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How to create and manage retirement income - Part 2

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Part 1 appeared in the June 12th edition of the New England Real Estate Journal in the Financial Digest section.

3. Dividend Paying Stocks: The obvious disadvantage is stocks decline on average one out of every four years and are subject to annual corrections in the 5% to 20% range and as we just experienced sometimes the declines are even more significant. For this reason, 30% to 50% - more or less depending on the investor - seems to be the ideal allocation to stocks for the average retiree. Also, returns are not guaranteed and the investment is subject to risk, including the risk of principal.

4. Real Estate Investment Trusts: REITS are publicly traded entities owning properties such as apartment, office, and industrial buildings. These investments typically produce about 5% annually in dividend income and over the longer term offer some upside growth potential (2). REITS are stocks and are subject to the same risks (3). These are best held in a tax deferred account such as an IRA. A small allocation - typically 5% - is usually recommended.

5. Annuity/Pension/Social security: Lifetime guaranteed annuities; company pensions and social security are guaranteed sources of income, for the most part. Pensions are only guaranteed as long as the employer stands behind the promises. These sources of income are very desirable to a retiree because typically the income is paid for as long as you live and you do not have to control or monitor the investment allocation. These sources of income make up the starting foundation of your retirement income plan.

6. Yourself: Many retirees will work because they want to others will work because they have to. Consider this, if you generate $25,000 annually in part time enjoyable work it is the equivalent of having $500,000 earning 5%. So if you are $500,000 short of your retirement goal this may be a good solution. If you don't need the money it still helps your overall portfolio by tapping into less each year or delaying social security payments.

Combine the income producing investments into a portfolio: A retirement income portfolio should ideally have an allocation to all of the above referenced investment options. Each retiree has a unique situation and therefore each portfolio would be designed differently depending on the investors risk tolerance and guaranteed sources of income. In general, I find a balanced portfolio evenly split between dividend paying stocks and bonds with a small -5% - allocation to real estate on the stock side works very well. I could go into much more detail on how we develop a well diversified balanced portfolio but for purposes of this article the important point is that 50% to 70% of the portfolio is very stable with high current income and 30% to 50% is in dividend paying stocks and real estate with the best opportunity for growth and an increasing future income. Again, the percentages would be adjusted based on the investors overall objectives, risk tolerance, and suitability.

In the long run, the goal of the portfolio is to provide a growing income stream that exceeds the

inflation rate that is designed with due regard for individual client goals and risk tolerance. In the short term, the bonds will provide stability, high current income, and be used for income during corrections and bear markets in stocks. The bond and money market allocation will also help the investor -from a piece of mind standpoint- maintain their stock holdings for future growth.

How to manage withdrawals: Many financial advisors consider a 4% withdrawal rate to be a conservative withdrawal rate to allow your money to last for your lifetime. This could be anywhere from 4% to 6% annually depending on your particular situation. Another issue to consider is which account to withdraw from to generate an income stream. When we develop a retirement income plan for a client we will typically withdraw from the taxable account first, followed by tax deferred accounts such as IRA's, 401k's and annuities and then finally tax free accounts such as Roth IRA's/Roth401k's. However, the strategy is customized to the needs of the client with the goal to minimize income taxes paid over their lifetime. Many of our clients have trust accounts set up that are not subject to estate taxes. In these situations, we allow the trust to accumulate and only withdraw funds if it is absolutely necessary.

One of the biggest mistakes I see in the retirement income planning area is withdrawing from stocks or stock funds in a correction or bear market. Your retirement income plan needs to be managed so when we have the inevitable down years in the stock market, on average one out of four years, your stocks are left alone and your income stream needs to come from the safe side of your portfolio - bond funds and money market accounts. Selling stock funds when the market is temporarily down will ruin your retirement income plan. I have met a few perspective clients who had been receiving IRA withdrawals on a monthly basis with the income coming out of each of their funds proportionally. When we make them aware that they are selling stock funds in a depressed market they typically will transfer the accounts to us and have us manage their withdrawals. We like to tell our clients we cannot predict the market but we can manage the market and make it work for your benefit.

Develop a Retirement Income Plan: Consider a financial advisor who can help you develop a well thought out retirement income plan. A good plan will address your lifetime income needs, protect you from the high costs of long term health care and smoothly transition your remaining assets to your family. You will be able to sleep well at night- through good and bad markets- knowing you can rely on a solid plan. Most importantly, you can reap the rewards of all of your working years and develop new interests, volunteer, travel, play golf, publish a book as my father has done or anything else you always wanted to do. It's your plan!

(2) Source: NAREIT Equity Index

(3) Source: NAREIT Equity Index

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