
CHAPTER 5

RETIREMENT INCOME RISKS AND YOUR PERSONAL RISK STYLE

In this chapter, we are going to take a deep dive into understanding each of the retirement income risks, assess your emotional reaction to them, and then determine your Personal Risk Style. This will help you build a PRIM that is both financially fulfilling and emotionally comfortable throughout your retirement journey.

LONGEVITY RISK

"The 85-and-over United States population, the fastest-growing cohort in the country ..."

Older Americans Key Indicators of Well-Being – Federal Interagency Forum on Aging 2016

Longevity Risk creates the fear of outliving your income.

Living beyond your income can have severely adverse effects on your lifestyle, sense of independence, and emotions. It could mean having to live with your children, being supported by the government or outright homelessness. The loss of independence can be quite embarrassing and emotionally difficult to acknowledge.

We all know that people are living longer. Back in the 1950s for example, people did not need much retirement planning. During those years, when someone retired at age 65, their expected lifespan was only another seven years or so. It's not terribly difficult to plan for just seven years in the future, and most people simply made-do. In the 1950s there was little fear about outliving your income.

The retirement planning picture today is quite different. A person retiring at 65 is expected to live well into their 80's, and possibly longer.

The fastest growing population in America is people living beyond age 90. If that turns out to be you, a retirement of 25 to 30 years is not out of the question.

Under the best of circumstances, managing retirement income for that long is quite challenging. In fact, 41% of CPA financial planners say running out of money is their clients' top concern, including clients who have a high net worth.

And it doesn't end there.

Further research reveals that 61% of people between the ages of 44 to 75 fear running out of money more than they fear death.

"Forty-one percent of CPA financial planners say running out of money is their clients' top concern about retirement—including those who have a high net worth."

Which Do You Fear More?

Age 44 – 75



Source: Allianz Life Insurance

What does this all mean? Almost everyone is subject to *Longevity Risk*. Now it's your turn.

Take a moment and ask yourself what your life would be like if you prematurely spent-down your money and saw your income disappear while you were still quite healthy.

How would you feel if you lost your independence? What if you had to rely on family, friends, or the government for assistance? What if you

had no choice but to cut back on all the things you enjoy, like travel, restaurants, movies, and music?

How you answer these questions will give you an idea of the level of fear you attach to this retirement issue. On a scale of 1 – 5, where 1 means you have absolutely no fear attached to this issue and 5 means that it is off the charts, where would you put yourself?

My Longevity Fear Ranking:

INFLATION RISK

Inflation Risk results in the fear of loss of lifestyle (quality of life) because your income will not keep up with increases in the cost of living. When income falls behind the rate of inflation, the amount you can buy for each dollar goes down leaving you with two choices:

1. Cut back on your expenditures, which means your standard of living goes down.
2. Deplete your savings to make up the loss of purchasing power, which then opens the door to another risk: Excess Withdrawal Risk (discussed next).

How Inflation Affects Purchasing Power



Inflation risk is slow moving. It eats away, little by little, year after year, at the value of your money. Many people hardly notice, until one day they wake up and realize they can't afford to buy the same items because things have become so much more expensive.

Let's look at this another way. If an item costs \$1 today, it would cost \$1.05 after one year of 5% inflation. However, after ten years of 5% inflation that same \$1 item would cost nearly \$1.63 due to compounding.

The chart below shows what things could cost in the future:



Fidelity Investments - Fundamentals of Retirement Income Planning

Most people are concerned about inflation, but rarely do they describe it as 'fear', the way they would describe running out of money or experiencing a potential stock market collapse. Nevertheless, inflation's long-term effects can be devastating.

Okay, now it's your turn again.

Take a moment and ask yourself what life would be like if your income did not rise to offset inflation.

Would you be concerned if you found yourself unable to afford the things you enjoy? Would you feel pressure or anxiety every time you went to the store? Would you make substitutions and buy cheaper versions of things you like?

On a scale of 1 – 5, where 1 means you have absolutely no fear attached to this issue and 5 means that it is off the charts, where would you put yourself?

My Inflation Fear Ranking:

EXCESS WITHDRAWAL RISK

Excess Withdrawal Risk results in the fear of running out of money as assets deplete at a much higher rate than planned. When people do run out of money during retirement, it is not uncommon for them to suffer emotionally as they lose their identity, sense of well-being and sense of independence. Add to that embarrassment and the stress of being forced into difficult choices for self and family, it is no wonder that the fear associated with this risk comes as no surprise.

