Special Report – March 2014
In Retirement: Net Worth is nice but Cash Flow is King

Prepared by Stephen Geist
Host of the radio show "The Retirement Guy" every Saturday at 7:30 AM on KNUS 710 on your AM dial
AND…Visit Steve's website at: www.RetirementWize.com

Hello! My name is Steve Geist, I'm a Financial Strategist and I specialize in Safe Retirement Plan Solutions that are tailored with care. More specifically, I help my clients tackle complicated retirement issues and guide them towards easy-to-understand solutions designed to safely preserve and grow their retirement wealth. Now, more than ever, people over the age of 50 are clamoring for education and advice regarding their retirement.

One way I like to teach my clients and my seminar students about Retirement is to present it as a Puzzle. And, I like to present the puzzle as containing five primary pieces. And they are:

- ✓ Puzzle Piece #1: Preserving and Safeguarding Your Accumulated Assets
- ✓ Puzzle Piece #2: Setting up a Lifetime of Guaranteed Income
- ✓ Puzzle Piece #3: Addressing Taxes in Retirement and Beyond
- ✓ Puzzle Piece #4: Having Proper Coverage for Health Care and Long Term Care
- ✓ Puzzle Piece #5: Leaving a Legacy for your Loved Ones

What Recent Studies Tell Us

So let me start by pointing out that the Great Recession -- including the collapse of both the housing market and stock market -- wiped out nearly 30 years of gains in net worth for the typical household. "The median household is no wealthier today than it was in 1984," according to Scott Winship, an economic studies fellow at Brookings Institute.

CNN Money recently did an analysis of new Census Bureau Data and they found that if you strip out the effects of the housing collapse, median household net worth still fell by 25% between 2005 and 2010. This decline was driven largely by the plummeting stock market which devastated Americans' portfolios and retirement accounts.

In a recent Wells Fargo Survey: When asked how much they would need to retire, the median response from survey respondents was $350,000. That's a good response from a practical standpoint, but the bad news is people have not saved much toward that answer. Of those surveyed, the median amount saved for retirement was only $25,000.

The survey also showed a disconnect between what people wanted for their retirement and what they were doing to achieve it. Most people surveyed said they expect to live 21 years into retirement. And since most people are living into their mid-80s; that survey response is pretty close to current reality. But when these respondents were asked how much they expected to withdraw from their retirement savings every year; 56% said they would withdraw an amount greater than six percent.

Unfortunately, that answer does not work in terms of their 21-year time horizon. That's because of the disparity between what they will have actually saved for retirement versus what they will need in order for that money to last 21 years at a 6% withdrawal rate.

If you retire, (that is, you stop working) and your income in retirement does not meet your living needs, then obviously at some point you'll experience retirement failure. In other words, you could be in danger of outliving your assets. So, you should make a plan, and then work the plan.

Retirement Income Planning – The next frontier

Retirement income planning, as a specialty practice, is gaining traction with the public. Advisors already help their clients accumulate assets for retirement, so what's the big deal about shifting from your accumulation phase of life into your distribution phase of life?

Retirement income planning as a separate discipline is a distinct process. For starters, consider the duration of your accumulation period versus your distribution period. Typical retirement planning focuses on accumulating assets up to a target date. Although the target date is subject to some unpredictability, you decide when to retire. By contrast, retirement income planning deals with an unknown lifespan.

Sure you can refer to life expectancy statistics and you can factor into your projections personal issues like your health and family history. But it's still a question of providing adequate funds for an unknown period of time.

What is Retirement Income Planning?

Retirement income planning focuses on your individual income needs and your other financial goals in retirement, such as contingency funds, risk management and legacy planning.

Retirement income planning is a process, not a product. It's not about achieving a single number because the process incorporates all of the things people face when determining how to live their retirement years. Those issues can include the timing of Social Security benefits, funding health-care expenses and determining how to generate additional income. It's a holistic planning process that tries to understand what you are hoping for in your retirement and then making sure that from a financial perspective you achieve what you're hoping for.

