step to making your savings work for you is to calculate your savings in their entirety. Taking a Panoramic View of our savings allows us to understand our entire financial picture. During this analysis of your savings, do not consider the purpose of these funds, only the fact that they are available for your use. Being open-minded regarding savings allows us to utilize financial strategies to our advantage. For example, many people think that because you had a retirement party, it is time to withdraw from your retirement accounts, but not necessarily. Retirement accounts allow for tax-deferred growth, so withdrawing funds before you need to may increase your tax liability. Keeping retirement funds tax

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deferred for as long as possible can prove beneficial, delaying withdrawals until the Required Minimum Distribution age. You may have received an inheritance or have after-tax investment accounts that you could spend down first or it may make sense to pull everything you need from a tax-deferred account so that you can have a lower required minimum distribution later.

When reviewing your savings in their entirety, don't forget to include pension and social security benefits. While these payments may be distributed as monthly income to you, they will impact when and how much you need to withdraw during retirement, which in turn directs how you should invest. It is also important to consider how to maximize pension and social security benefits. Delaying the start of this income until the maximum retirement age may result in thousands of extra dollars over your lifetime. This strategy may mean during your first few years of retirement the withdrawal rate of your investment or retirement accounts could be higher than expected, but once the delayed income sources begin, you can lower your withdrawal rate without sacrificing your lifestyle.

The goal of savings is to eventually spend it. Just as important as creating a plan to save, is creating a plan for how to spend your savings. Realizing your savings are flexible can open opportunities for new spending strategies but is also a readjustment in our relationship with our money. As we consider the Stages of Retirement, transitioning from savings mode to spending mode, we often must modify our thought process. Accepting that during spending mode, your savings will decrease is just one adjustment we must make when viewing our savings as flexible. While keeping goals, such as vacation, emergency savings or inheritance for our loved ones, in mind creates motivation for savings, allocating specific funds to these goals reduces savings flexibility and may cost you more. Instead of allocating specific funds for your goals, create a savings outline. This outline allows you to continue to prioritize your savings goals, without limiting your savings flexibility.

By changing our thoughts around savings from a rigid mental accounting mindset based on allocations for specific goals to a more broad and flexible approach, our savings can work better for us. We can still accomplish our goals of lifestyle, gifting and unforeseen expenses while seeing our savings as flexible,

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which can potentially reduce our tax liability and create increased income during retirement. A CERTIFIED FINANCIAL PLANNER ™ professional can help you treat your savings as a single, fungible pool and develop a plan to help you feel more confident in your spending strategies.

This article was written by Sandra J. Wagner, CFP®. Sandra has been helping people with their finances since 2001. She is a CERTIFIED FINANCIAL PLANNER™ professional and CEO of Wagner Planning.

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