Imagine this: you and your partner are stranded on a desert island with a bottle of water and two cups. You stumble on a magic lantern during your search for food. Upon rubbing the magic lantern, a genie appears! He tells you that he will come on a regular schedule to refill your water bottle, however he has certain rules:

1. You drink two cups of water a day, enough to sustain yourselves comfortably.
2. He will only add two cups of water to your supply each time he comes.
3. If there is no more water in the bottle he will not add any water at all.
4. If you want, you may drink more than two cups of water, but if the bottle is empty, he will no longer come.

You and your partner follow the genie's directions and drink only two cups of water a day. You find that you live well and the genie appears every day to refill the two cups of water. Life is good and you always have a full bottle of water.



Soon, however, a rare heat wave arrives at the island and it gets much hotter than you can bear. The heat is so unbearable your heads throb and sweat begins to pour out of each of you like an open faucet. As your thirst goes through the roof, you realize that you can no longer sustain yourselves sharing two cups of water. You need to drink more to survive, and you do. Now, every time the Genie appears, despite the refill, you see the level of water in the bottle slowly diminishing.

Then one day your partner falls ill and his temperature skyrockets. He needs to drink even more water to hydrate and to keep the fever down. Without realizing it, and with no other choice, you give your partner the last drops of water from the bottle. Then it hits you both—no more water. And, no more Genie!

Imagine if that were you and your loved one on the island. How would you feel at the moment of realization that things are not going to work out too well for you? It would probably be devastating, wouldn't it?

Excess withdrawal risk works the same way as our desert friends' water. In a perfect world, each time you withdraw funds from your investments for income, your money will replenish itself and grow back

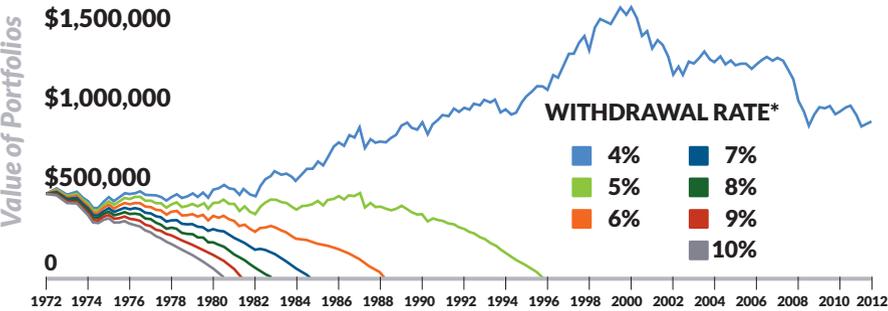
to its original level.

Unfortunately, if you begin taking larger withdrawals due to inflation or an emergency, your money will not have the time necessary to fully replenish. Like the bottle of water in the desert, your money will eventually run dry. When that happens, your income (your two cups of water) will run dry as well.

Excess withdrawals can hide under your financial radar, until one day you wake up and realize you are about to run out of money. By then, of course, it's too late to fix the problem. Running out of money due to excess withdrawals from your investments will not end as badly as the story, but it will change your life, always for the worse.

In the illustration below, look at how quickly assets deplete as the withdrawal percentage increases.

Excess Withdrawal and Rates of Asset Depletion



*Hypothetical value of assets held in a tax-deferred account after adjusting for monthly withdrawals and performance. Initial investment of \$500,000 invested in a portfolio of 50% stocks, 40% bonds, and 10% short-term investments. Hypothetical illustration uses historical monthly performance from January 1972 through December 2011 from Ibbotson Associates: stocks, bonds, and short-term investments are represented by the S&P 500® Index, U.S. intermediate-term government bond, and U.S. 30-day T-Bills, respectively. Initial withdrawal amount based on 1/12th of applicable withdrawal rate multiplied by \$500,000. Subsequent withdrawal amounts based on prior month's amount adjusted by the actual monthly change in the Consumer Price Index for that month. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. Important Information and Methodology can be found at end of presentation. Fidelity Investments - Fundamentals of Retirement Planning

Again, it's your turn.

Take a moment and ask yourself what your life would be like if you began taking excess withdrawals and saw the level of your assets dropping month after month.

