

Independent Investor  
March 2008

## **Everything You Ever Wanted to Know About Retirement Income**

After years of saving and investing, you can finally see your retirement on the horizon. But before kicking back, you still have some important planning to do. For instance, it's important to figure out how much retirement income you may need. To do that, you'll need to consider your housing cost, the length of your retirement, whether you have earned income, your retirement lifestyle, health care and insurance costs and the rate of inflation. You'll also need to identify all of your potential retirement income sources and review your asset allocation. Remember, decisions made now could make the difference between your money outlasting you—or vice versa.

The following frequently asked questions about retirement income should help you begin the final stages of retirement planning on the right foot.

### **When should I begin thinking about tapping my retirement assets and how should I go about doing so?**

The answer to this question depends on when you expect to retire. Assuming you expect to retire between the ages of 62 and 67, you may want to begin the planning process in your mid to late 50s. A series of meetings with a financial consultant may help you make important decisions such as how your portfolio should be invested, when you can afford to retire and how much you will be able to withdraw annually for living expenses. If you anticipate retiring earlier, or enjoying a longer working life, you may need to alter your planning threshold accordingly.

### **How much annual income am I likely to need?**

While studies indicate that many people are likely to need between 60% and 80% of their final working year's income to maintain their lifestyle after retiring, low-income and wealthy retirees may need closer to 90%. Because of the declining availability of traditional pensions and increasing financial stresses on Social Security, future retirees may have to rely more on income generated by personal investments than today's retirees.

### **How much can I afford to withdraw from my assets for annual living expenses?**

As you age, your financial affairs won't remain static: Changes in inflation, investment returns, your desired lifestyle and your life expectancy are important contributing factors. You may want to err on the side of caution and choose an annual withdrawal rate somewhat below 5%; of course, this depends on how much you have in your overall portfolio and how much you will need on a regular basis. The best way to target a withdrawal rate is to meet one-on-one with a qualified financial consultant and review your personal situation.

**When planning portfolio withdrawals, is there a preferred strategy for which accounts are tapped first?**

You may want to consider tapping taxable accounts first to maintain the tax benefits of your tax-deferred retirement accounts. If your expected dividends and interest payments from taxable accounts are not enough to meet your cash flow needs, you may want to consider liquidating certain assets. Selling losing positions in taxable accounts may allow you to offset current or future gains for tax purposes. Also, to maintain your target asset allocation, consider whether you should liquidate overweighted asset classes. Another potential strategy may be to consider withdrawing assets from tax-deferred accounts to which nondeductible contributions have been made, such as after-tax contributions to a 401(k) plan.

If you maintain a traditional IRA or a 401(k), 403(b) or 457 plan, in most cases, you must begin required minimum distributions (RMDs) after age 70½. The amount of the annual distribution is determined by your life expectancy and, potentially, the life expectancy of a beneficiary. RMDs don't apply to Roth IRAs.

**Are there other ways of getting income from investments besides liquidating assets?**

One such strategy that uses fixed-income investments is bond laddering. A bond ladder is a portfolio of bonds with maturity dates that are evenly staggered so that a constant proportion of the bonds can potentially be redeemed at par value each year. As a portfolio management strategy, bond laddering may help you maintain a relatively consistent stream of income while limiting your exposure to risk. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and changes in price.

When crafting a retirement portfolio, you need to make sure it generates enough growth to prevent running out of money during your later years. You may want to maintain an investment mix with the goal of earning returns that exceed the rate of inflation. Dividing your portfolio among stocks, bonds and cash investments may provide adequate exposure to some growth potential while trying to protect against market setbacks.

*This article is not intended to provide specific investment or tax advice for any individual. Consult your financial advisor, your tax advisor or me if you have any questions.*