May 2019: Saving for College–529 Plans

We all want what is best for our children. At an early age, we teach them to eat the right foods; we place them in the best preschools; we encourage them in grade school and high school; and we cheer them on when they excel in extracurricular activities.

Put another way, we want our children to succeed in all aspects of life.

As our kids make their way through high school, most of us want them to attend college. For some, it's not just about going to a university but being accepted by and graduating from the "right one." Unlike when we were growing up, the pressure today is enormous.

Pay to play

Are you familiar with the college admissions scandal? Most are.

Succumbing to pressure to get their kids into the best universities, dozens of people were charged with circumventing established protocols and allegedly paid millions of dollars to secure entrance into elite universities for their children.

It's not that these folks didn't have the resources for tuition, textbooks, and living arrangements. They did. But they took the wrong path in the hopes of securing their child's future.

My own two cents: Do we only want to teach integrity? Or do we want to model it, too?

Exploding costs

The cost of college has soared. In 1985, the annual tuition, fees, room and board rates charged for full-time undergraduate students at a four-year public university ran $3,859. Thirty years later, the cost had ballooned to $19,189, according to the National Center for Education Statistics. For private schools over the same period: $9,228 to $39,529. That's a painful hit to the wallet.

The increase in costs is both astounding and sobering. No wonder so many kids today graduate with both a degree and debt. Of course, these are averages and costs will vary, but they paint an unsettling picture.

Fortunately, the bill isn't due all at once and there are vehicles that can help ease the burden. Plus, the magic of compounding can greatly ease the worries that come with saving for college.

The 529 college savings plan

One such vehicle is the 529 college savings plan. What is a 529 plan? A 529 plan is sponsored by the state or a state agency. It allows someone to save for college (or K-12th grade).

Benefits

1. **Pay for qualified educational expenses**. One can use the savings for tuition, books, and education-related expenses at accredited universities, vocational-technical schools, and eligible foreign institutions. Funds accumulated in the plan may go to public, private, and religious schools.

2. **Tax advantages abound.** Although there is no deduction when cash is deposited into a 529 plan, any earnings are not subject to federal taxes, and qualified withdrawals are exempt from taxes.

   Some states also offer full or partial deductions or credits for 529 contributions.

3. **Maintain control of the money.** Unlike a UGMA account, in which the child will eventually take control of the accumulated funds, you remain in control of the plan. You make sure it goes toward its intended use.

4. **Set it and forget it.** Most 529 plans have a "set it and forget it" feature. You make the automated investment and an outside company manages your investment.

5. **Just about anyone can open a 529 plan**. Contributions are not limited by the donor's income. Earn $50,000 per year and you can set up a 529. Earn $50 million per year and you also qualify.

6. **There is no maximum annual contribution.** Unlike with retirement accounts, the IRS doesn't specify an annual maximum contribution. There are no age limits on contributions. Total contributions range from $235,000-$520,000 depending on the state.

7. **529 plans complement FAFSA**. A 529 plan helps maximize your ability to pay for college without jeopardizing financial aid. The 529 account is the parent's asset, much as if you had saved the money under your own name. With the 529, however, you'll receive tax benefits that wouldn't accrue if it were in a taxable account under the parents' name.

Drawbacks

529s are an excellent vehicle, but no plan is perfect. Here at some potential pitfalls.

1. **The plan does not guarantee it will cover the full cost of a four-year college education.** Still, the earlier you get started, the better.

2. **Investment options may be limited**. You are not in complete control of the plan. Therefore, it is important to invest in a plan that offers flexibility and low-cost funds.

   Do you want an age-based portfolio–one that begins with a more aggressive mixture of stocks versus bonds and gradually shifts to a more conservative mix as your child approaches 18? Or will you choose a static asset allocation?

3. **You don't need the savings in your 529 after all.** What if Johnny received a full ride to college? It's a high-class problem, but still, alternatives must be considered.

   Possible options:
   - You can withdraw up to the amount of the scholarship without paying the 10% penalty.
   - You can hold the money for graduate school.
   - You could change the beneficiary to another qualifying family member without a tax or penalty.
   - You may name yourself as the beneficiary if you intend to take classes.
   - Or, you could consider keeping the account active for a grandchild.

   If money is used for noneducational purposes, you will likely incur taxes and a 10% penalty on the earnings.

4. **You must time your contributions and withdrawals carefully**. Contributions must be made by December 31st, though states that offer tax advantages may extend the deadline to April 15th. Make sure that any withdrawals coincide with qualified expenses in that year.

Green grass and high tides

It has been a very strong start to 2019. The broad-based S&P 500 Index has advanced nearly 18% in just four short months, and the tech-heavy NASDAQ Composite has surpassed the 20% mark–see Table 1.

More good news: The S&P 500 Index and the NASDAQ have both topped previous highs. It's quite a snapback from the gloomy outlook and oversold conditions we saw in late December.

Some of this year's rebound is simply timing. After a steep sell-off last year, the major market indexes bottomed in late December. Hence, much of the rally has occurred since the end of December. But let's not discount the fundamentals.

What has been powering the rally?

1. Recession fears have faded. Put another way, recessions crush profits and severely dampen the outlook for profits. Earnings growth isn't very strong right now, but Q1 reports are topping a low hurdle.

2. After slowing through much of 2018, the global economy appears to be stabilizing.

3. The Federal Reserve is on hold and interest rates remain low. Last year, the 10-year Treasury yield peaked above 3%. Today, it's hovering near 2.5%. Given expectations of modest economic growth, options to earn a higher return in safe investments are limited, reducing competition for stocks.

4. A major concern has been the trade talks with China, the upshot of which has been ongoing volatility.

Table 1: Key Index Returns

	MTD%	YTD %	3-year* %
Dow Jones Industrial Average	2.6	14.0	14.4
NASDAQ Composite	4.7	22.0	19.2
S&P 500 Index	3.9	17.5	12.6
Russell 2000 Index	3.3	18.0	12.1
MSCI World ex-USA**	2.5	12.3	4.3
MSCI Emerging Markets**	2.0	11.8	8.7
Bloomberg Barclays US Aggregate Bond TR	Unch.	3.0	1.9

Source: Wall Street Journal, MSCI.com, Morningstar, MarketWatch
MTD: returns: Mar 29, 2019-Apr 30, 2019
YTD returns: Dec 31, 2018-Apr 30, 2019
*Annualized
**in US dollars

Some folks were probably feeling queasy when shares were getting beat last fall, but staying the course during these periodic pullbacks is the path to worthwhile returns over time. Proper diversification along with a fair degree of emotional fortitude helps, too.

As always, I'm honored and humbled that you have given me the opportunity to serve as your financial advisor. Please feel free to contact me for any questions or concerns you may have.