



Is Your Retirement Income RECESSION-PROOF?

Retirement Income Perils

Where will you get income in retirement? Most people think: By cashing in the investments I've accumulated during my working life. But even if you have a lot of money saved, cashing in will not always work. You need to have an income plan. The notion that you can withdraw a fixed amount every month carries a lot of risk.

Imagine a scenario where two brothers, three years apart in age, both retire when they are 62 years old. The year they retire, both brothers have exactly \$1 million in assets and the exact same investments. They each withdraw 5% or \$50,000, adjusted for cost of living, each year, and live 30 years in retirement before dying. This story ends happily for the older brother who left behind a large estate, but unfortunately, not for the younger brother who ran out of money at 84. How can this happen?

In this case, the older brother had positive returns during the first couple of years in retirement, while the younger brother had losses. The older brother's first two years' gains were good enough to bolster him against the later downturns. The younger one had no such cushion against bad fortune. The older one was lucky. It could have been the opposite, as both brothers left their retirement in the hands of the stock market's whims. Their withdrawal strategy was a version of dollar cost averaging, which is done to accumulate assets during your working years. This

involves purchasing a constant dollar amount of stock on a regular basis. It allows you to take advantage of the ups and the downs of the market, smoothing out the cost curve. Withdrawing on autopilot like the brothers both did is dangerous. It risks dollar price erosion, the evil twin of dollar cost averaging.

When an investment is up, there's no problem. You sell and reap the rewards. But if an investment is down when you sell, the loss is magnified. Between 1970 and 1999 the Standard & Poor's 500 stock index's average annual return was 13.66%. If you were retired during that three-decade span, it appears you could withdraw \$136,000 each year without running out of money. That's true if the market moved in a straight line, known as a linear return sequence. Unfortunately, when we factor in the market volatility that occurred then, an investor who withdrew \$100,000 annually was left with just \$119,111 after 15 years. Not much to live on. Given a yearly return of 13.66% over 15 years under a linear return sequence, the ending balance was \$1,025,586. This is why income planning is so important.

There are many strategies for income planning, including a defined withdrawal strategy, purpose-based investing or a sequential income portfolio. Each income strategy has its good and bad side. Let's look at defined withdrawal. Here, you create something called an income ladder, which minimizes the risks of

needing to sell stocks in a down market. You buy a series of quality fixed-income securities with staggered maturity dates. You meet income needs with money you get from matured principal and interest. On the negative side, you forego capital gains' selling if bond prices go up because you are locked in until maturity. And when rates go up, you are stuck earning less in

interest than you could if you had more flexibility. Which alternative is right for you depends on how much income you require, your total assets and many other factors.

Make sure you work with an advisor that understands the importance of providing income in all markets without jeopardizing your retirement plan.