Two of the main factors you must consider with pre-retirement financial planning is the amount to be saved and how those savings should be invested—your asset allocation decision.

The scope of required decisions expands, however, for retirement income planning. And the challenge is compounded because of your uncertain life expectancy.

When you get to retirement, not only do you have to replace the income that your employer was paying you but you have to make major new decisions about how you're going to handle issues such as health care, long-term custodial care, frailty, incompetence, longevity and inflation. Financial risks also change after retirement. And, you have an unknown end date that you're moving toward. That uncertainty has some pretty significant impacts in terms of how you approach the income planning process.

Understanding how to navigate through retirement is a completely different skill set than navigating through your accumulation years. Accumulating money is actually pretty simple compared to learning how to maximize your Social Security, how to minimize your taxes, how to make your money last a lifetime, when to retire, understanding the risks you're facing in terms of long-term custodial care…..all of that IS a big deal.

Retirement Budget and Cash Flow

To safely prepare for retirement, you must first prepare a detailed and well thought out budget and cash flow. That is, determine what your spending needs will be over the life of your retirement.

First, make a list of the essential expenses such as housing, food, utilities and health care. And then, in order to enjoy retirement, you must also account for the discretionary expenses such as entertainment, travel, hobbies and charitable giving. Also, remember to factor into your budget large and infrequent expenditures, such as a new roof, a new car, property taxes or a special vacation.

Regarding saving more and spending less when preparing your budget
As you approach retirement, saving more and spending less could significantly improve your financial situation in retirement. An emphasis on greater thrift doesn't have to mean living cheaply -- far from it. Instead, thrift or frugality should push us to match our money with our values.

I like the concept of "judicious expenditures." When reviewing your spending, think about the things you cherish most. Then align those insights with the practicalities of your personal finances.

Maybe you've equated living better with owning lots of stuff for far too long, even as you recognized in the back of your mind that what gives you joy is learning, creative activities, and shared experiences with family and friends. Retirement income planning is an opportunity to bolster your finances and to translate those values into reality.

As a final step in your budget preparation, be sure to add a 10% cushion to cover the items you have overlooked that could come up unexpectedly. And finally, be sure to properly account for inflation and longevity.

Inflation

Inflation is a slow but lethal killer of retirement dreams. Many individuals that retire early fail to consider how seriously inflation can impact their lives during a long retirement period.

People in or near retirement could still have several decades of need for inflation-protected income. Making the situation worse, interest rates are still near record lows, and most bank savings accounts, money market and CDs are yielding less than 1 percent.

Rule of 72
A rule stating that in order to find the number of years required to double your money at a given interest rate, you divide the compound return into 72. The result is the approximate number of years that it will take for your investment to double. So if you're earning 1% in a CD it will take you 72 years to double your money!!!

"Going broke safely" is a situation where investors have unknowingly kept money in low-yielding accounts or under the mattress. While it allows investors to sleep at night, inflation, over time, will erode the purchasing power of that safe money.

Inflation caused by the U.S. Government's actions
It all comes down to the loose monetary policies of the Federal Reserve and other central banks. The Fed is currently buying about $65 billion a month in longer-term treasury bonds and mortgage securities. We've already seen trillions of dollars in asset purchases since the financial crisis of 2008 through two prior rounds of quantitative easing (i.e. QE1 and QE2).

So where does our Government get the money? Mostly the Feds are increasing the money supply by just printing it! What happens to the value of money if the Feds print a lot of new money? The value of money goes down. That's called inflation! The Government is creating an impending inflation disaster in order to fix the current financial mess.

The Consumer Price Index
The most widely used measure of so called "core inflation" is the Government's Consumer Price Index (CPI). The CPI is used to measure changes in prices of all goods and services purchased for consumption by households. It is also an important measure of the overall health of the economy. It's important to realize that healthcare, food and energy costs are increasing and can take a serious bite out of your retirement budget.

