Retirement – Meeting Your Spending Needs

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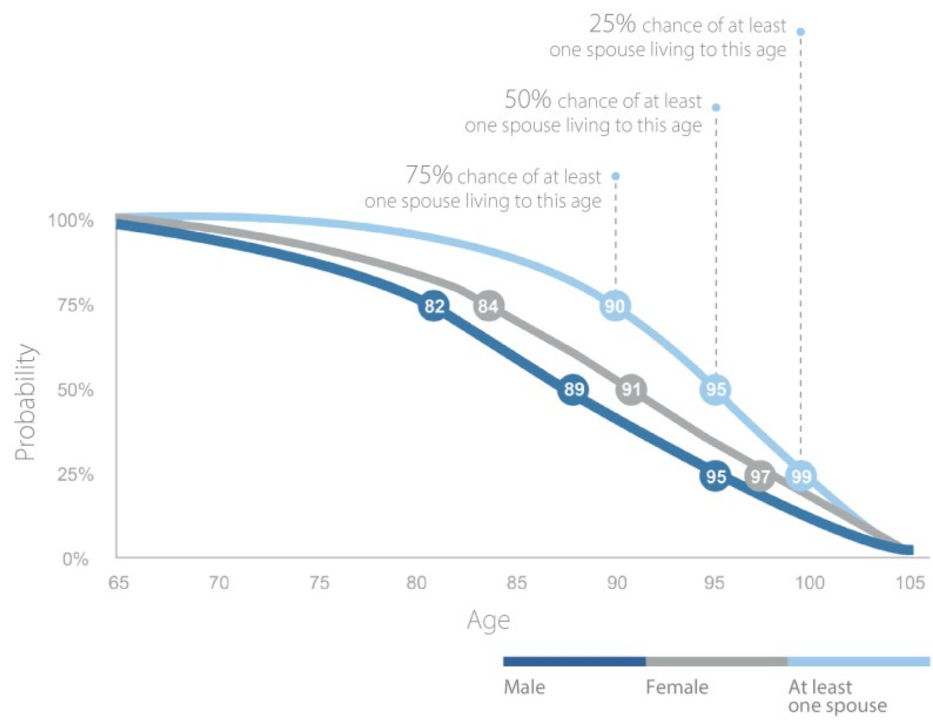
Day one of retirement may bring about some new and unsettling feelings.

What becomes top of mind is the transition from focusing on accumulation and growth of your assets to income, cash flow and capital preservation. You also may become more aware or concerned with heightened investment risk, your unknown longevity, spending shocks, inflation or even declining cognitive abilities.

If you retire at 65, you could possibly have 30 years of retirement. This graph provides some interesting insights into your possible longevity:



Source: 2012 IAR Mortality Table

Based on life expectancy alone, this usually leads to the question of "How much can I spend in retirement and still meet my goals?" The first step in finding a viable solution is identifying and accepting the risk to our expenses in retirement. These can be defined as:

Longevity risk – an unknown planning horizon

Macro/Market risk – investment volatility, interest rate volatility, public policy and taxation, sequence of returns

Inflation – rising costs of living

Personal spending – health and long-term care, the needs of other family members

You cannot accurately figure each possibility into your planning, so you need a starting point. One that allows you the flexibility over the years to modify your distributions and meet your needs. You want to feel as though you can accept the various risks listed above and not deplete your assets too quickly. There are many different retirement income distribution strategies that provide this flexibility and give you a great starting point. I will briefly describe five of them.

1

Flexible Capital Preservation – If your total assets are sufficient, this is a very sensible strategy for early retirement where there are still decades of uncertainty ahead. You live on the interest, dividends and some of the growth, all with an eye to preserving assets.

2

Flexible Withdrawals – Also known as the bucket system, where you keep less volatile assets like cash and bonds on hand for near-term living expenses that cannot be met by selling down volatile equity assets when they are growing. You are saving your safe "buckets" for the tough times.

3

Annuity Payments – You can purchase an annuity from an insurance company to guarantee a base of income for your life or the joint lives of married couples. This provides the base level of income for life and you can use your remaining principal to determine how to meet unexpected expenses.

4

Variable Withdrawals – Similar to the Required Minimum Distribution rules for IRA accounts. You begin by basing your withdrawal on your life expectancy. In simple form, you would withdraw an amount per year equal to your beginning asset value times the fraction of 1 over your life expectancy number. You may never run out of money, but you will likely wind up with smaller withdrawals in early retirement and possibly large withdrawals late in life.

5

The 4% Rule – Probably the most widely used, this method has statistical evidence of working well over long periods of time. Variations exist but it entails taking 4% of your total investment assets per year as you start retirement. It works well when some flexibility can be included to buffer variations for inflation or extreme market fluctuations.

With a great starting point such as the 4% distribution method, you can prepare for the somewhat random and unpredictable world of managing sequence risk. This is the risk of both the markets and of life. Your preparation begins with spending conservatively as retirement starts. Next, remain flexible in your spending and do not let

"lifestyle creep" continue and erode your assets quicker than planned. Reduce volatility by rebalancing your portfolios each year. Finally, buffer your assets and avoid selling at losses. Allocation is paramount in your retirement years. Each year, review your plan and see how well these sequence risks are managed.
For couples, there are two eras in retirement to plan for. When both are living and when either one is the survivor. This can affect long-range budgeting. But for everyone, retirement is also a great time to revisit your wills, power of attorney, directives and your other estate planning documents to ensure they are up to date. Plan to enjoy this next phase of life — a retirement of new purpose and fulfillment.

Tom Williams, CFP®

Vice President, Trust Officer