Income Planning Strategies in Retirement

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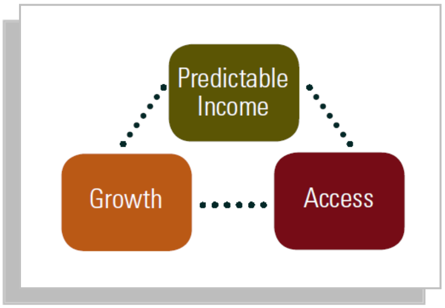
Today's retirees may be challenged as no recent generation has.

A "perfect storm" has emerged comprised of low interest rates, volatile stock markets and unprecedented longevity. These realities are sure to create stress for many retirees as they seek ways to make their retirement income last as long as they do.

More than ever before, retirees are dependent upon their investments to generate retirement income. With fewer companies providing traditional pension plans, retirees are being forced to assume the investment risk associated with their retirement assets.

Of course, widespread uncertainties about the future of Social Security continue to linger. Increasing budget deficits and financial uncertainty only serve to create additional anxiety for retirees. All these factors combine in a way that causes retirees to seek investment choices that offer safety but also provide growth opportunities to meet their income needs for both today and tomorrow.

Objectives of a retirement income strategy



Within an income strategy, your objective should consist of **three** things:

1. **Predictable Income**
2. **Access**
3. **Growth Opportunities**

1. Predictable Income- Predictable income should be reliable in good markets and bad. For that reason, it provides a solid foundation for your plan. Once created, a predictable income stream places you in a much better situation to address other needs or goals such as healthcare or legacy planning. Its objective is to maximize guaranteed lifetime income and can cover necessary expenses.

2. Access- This portion of your retirement assets should be liquid and available for emergencies and special needs. If desired, you can also set aside some for supplemental income needs or discretionary spending.

3. Growth opportunities- Growth is an important aspect of your retirement income because it provides you with the most opportunity to sustain your long-term needs. It can also help maintain your standard of living by offsetting the effects of inflation and/or can be used to leave a legacy to heirs.

What Are My Retirement Withdrawal Strategies?

Here are some strategies to consider if you are invested in an IRA, 401(k) or any other type of plan to fund your retirement:

The Systematic Withdrawal Plan

With this traditional strategy, assets are invested in a diversified portfolio—for example, a 70/30 or 65/35 equity-to-fixed income allocation, depending on your risk tolerance. During the accumulation phase, the goal is to maximize the total return of the investments. Once you retire, the idea is to draw down assets evenly from the entire portfolio at a rate that is appropriate for your needs and circumstances. Historically, the withdrawal rate is widely quoted as 4 percent.

The main drawback of this approach is that more shares of the investments must be liquidated to meet your withdrawal needs when the investments are down in value—in other words, you are forced to sell into a falling market. This approach has been criticized for not considering the effects of rising interest rates and market volatility and depleting your savings early.

But, this strategy has been a well established and trustworthy retirement withdrawal stretgy since the 1990's. This strategy is valued by many retirees due to its simplicity and gives you a predicatable amount of income each year.

The Bucket Strategy

This approach, which has become more popular in recent years and what I am seeing more and more of, takes away that market/timing risk of having to sell into weakness to meet income needs during retirement. Plus, it helps me as the planner to gain a framework for planning the distribution phase.

When individuals are approximately one to three years away from retirement, I divide the assets among several portfolios (or buckets), each with different time horizons, asset allocations, objectives, and risks. By segmenting monies into buckets (usually three or more) that each have their own purpose, it enables you to tap into some assets for income (the first bucket will meet your more immediate needs) while letting other assets grow. The strategy, by design, is effective in dealing with the 3 major risks in creating retirement income:

1. Outliving one's savings (i.e., longevity risk):
The segmentation strategy helps to match up investments with varying income levels at different stages of your life. Also, by having short-term investments in the first bucket, you are more likely to leave the other bucket's investments alone so that they can grow and have enough appreciation to provide income for life.

2. Having expenses that outgrow savings (i.e., inflation risk):
Your ability to be hands-off and more aggressive with the later bucket leads to a greater chance of reducing this risk than the systematic withdrawal plan.

