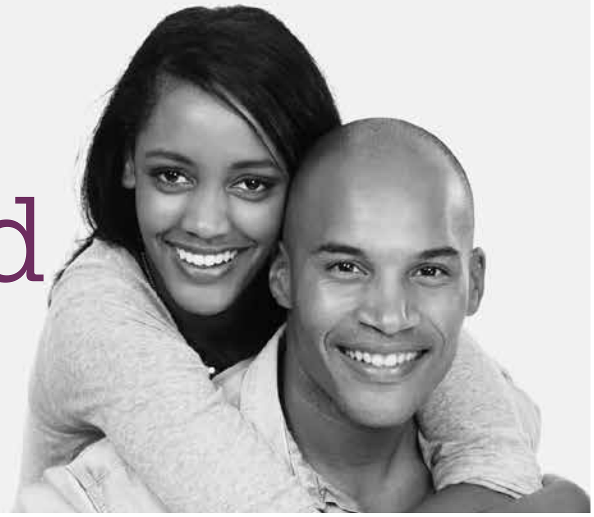
Financial Wellness
& Education

You just received a windfall



Congratulations

For most of us, money arrives on a fairly predictable schedule. But occasionally, you might receive an extra windfall above and beyond your normal paycheck. At work, perhaps you might get a bonus for a job well done. Or, maybe you receive a lump sum from your employer, either via a severance package or a retirement account distribution, as you switch jobs. Outside the workplace, many Baby Boomers may receive a significant inheritance when their parents pass away. So what should you do if you receive an unexpected windfall?

Many Baby Boomers are in line for an inheritance. What should you do if you receive an unexpected windfall?

Face down temptation

An unexpected boost to your finances can really make your day, and it's perfectly natural to want to celebrate your good fortune. To be sure, there's nothing wrong with giving yourself a small treat – dinner at a nice restaurant, or tickets to a ballgame or concert, for example.

But the urge to spend it all can be tempting. We're fortunate enough to live in a society where many luxuries are readily available, and we all have a wish list of things we promise to buy for ourselves someday: high-tech gadgets, a beautiful new car, a rare piece of collectible memorabilia – the list goes on. Your windfall might seem like the perfect opportunity to fulfill those promises. It's important to know, however that giving in to such impulses can end up costing you much more than you realize.

Hidden costs

Suppose Joy, age 45, is changing jobs and is considering what to do with the $50,000 she had in her former employer's 401(k) plan. Joy could decide to cash out that money and spend it. She has a lot of options: she could buy a sleek new car, go on a couple of luxury vacations or buy a state-of-the-art home electronics system. But that $50,000 windfall won't go as far as she anticipates, because it will be subject to taxes and possible penalties for an early withdrawal. Joy will only get to spend $32,500 – 65 percent – of her money after the federal government takes its share, and it's possible that her state and local governments will want a cut as well.

However, if she chooses to roll over that lump sum into an individual retirement account, the end result differs considerably. If Joy puts that

Gross Distribution For Early Withdrawl From 401(k) Account $50,00		
Less	Mandatory 20% federal withholding	- $10,000
	5% for remaining federal taxes	- $ 2,500
	10% early withdrawal penalty	- $ 5,000
Amount Remaining		$32,500

This hypothetical example of an early withdrawal from a 401(k) is for illustrative purposes only and does not reflect the performance of any Foresters Financial products or other actual investments. It assumes a 25 percent federal income tax bracket. Additional state and local taxes may also apply, and after applicable taxes and fees, values will be less. Changes in tax rates and tax treatment of investment earnings and applicable tax laws may also impact results.

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$50,000 into a retirement account such as an individual retirement account, she will postpone taxation and can avoid early withdrawal penalties, giving her the chance to grow a nest egg that will help her reach her retirement goals. Assuming a constant annual return of 8 percent that $50,000 will grow to more than $233,000 over the next 20 years.

Joy would lose that investment potential if she decides to spend her windfall on luxury goods instead of investing it. Factor in the opportunity cost of her purchase, and we can see that Joy essentially paid a potential $233,000 for $32,500 worth of goods that will bring her only temporary satisfaction and eventually lose most or all of their value. Twenty years from now, those vacations will be a distant memory, those high-tech toys will be obsolete, and the sports car will probably be in the junkyard.

However, if she exercises some financial discipline and rolls over her windfall, Joy can end up with a sizable sum in 20 years that can truly enhance her lifestyle.

What are the alternatives?

The best way to avoid hefty opportunity costs, regardless of the source of your windfall, is to take advantage of the chance that your good fortune gives you to improve your financial situation. In the case of a retirement distribution, the best option for many individuals is to roll it over into another tax-advantaged retirement account such as an individual retirement account, where it can continue to work for you.

For other types of windfalls, such as a bonus, there are several options:

Pay down debt. A windfall can be used to pay off debts such as mortgages or loans earlier than you had originally planned. This will save you from the need to pay future interest fees – a sum that can be sizable, especially when it comes to high-interest debts such as credit card balances.

Invest for your future. An appropriate investment vehicle such as a mutual fund can give your windfall the chance to grow into a significant sum that can help you reach your financial goals.

Shore up your life insurance coverage. Many Americans have inadequate amounts of life insurance, and this oversight puts their family's financial future at risk in case the unexpected happens. Your windfall can be used to establish coverage or to augment any coverage you already have.

Save money for a rainy day. While you might be basking in your good fortune today, it's a fact that sometimes luck doesn't always swing your way. It's a good idea to have a "rainy day fund" in the form of a savings account or a liquid, interest-bearing vehicle such as a money market fund to safeguard against that possibility. Your windfall can be used to establish such a fund.

Benefit from our experience

Foresters Financial Services, Inc. provides everyday families and individuals with financial solutions, guidance and tools, to meet their needs across all life stages. Our Financial Representatives offer personalized service combined with a solid, long-term approach and fresh thinking to help you:

- Save and invest for retirement, education and other life events
- Create retirement income strategies
- Protect the ones you love
- Plan your legacy

Together, we can help you achieve financial and family well-being—now and tomorrow, this generation and the next.

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