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Creating a retirement *income plan you can rely on*

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Now that you're getting closer to retirement, it's important to make sure that the retirement funds you've accumulated can last as long as you need them. Even if you have considerable assets saved for retirement, you'll need a thoughtful strategy around which funds you draw down and how quickly you do so. We thought this information about managing your income during retirement might be helpful.

Retirement challenges

As retirement approaches and your preparations proceed, it's important to consider any potential obstacles to a secure financial future. Of course, you cannot control external factors such as inflation or market volatility, but you can prepare for them. For one thing, Americans in general are living longer, so your assets simply need to last longer.[1]

In addition, markets remain volatile and retirees are particularly susceptible to these ups and downs. If a major market correction occurs during your retirement, the decline in portfolio value could force you to withdraw less from your accounts or risk running out of assets later.

Finally, inflation can reduce the value of your savings, forcing you to withdraw more from your accounts to maintain purchasing power and ultimately increasing the chance of outliving your assets. While inflation has been low in recent years, many experts expect it to climb in the decade ahead. And even at a 3% rate, your assets would have to increase by more than 80% over a 20-year period to maintain today's purchasing power. Note that healthcare inflation runs at a rate nearly double that of general inflation.[2]

Know your retirement spending needs

The first step in planning for retirement is to know how much you'll need and how you'll spend it. When talking with clients about spending, we try to think of all costs fitting into one of three categories:

- **Needs** are essential expenses such as food, shelter, utilities and clothing.
- **Wants** are discretionary expenses that let you maintain your lifestyle, such as vacation spending, leisure activities and luxury items.
- **Wishes** are the objectives you aspire to beyond your basic needs and lifestyle spending, such as leaving assets to heirs or charity.

In addition to meeting your spending needs, your retirement income plan should include a strategy for preventing losses below a threshold that would cause financial hardship or emotional distress. It's also important to maintain enough financial flexibility to deal with unexpected circumstances.

Identify sources of income

During retirement, your income is likely to come from a variety of sources, which can be challenging to assess. Your income sources could include:

- **Pensions**
  Many defined benefit pension plans are being frozen, terminated or restructured. As a result, personal investments, including 401(k) plans, will have to provide an increasing share of retirement income. Let's identify any pensions or 401(k) plans that aren't already incorporated into your retirement plan.

- **Social Security**
  While few of our clients intend to rely on Social Security benefits as a primary source of retirement income, lifetime benefits can be larger than you might expect: nearly $600,000 on average for a couple who turned 65 in 2010 and significantly more for high earners with longevity.[3] The amount of your benefits is primarily determined by when you begin receiving them, so it's important to have a Social Security strategy in place.

- **Earned income**
  You may leave your current job, but you might keep working in some other capacity. The number of Americans working after age 55 had gradually declined over several decades to a low of around 30% in the early 1990s. Then that trend reversed. By 2008, more than 40% of Americans continued working beyond age 55.[4] Most of them do so because they haven't yet accumulated enough assets to fully retire or because the value of their savings declined with the market.

Create a retirement income plan

Once we've determined your retirement spending needs and identified sources of retirement income, we can create a formal plan. It should focus on balancing growth and income in your portfolio, and for withdrawing assets at a sensible rate in a tax-efficient manner.

Every situation is different, but in general, drawing down your taxable investment accounts first may be preferable, because those contributions were made with after-tax dollars. The long-term capital gains tax rate you pay on these assets will likely be less than the income tax rate that you will face on most retirement plan assets, which, left alone for now, can continue to potentially grow and compound on a tax-deferred basis.

Consider a few distinct milestones:

- At age 55, you may start withdrawing from 401(k)s without incurring the 10% early distribution penalty, as long as you are no longer employed by the company that sponsors the plan.
- At age 59½, you can begin taking penalty-free withdrawals from traditional 401(k)s or any type of IRA. You will owe income tax at your current income tax rate (except on Roth IRAs and Roth 401(k)s, which allow tax-free withdrawals as long as you had the account for at least five years).
- At age 70½, you must begin required minimum distributions (RMDs) from traditional IRAs or 401(k)s, taxable at your current income tax rate. Roth IRAs do not require minimum distributions.

Before you withdraw anything, we should talk about your future goals. For instance, from an estate planning perspective, you may find it preferable to draw down tax-deferred savings first. Doing so could create beneficial tax consequences for heirs, who inherit your taxable assets. Be sure to include your tax advisor and attorney in these discussions.

Sustainable withdrawal rates

When determining how much you can reasonably withdraw from your accounts each year, we should base the rate on your assets, expenses, expected lifespan, inflation and portfolio return. For instance, we may find that if you withdraw 8% of your total assets each year as retirement income, those assets could last 20 years. Or we might find that adjusting the withdrawal rate down to 4% could help your assets last 30 years. Whatever the plan, it's important to tailor it to your specific situation.

As you can see, there's a lot to think about when crafting a plan for income. We'd like to help you review your overall preparations and determine if your approach is likely to accommodate your needs. Please feel free to contact us at your convenience.

[1] Source: CDC/NCHS, National Vital Statistics System; DHHS Publication No. 2012-1232, May 2012, Table 22: Life expectancy at birth, at 65 years of age, and at 75 years of age, by sex, race, and Hispanic origin: United States, selected years 1900–2009.
[2] Source: Department of Labor, Bureau of Labor Statistics, Consumer Price Index, as of 12/31/11. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Core CPI includes all items less food and energy.
[3] Social Security and Medicare Taxes and Benefits Over a Lifetime, by C. Eugene Steuerle and Stephanie Rennane, Urban Institute, Updated June 2011.
[4] Source: Bureau of Labor Statistics.

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