3.Experiencing a down market during retirement (i.e., market/timing risk):
By putting the first bucket in place before retirement, you will be able to receive the income that you need from cash or very conservative investments without having to sell more aggressive investments into a down market.

There are some downsides, though. The strategy can become difficult to monitor and analyze because people typically have more than one retirement account with varying balances; these might not easily match up with the recommended amounts for each bucket. People generally will also have a mix of taxable, tax-deferred, and tax-free accounts.

The Mechanics of the Process

The first step is estimating your income needs throughout your retirement years (as well as the year or two before you retire, if applicable). This can be done by figuring out the cash inflows and outflows during each retirement year and calculating the difference between them. You can then set up the buckets with the correct amount of monies to match these income needs. There are two ways to run the overall strategy. The sequential approach involves using up the monies in each bucket in order—in other words, you would take the income and principal from the first bucket in the years assigned to it and then move on to second and take the income and principal in the years assigned to it.

The second way is to constantly refill the first bucket so that it exists during your entire retirement period. By having a consistently full or partially full Bucket 1, you will feel more assured that your retirement—present and future—is in a good place.

Bucket 1

Goals and objectives: This bucket provides income in the one or two years leading up to retirement and then the first five years in retirement. Its main goal is to provide immediate income to supplement other income sources. It is meant for alleviating liquidity and market/timing risk as the investments are conservative enough that they will not be significantly affected during a decline.

Because this is "safe money" that must meet your income needs regardless of market conditions, securities that have a high risk of loss of principal do not belong here. Appropriate investments should be relatively stable and high quality in nature.

Potential issues:

- An emergency during early retirement exceeds assets in the bucket
- You are spending at an unsustainable rate
- Interest rates are too low to support conservative investments

Bucket 2

Goals and objectives. This bucket normally covers the income needs for the retirement years six through ten. This is money that is either waiting to be tapped for income when Bucket 1 runs out (if you are using the sequential approach) or it is the money that will be used to refill Bucket 1. Its investments also help to mitigate timing and risks.

These investments are slightly more aggressive than those in the later buckets but more conservative than those in the third bucket. The primary investment objective is producing income (yield), with the secondary focus on preserving capital.

Potential issues:

- Interest rates are low, and achieving a higher yield is difficult without taking on too much risk
- Interest rates rise, and fixed income and higher-paying equities get "hit" as a result

Additional Buckets

Goals and objectives- These buckets normally cover the income needs for years eleven on. It represents the long-term growth allocation piece of the retirement income plan. The goal of these buckets is to help alleviate timing risk, inflation risk, and liquidity risk, as well as to further some of your potential estate planning objectives. The profile of these buckets are the more aggressive, as they have the longest time horizon and will have a better chance of recovering from any market downturn.

Investment choices: Assets in these buckets are typically invested in portfolios that seek some degree of capital appreciation.

Potential issues:

- We head into a recession
- You are at risk of not having enough money to cover lifetime income needs

Putting It All Together

By linking asset buckets to specific time horizons and goals, and investing them in the appropriate vehicles, you can create a more efficient and effective way of generating a steady stream of income.

Another Thing to Consider: Tax Considerations in Retirement Income Planning

- Income strategy should be structured in a way to maximize economic returns while minimizing taxes.

Potential tax considerations

- Tax sensitive account allocation: The retirement investment vehicles included in the distribution portfolio
- The order in which plan assets are withdrawn from accounts (taxable, tax-deferred, tax-free) based on future income being higher or lower
- Tax bracket management
- Loss harvesting
- Tactical income tax planning with defined benefit plans, tax deferred annuities, and Roth conversions
- Manage taxation of Social Security benefits

If you have interest in further discussing these strategies, please give me a call. I am here to help.

As always, thank you for being a client of mine. It is my goal to offer my services to other clients just like you, and often many of my new and high-quality clients come from recommendations.

Our client advocate program gives us a chance to be able say thank you to those clients who have been advocates on our behalf.

If you would like to participate and know of someone who could benefit from my services, please give us a call. Thank you to all our clients so far who supported my growth initiative and been valuable clients.

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