Would you continue to live life as normal? Would you be nervous watching your assets deplete faster than expected? Would the prospect of running out of money put stress and pressure on you and your loved ones?

On a scale of 1 – 5, where 1 means you have absolutely no fear attached to this issue and 5 means that it is off the charts, where would you put yourself?

My Excess Withdrawal Fear Ranking:

SEQUENCE OF RETURN RISK

Most people understand **Market Risk**; the fear of losing money when the stock market declines. However, few people understand **Sequence of Return Risk**; the risk of taking systematic withdrawals from investments when the market is declining. Taking withdrawals by selling assets when the market is falling is a bad idea in most circumstances because:

1. You are compounding a loss by selling shares when the market is low.
2. When the market recovers, you have less assets available to take advantage of the recovery.

Taking withdrawals by selling assets when the market is falling at the beginning of your retirement years (the sequence of negative returns is working against you) is an especially bad idea. Why? Research shows the likelihood of an early depletion of savings rises dramatically.

Let's say you retire at age 65 and start taking withdrawals from your market-based 401(K) to produce retirement income. If the market goes up 5%, and you

"... If a retiree is unfortunate enough to be exposed to a *sequence of adverse returns early in retirement*, the likelihood of an early *depletion of savings* rises dramatically."

W. Van Harlow, PhD, CFA Director of Research at The Putnam Institute

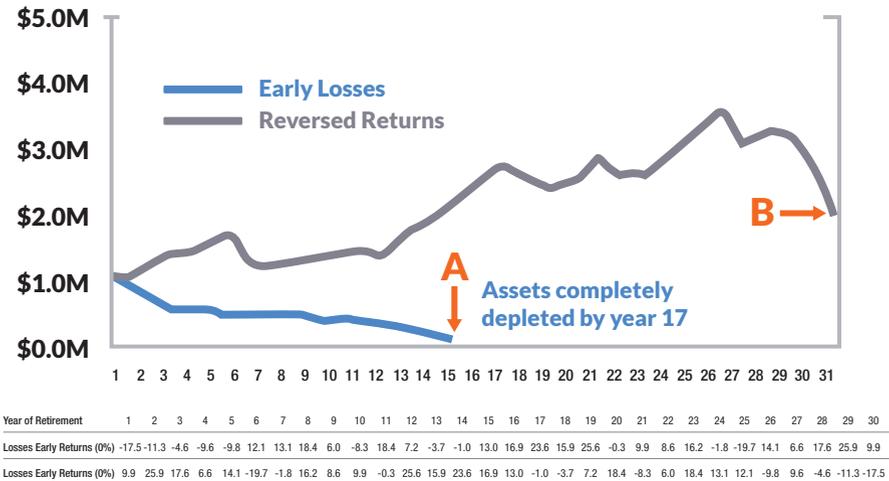
then withdraw only the gains, your principal remains intact.

However, if the market goes down 5%, not only have you lost principal, but you still must make a withdrawal for your needed income. This further compounds your losses by forcing you to take out **additional** principal. The market did not provide a good “sequence” of return for you.

Below is a comparison of how positive and negative sequence of returns can affect retirees. In the example, both investors begin with the same asset value: \$250,000. They experience the same average growth rate of 6.6% over a 30-year period. As a matter of fact, they have the exact same returns, just in **reverse** order. They also withdraw the same amount of money each year (\$12,500 inflated by 3% for inflation).

Investor A experiences an unfortunate **sequence of returns** in the first three years by enduring negative market returns. Investor B experiences the same losses, but not until the last three years (a fortunate sequence). As you can see, Investor A runs out of money by year 17; Investor B still has assets remaining after 31 years.

Return Sequencing Results (Success or Failure)



Sequence of returns can be a true ally, or it can be the reason your income fails you in retirement. The problem, of course, is that no one can predict when the market will decide to tumble! This is why building a PRIM using only a market-based Variable Income Driver is not for the faint-hearted.

Your turn again.

Take a moment and ask yourself how you would feel if you experienced both market losses and an adverse sequence of returns early in retirement.

Would you feel comfortable taking a withdrawal out of a depreciating asset? Would you have confidence that your portfolio would bounce back? Could you sleep at night if you were making withdrawals and experienced another market decline like we did in 2008?