It's also interesting to note that cyclical price swings in energy costs, health care and food <u>do not</u> get included in the CPI. This then brings into question the formal news on the inflation front as reported by the Government that there is <u>little change in inflation</u>.

<u>Planning for Inflation</u>
Most experts agree you should plan on approximately 3% inflation every year. In some cases, we have seen as much as 10% inflation in one year. This can have a dramatic impact on how far your retirement dollars can go.

For example, if you need <u>$50,000</u> a year for current living expenses. Then in just 24 years at 3% inflation, you'll need <u>$100,000</u> a year just to have the same standard of living.

So, sit down with your financial professional and go over how much money you will need to retire and assume inflation will keep moving up at 3% per year.

<u>**Longevity**</u>

In my business, I have a keen interest in understanding the current state of longevity in America. And we should all be very nervous about its implications. In the past 100 years, we have made great strides in improving human health and increasing life expectancy. Back in the year 1900, the average American lived just past at 40.

Today, according to the Centers for Disease Control, average life expectancy in the U.S. has increased to 78.2 years. Since 1940, we have gained one year of life expectancy every five years. If we keep this pace, by the end of this century, the average American will live to be close to 100 years of age. For couples in their 60s today, there is a 50% chance that one partner will live to the age of 94, and one out of 10 couples will have a partner that lives to be 100 or older.

So it's important to factor life expectancy into your budget. Your nest egg must be properly allocated to provide a stream of income that will last as long as you do. I like to recommend that since science, medicine and technology could work in your favor, you should plan to live into your 90s and budget assets to last to age 100.

<u>**Health Care Costs**</u>

It's not news that health care costs are increasing. Yet several recent studies show that few people factor those rising costs into their retirement plans.

Consider this example from an annual report from Fidelity Investments. For a 65-year-old couple retiring this year, the cost of health care in retirement will be $240,000. The report assumes that the man will live 17 years and the woman 20 in retirement. Most people don't realize Medicare covers much less than traditional employer plans. The $240,000 number captures the Part B premium for physician services, Part D for prescription drugs. Then there are deductibles and coinsurance, and benefits that are not covered like vision exams and dental care.

Another study, this one from Nationwide Financial, found that people who were near retirement routinely and wildly overestimated the percentage of health care costs covered by Medicare. It covers only 51 percent of health care services, according to the Employee Benefit Research Institute.

So I suggest you set aside 5 percent of your annual budget for health-related costs and deductibles. If you don't spend it, you can always use the money to do something healthy.

SPECIAL REPORT TIMEOUT

In case you belong to a group, club, church, association or any type of organization that invites outside speakers to give interesting talks – please know that as a community service, I would be delighted to speak at your next group meeting. And I would speak on a topic that would be both informative and relevant to Retirement. Just call my office and let me know how I might be of service.

Long-Term Care Costs

- Chance of needing Long-Term Care after age 65: 70%.
- Most people believe Medicare pays for long-term care. It does not!
- The average stay in a nursing home is 2½ years.
- About one-half of people entering nursing homes will spend their entire net worth before death.
- 70% of married couples now 65 will have at least one of the spouses entering a nursing home.

According to the 2013 Cost of Care Survey by Genworth Financial

- Cost of Non-Skilled Home Health Care (5 hours/day, 5 days/wk): National average rate = $24,700/year
- Cost of Assisted Living – One Bedroom Unit - Single Occupancy: National average rate = $41,400/year
- Cost of a Nursing Home (semiprivate room): National average rate = $75,500/year
- Cost for Nursing Home Care in 18 years at 4.0% inflation: $151,000/year

The question is: Are you going to pay for long-term custodial care out of your current assets or are you going to look at alternatives for covering these potentially catastrophic costs? For more information on the subject of long-term care and some alternatives to cover costs, you can order one of my free Special Reports titled "A Primer on Long-Term Care Coverage."

