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Stern Advice: What to do with that windfall

By Linda Stern (excerpt)
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WASHINGTON (Reuters) - Here's a happy headache to have: A chunk of money might fall into your lap and you will have to figure out how to manage it.

There are many reasons for that: For starters, tens of thousands of auto industry retirees have been offered lump-sum pension buy-outs from General Motors Co. and Ford Motor Co.

Workers in other industries may be offered early retirement buy-outs, lump sums in lieu of monthly pension payments or simply 401(k) rollovers when they leave their jobs. There are legal settlements, life insurance payouts and the rare big lottery prize. There's also the $8 trillion to $11 trillion that baby boomers are expected to inherit over the next 25 years or so.

Some financial advisers are gearing up programs and products aimed at people who suddenly have enough money to worry about. That can be a mixed blessing. Good financial advice can save you from yourself, but whenever you are a marketing target, that can be scary.

Here are some tips from financial professionals about how to approach the big lump sum.

-- Decide if you really want it. If you have the choice of a lifetime pension or a lump-sum distribution, you may prefer to stick with the pension. That's what almost all of the auto-industry retirees have decided, says David Kudla, a prominent Detroit-area money manager whose firm, Mainstay Capital Management, has many of them as clients. …

… -- Tuck it away safely. There is almost never a reason to rush when you are committing new money to an investment or product. You can keep it all in a bank account (up to $250,000 per individual account and account holder would be backed by the Federal Deposit Insurance Corp.). Or you could keep it in a brokerage money market mutual fund or ultra-short-term bond fund while you decide how to deploy it.

-- Think about taxes early. If you're taking a pension distribution or 401(k) payout, make sure you roll it over quickly into an appropriate tax-deferred rollover individual retirement account.

If you are inheriting securities, know that you could benefit from the so-called "step up in basis" tax rule. That means that the shares will be valued on the day you inherit them, and any big gains your benefactor logged would simply be rolled into their estate. That allows the estate to avoid capital gains taxes. …

…-- Treat the money as special, but in your own way. You may inherit shares of a company that was important to your parents or grandparents, but that doesn't mean that you should own the stock forever. …

…-- Deploy it gradually. Generally speaking, new money should be invested so that it fits your overall retirement and investment strategy. But unless the new money is a very small percentage of everything you own, don't invest it all at once. Use a technique such as dollar cost averaging, so that you are investing some percentage every month or so... for six months to a year or more. That's an approach that both Garrett and Kudla recommend, though they concede that in an up market, you could give up a bit of gain that way.

"At the end of the day, it's about where your comfort zone is," says Kudla. …

… -- Get help. Especially if you're dealing with a life-changing amount of money, it's a good idea to get impartial advice from a planner who is knowledgeable about taxes and investing and who does not sell products. …