Mid-Year Financial Checkup: 5 Questions to Ask Yourself

Fidelity Viewpoints, 5/13/2020

These days you're probably thinking about the beach, the mountains, or a road trip with the family. But summer, when life may be a little slower and your mind a little less cluttered, is actually a good time to do a quick mid-year financial reality check.

A mid-year checkup can accomplish several things. You can stop and think about your financial goals, such as saving for retirement, a house, a child's education, or a financial cushion, and then make sure that you are investing appropriately for those goals. And while you are looking at your accounts, take care of "housekeeping" items too, like checking beneficiaries, which isn't complicated but can have serious consequences if neglected.

Here are 5 questions to ask yourself at your mid-year checkup.

- Is my investment strategy on track?
- Am I saving tax-efficiently?
- Am I protecting my income?
- Am I preserving my assets?
- How does my plan affect my family?

1. Is my investment strategy on track?

You probably have several savings goals and accounts. Your financial checkup should revisit each of your priorities and your strategy for reaching them. If your situation has changed, make adjustments as necessary. At least once a year, check your target asset mix to ensure that it continues to meet your time frame, risk tolerance, needs, and preferences, and to perform any rebalancing that might be necessary in light of the past year's market performance.

On your own or with your advisor, take some time to look at specific investments and evaluate whether they continue to have a role in your portfolio. It's important to match your investments to certain time frames or specific goals. Some may be long term such as saving for a child's education or your retirement. Others may be more short term such as saving for a new car, a vacation home, or travel.

For example, you may take on more risk saving for a retirement that is decades away, or you may want more conservative investment options to fund 25% of a grandchild's college education in 5 years. Or, you may earmark $35,000 from a particular fund this year to pay for a new car for your spouse. As part of your review, give your portfolio

a regular checkup with an eye to diversification. The goal of diversification is not necessarily to boost performance—it won't ensure gains or guarantee against losses. But once you target a level of risk—based on your goals, time horizon, and tolerance for volatility—diversification may provide the potential to improve returns for that level of risk.

Tip: To build a diversified portfolio, consider looking for investments—stocks, bonds, cash, or others—whose returns haven't historically moved in the same direction and to the same degree. This way, even if a portion of your portfolio is declining, the rest of your portfolio has an opportunity to grow, or potentially not decline as much.

2. Am I saving tax-efficiently?

Beyond applying diversification strategies broadly to your overall portfolio, what approaches are you exploring to help defer, reduce, or more efficiently manage taxes on your investments? Investing tax-efficiently doesn't have to be complicated, but it does take some planning. While taxes should never be the sole driver of an investment strategy, better tax awareness does have the potential to improve your returns. Morningstar estimates investors gave up an average of 1% to 2% of return per year to taxes for the 92 years through 2018. Let's say a portfolio could earn 8% per year instead of 6%, that extra return of 2% per year on a hypothetical portfolio of $100,000 could result in an additional $1 million after 40 years.

Although you cannot control market returns or tax law, you can control how you use accounts that offer certain tax advantages. This type of approach is often referred to as active asset location. Employing this strategy allows you to choose which assets to keep in your tax-advantaged accounts and which to leave in your taxable accounts. In general, the more tax-inefficient an investment is, the more tax you pay on it.

Our basic rule of thumb: Consider putting certain investments which generate taxable income—for example taxable bonds and real estate investment trusts—in tax-deferred accounts like 401(k)s and IRAs. For those investments which are more "tax-efficient"—like stocks and ETFs held for more than a year—place them in taxable accounts.

Tip: Asset and account location should be considered within the context of tax efficiency and maintaining an appropriate asset mix. Asset location is the strategic matching of asset type and account type based on the asset's tax efficiency and the tax treatment of different account registration types. Account location is the strategic ordering of money flows to potentially help minimize taxes and help determine where to invest or where to withdraw from next, depending on your situation.

Are you already taking full advantage of a 401(k) plan, IRA, or other qualified account that may be available to you? Generally, these accounts are the best place to start a program of active asset location, because of their tax advantages, but each comes with contribution and withdrawal restrictions.

If you are entering retirement and transitioning from saving to spending, a tax-savvy withdrawal strategy can help your savings last through retirement. While the traditional withdrawal hierarchy of taxable, tax-deferred, and tax-exempt assets is a good starting point, individual situations and changing circumstances may require making adjustments. Aim to withdraw no more than 4%–5% from your savings each year to help ensure that your savings will last for 20 to 30 years in retirement.

3. Am I protecting my income?

You've worked hard and want to protect your income. So it's wise to evaluate your family's total insurance needs annually to make sure you have the right amount and type of insurance to cover unforeseen circumstances that can derail a financial plan.

If your family is growing, you might want to increase the amount of your life insurance to protect your loved ones. On the other hand, many people find as their net worth climbs and their children reach adulthood, they need less life insurance.

It's not uncommon for individuals to purchase a life insurance policy and spend years paying premiums without ever revisiting and reevaluating the need for it throughout life's changes. The advantages and disadvantages of life insurance

vary greatly depending on age, health and responsibilities. It's important to complete a thorough evaluation of your policy and make the necessary changes to fully benefit.

If you choose to reduce your life insurance, you may want to apply the savings toward your health insurance, which becomes more critical as you age and continues to increase in cost. You might also benefit from looking into long-term care insurance, which may offer a variety of features and options.

One more thing: Your review should also include a simple check of your insurance beneficiary designations to see whether they are up to date.

4. Am I preserving my assets?

Use your checkup to make sure you have an estate plan, and that it continues to reflect your family status and financial situation. Ensure that it helps make the best use of the latest estate and tax laws, and that key individuals know where to find relevant documents and information.

If you do have an estate plan, do the people you care about know about it? Where is it, and what role should your loved ones play if something happens to you? Marriage, divorce, birth, and death are the 4 big events that affect estate plans, but you may also want to consider other factors, such as longevity and health, that could affect your planning.

Thinking about a will, health care proxy, and power of attorney can be uncomfortable, but consider the alternative. Do you want someone else making these decisions for you? If you don't have any of these key documents, take the time to set them up. If you have them, review not only your paperwork but any life events that have occurred. Changing careers, moving, having children or grandchildren, or losing a loved one can have a big impact on your plan overall.

5. How does my financial plan affect my family?

It's not just your retirement or financial future that you are planning for, especially as you age. You are likely researching and cultivating strategies to provide financial assistance to a number of people that you care deeply for, including parents, children, or even grandchildren. Beyond college, a lot of parents are helping to launch their millennial children into the world of fully independent living. Meanwhile, many have aging parents who can no longer live on their own or manage their own financial and personal affairs. Will caring for others affect your financial goals, priorities, and outcomes?

A mid-year checkup can help prioritize financial decisions that you need to make to support your family's goals across the generations—and help tee up long-neglected family money conversations. It can help you bring your family together to sort through vital matters related to such things as college savings, caregiving responsibilities, health care decisions, estate planning, and the tax implications of an inheritance.

Take a long-term view for your family

While this might sound like a lot of ground to cover, a mid-year checkup is well worth the effort when you consider the hard work you have invested in building and protecting your savings. It represents an opportunity to reassess your investment and financial situation, while also thinking about future milestones and moments that matter for the people you care about the most.