Final Point on Your Retirement Budget

This kind of number crunching can be done with a simple budget worksheet (found free online) or with your favorite budgeting software. But I highly recommend you have your financial professional assist you with this retirement budget preparation or at least review your work before casting it in concrete. A second pair of professional eyes can help spot errors in your assumptions.

Matching Guaranteed Lifetime Income to Lifetime Living Expenses

Once the retirement budget is complete, the second step is to match your spending needs with anticipated sources of retirement income that are guaranteed for your lifetime. There are three sources: Pension (if any), Social Security benefits and lifetime income from Annuities.

So let's spend a moment contemplating Social Security.

Specifically, you need to understand that retiring early can have a significant impact on how much money you are able to collect from Social Security for the rest of your life. Too many Americans begin collecting Social Security benefits as soon as they turn age 62 even though they are penalized severely for not waiting until they reach their full retirement age. Between the age of 62 and 70, workers can boost their Social Security checks by 7 to 8 % for each year they delay signing up for benefits.

So, if you can afford to live on income from other sources, then waiting to collect Social Security is something you should strongly consider.

On the other hand, if you are going to be relying heavily on Social Security, as many people do, then you and your financial professional need to take some time to calculate how much less your Social Security check is going to be by starting to collect at an earlier age.

I have prepared a Special Report titled "A Primer on Social Security". In that report I explain the many rules and deadlines that you must understand as you begin to receive Social Security benefits. And you can get a free copy of this report simply by calling my office or sending me an email.

Tapping into your Retirement Assets for Income

OK, you've determined your guaranteed lifetime retirement income that will come from Social Security and any pension you are lucky enough to have. As an important sidebar: If you're married, remember to account for possible reduction in your pension and social security benefits when one of the spouses passes away first.

The next step: If your total guaranteed lifetime income equals or exceeds your spending needs which have been adjusted for inflation and longevity, then you're prepared for retirement without the need of drawing on your retirement assets. However, if the numbers don't line up then your retirement assets will have to be tapped into.

Over the years a number of studies have been done to attempt to determine how much a person can safely withdraw from their retirement assets each year without running out of money. This is known as the safe withdrawal rate.

Wall Street has typically followed the 4% rule by advising that to avoid running out of money you should withdraw no more than 4% of your stock and bond portfolio the first year of retirement. You would increase that withdrawal each year by the rate of inflation to maintain your purchasing power. Wall Street says do this, and you'll have 90% assurance that your savings will last at least 30 years.

Wall Street's advice seems so simple and so certain.

But sadly, there are many road bumps that can cause your retirement income plan to go awry. For one, the stock market could take another frightening downturn. Or you could encounter a lost decade of go-nowhere returns like what we've had for the last fourteen years.

Sequence-of-returns risk

Research has shown that once a person starts to take withdrawals, the portfolio's returns during retirement's early years have a major impact on its sustainability. This is the period when retirees are most exposed to sequence-of-returns risk. If the stock market is bad for the first few years of retirement, you're going to run out of money much quicker unless you have some system or some plan for addressing that. So, one of the big differences between accumulation and distribution is sequence of returns risk.

If you're unlucky enough to experience a large loss or period of paltry gains, especially early in retirement, the odds of your stock and bond portfolio surviving 30 years can easily drop from 90% to 60% or lower.

Now, a new Study that appeared recently in the Journal of Financial Planning suggests that a more reliable safe withdrawal rate should be 2.52% instead of 4%. The study reaches this conclusion by taking into consideration that life expectancy is increasing, the number of retirees covered by pensions is decreasing, and the ongoing turmoil in the financial markets has adversely affected retirement savings.

So then, using this new 2.52% withdrawal rate, and in order to get a rough idea of whether you'll have sufficient assets, you would take your annual expenses in retirement which are not covered by your guaranteed annual retirement income and then multiply that number by 40 (which is the approximate inverse of 2.52%).

For example, if you'll need $40,000 per year over and above your guaranteed annual retirement income, then you will require 40 X $40,000 which equals $1,600,000 in assets to draw from when you retire.

I want to emphasize that even this 2.52% withdrawal rate does not perfectly account for the growth or loss of your risk-based assets during a long retirement. You can't control where markets will be the year you begin tapping your investment nest egg. If you have some bad years before you start retirement then you might have significantly less money in your stock and bond portfolio than you had intended.

Which Assets Provide Guaranteed Lifetime Income?

Let's take a moment and ponder which, if any, of your current retirement assets are actually able to provide a reliable and adequate source of guaranteed lifetime income.

We know that savings accounts, money market accounts and CDs, are all safe money alternatives. But these choices are currently paying historically low interest rates (basically going broke safely) and offer nothing in the way of lifetime guaranteed income.

We also know that stocks and mutual funds offer potential growth but also subject you to the risk of losing part or all of your principal. And, sometimes these types of investments pay dividends. But again, dividends are not a guaranteed source of lifetime income.

Perhaps you have a portfolio of Real Estate investments that provide income. Unfortunately, such income can be subject to the volatility of the market and offers nothing in the way of a lifetime of guaranteed income.

Next come bonds and bond funds, a choice that Wall Street appears most comfortable with. And, as a result, Wall Street recommends various types of bonds to clients that are looking for stable growth and income in retirement. I guess one could say that the bond is the broker's annuity -- their "safe money place."

But let me make a couple points about bonds and bonds funds whose yields are also flirting with historical lows. First, the flaw with positioning bonds as income vehicles is their lack of lifetime guarantees. Consider, for example, if a couple had retired in 1991 and put $1 million into 10-year Treasury Bonds, they would have received payouts of around $84,000 per year for ten years. A couple trying the same maneuver this winter, 2014 would receive about $26,000 per year for ten years.

My second point is that bond and bond funds are not necessarily the safe haven Wall Street says they are. Don't take my word on this, and don't take the word of your broker who says they are completely safe. Do your own research as part of becoming knowledgeable about investing.

One of the risk issues is that bond ownership means taking on interest rate risk. That happens because when interest rates rise, bond prices fall. Given that interest rates are currently at historical low levels, the likelihood is that rates will rise in the coming years. In that case, bond holders will be seeing a decline in the value of the bond accounts.

Another Alternative for Guaranteed Lifetime Income

And so, there is one other type of investment that is both a safe-money alternative and offers a lifetime of guaranteed income and it comes from the world of deferred annuities.

It's known as an Index Annuity and it offers safety of your principal, reasonable rates of return, diverse liquidity options, and various income options. An Index Annuity, then, is an excellent alternative that should be considered for every retirement portfolio.

SPECIAL REPORT TIMEOUT

In addition to hosting the Retirement Guy radio show, which I have done now for over four years, I also conduct free (open to the public) educational events. To meet me in person and learn about retirement, in a public setting, then please call or email me with a request for the date, time and location of my next event.

And now there's a new feature with Index Annuities known as the <u>Guaranteed Lifetime Income Benefit Rider.</u> This is a living benefit that guarantees lifetime income and it allows you, the owner of the annuity, to remain in control of your money. And how important is that in retirement?

<u>How an Index Annuity with an Income Rider works:</u>

The Income rider has a value that is established at the same time that the annuity is issued. The income rider's initial value is the same as the initial premium and bonus that's used to set up the annuity. Income riders normally have two distinct phases: the <u>growth</u> phase and the <u>payout</u> phase.

First, during the <u>growth</u> phase: the income rider is growing in value each year based on what's called the roll-up rate. Today's roll-up rate for the income rider value will be in the 7- 8% range and compounded annually.

Then regarding the <u>payout</u> phase: you can access the income rider any time after the first anniversary of the annuity. When you are ready for income, you will have "age based" access to the income rider. The older you are the larger the percentage access to that account.

Once you access the income rider your payout amount is guaranteed to never decrease and it will last for your lifetime. At your death, the Annuity's accumulated value, less your withdrawals, will pass to your beneficiaries.

<u>Example of Owning an Index Annuity with an Income Rider</u>
Let's Assume:

- Your Age at start of Annuity: 60
- Initial Premium that you put into Annuity: <u>$100,000</u>
- The starting Value of Annuity (with 10% Bonus): <u>$110,000</u>
- Guaranteed annual Roll-up of Income Rider: <u>7.2%</u>

The <u>guaranteed</u> results would be:

- Income Rider's Guaranteed Value after 10 years: <u>$220,000</u>
- At age 70, Guaranteed Annual Withdrawal Percentage: <u>6%</u>
- That means your Guaranteed Lifetime Withdrawal: <u>$1,100/month</u>
- That means that living to age 100, for example, you will receive $396,000 of total income over the 30-year remainder of your life.
- And, when you pass away at some point, whether early or late, the accumulated value of Annuity, less any withdrawals, will pass to your beneficiaries.

This is a <u>Guaranteed Lifetime Income Solution</u> with many features and benefits not offered by any other investment alternative.

<u>Wall Street's Safe Withdrawal Rate versus Income Rider Withdrawals</u>

So let me return to a point I made earlier. Wall Street used to advise that if you withdraw 4% each year from your stock and bond portfolio, then you probably won't run out of money before you die. However, due to all the market volatility in recent years, this rule has been revised downward to 2.5%. That means on a $1 million stock and bond portfolio, you would withdraw just $25,000 per year.

By contrast, the guaranteed lifetime withdrawal rate of an income rider on an index annuity is typically 5% per year if you wait until you're in your 60s to start withdrawals. That withdrawal rate increases to 6% or more per year if you wait until you're in your 70s to start withdrawals. So which is the better alternative in retirement: Withdraw 2.5% from your oversized, risk-based stock and bond portfolio to generate inadequate income OR withdraw 5 to 6% from the Income Rider of an index Annuity that is guaranteed not end until you end?

The "Three Buckets of Money" Strategy for Financial Peace of Mind

Finally, I would like to say that one truth about retirement planning is that you should not put all of your nest egg in one basket. In retirement, you have to live in the here and now. So you need to have income for today. But you also need a plan for retirement income for tomorrow's inflated costs of living as I pointed out earlier.

So one way to allocate assets to meet your retirement income needs is to place your assets into three buckets:

Bucket of Money #1 is for Emergencies:
An emergency constitutes an immediate financial need, such as out-of-pocket expenses for such items as a new roof or new vehicle. My suggestion is to keep adequate emergency funds in a safe financial vehicle such as a savings or money market account so you can get at it at any time.

Bucket of Money #2 is to cover Essentials Expenses
Essential expenses tend to be constant from month to month, such as food, clothing, mortgage payments, utilities, taxes and health care expenses. According to the U.S. Bureau of Labor Statistics, these essential costs represent more than 86% of the retirement budget for people age 65 and older.

Bucket of Money #3 is to cover Discretionary Expenses
Discretionary expenses include entertainment, travel, hobbies and charitable giving.

So one retirement strategy is to ensure that all of your essential living expenses in retirement will be covered by guaranteed income sources, such as Social Security, pensions, and annuities.

In other words, if you can cover essential expenses (adjusted for inflation and longevity) with guaranteed lifetime streams of income: then you will have the freedom to use the rest of your money as you wish. You no longer have to worry about outliving your money in retirement. You are able to enjoy your retirement with greater peace of mind.

Three Reasons Why You Might Want to Contact Me for help after reading this Special Report:

1. You want a financial professional to help you in preparing your retirement budget or at least review your work before casting it in concrete.
2. You want help to ensure that you have sufficient income for the life of both you and your spouse
3. You want to set up a stream of guaranteed lifetime income using Index Annuities with Income Riders

I wish you a long, happy and financially secure retirement. And if I can be of any assistance, please do not hesitate to contact me.

Sincerely;
Stephen Geist - Financial Strategist and Safe Retirement Plan Specialist
303-586-4198
www.RetirementWize.com