On a scale of 1 – 5, where 1 means you have absolutely no fear attached to this issue and 5 means that it is off the charts, where would you put yourself?

My Sequence of Return Fear Ranking:

Your PRIM will be designed to provide a lasting and steady flow of increasing income during your retirement. However, the end-goal is more emotional than financial. It needs to give you the confidence and peace of mind about the future. If your PRIM is built out-of-sync with your risk style, it is very likely that you will suffer emotionally.

Each of the retirement income risks plays its part in making your life feel like an emotional roller coaster, a still lake, or somewhere in between. Some fears will be more prominent than others; some will cause immediate anxiety; and others will fester over longer periods of time. When looked at as a whole, however, these individual fears combine to determine your Personal Risk Style. Score yourself on the following chart and then identify your Risk Style.

IDENTIFYING YOUR RISK STYLE

Now let's add up your fear rankings and identify your risk style:

Longevity Fear Ranking

Inflation Fear Ranking

Excess Withdrawal Fear Ranking

Sequence of Return Fear Ranking

TOTAL

Compare your total fear score with the key below to determine your risk style:

Score 4 – 8

You are a:

RISK TAKER

You have ice in your veins, and risk doesn't seem to have much of an emotional effect on you.

Score 16 – 20

You are a:

RISK AVOIDER

Risk is not your cup of tea. If you see risk coming, you prefer to move in another direction.

Score 9 – 15

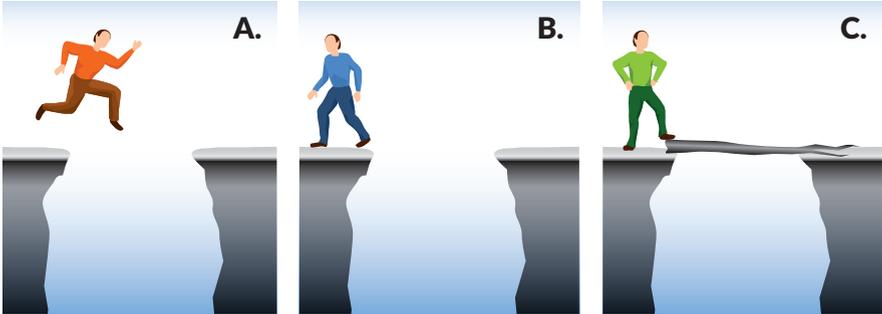
You are a:

RISK MANAGER

You are willing to take managed risk but are careful about it.

Do you agree with the evaluation? Here’s another way to check the results.

Imagine here you are walking on a mountain path and suddenly you come to wide crevasse. You must get to the other side. Look at each of the pictures below. Without trying to think it through, select the one that you are immediately drawn to – do you jump over; turn around to find another way; or build a bridge?



A.

RISK TAKER

Risk Takers embrace risk. The upside potential and the excitement that risk brings with it all serve to outweigh any fear of danger or loss. If they fall, it’s no problem. They just pull themselves up and try again. These risk takers like to wing it and sometimes the ride is more important than the results.

B.

RISK AVOIDER

Risk Avoiders march to a different beat. These types simply do not like the downside. They fear making mistakes that may hurt them in the future. Risk stresses them out.

C.

RISK MANAGER

Risk Managers figure out how to take measured risk. This may be uncomfortable for them, but they understand it may be in their best interests. Balance is the keyword for risk managers.

Each PRIM uses a specific technique by which its drivers produce income.

- **Risk Takers** use some type of Systematic Withdrawal technique such as a percentage of assets.
- **Risk Avoiders** use a Flooring approach which guarantees a floor of income to assure that certain expenses are always covered.
- **Risk Managers** use a Bucket System and employ a combination of techniques whereby each bucket creates income for specific periods of time as you age.



Each technique works differently and each has its pros and cons. In the following chapter we'll explore each technique and explain why each caters to a specific Risk Style.

Chapter 5 Wrap-Up

- ❑ Longevity Risk raises the fear of outliving income.
- ❑ People fear running out of income more than they fear death.
- ❑ Inflation Risk raises the fear that your income does not keep up with the rise of prices over time.
- ❑ Excess Withdrawal Risk raises the fear of depleting assets too quickly.
- ❑ Sequence of Return Risk results when the market has negative returns early in a person's withdrawal period and thereby raises the fear of accelerated asset depletion.
- ❑ If your PRIM is built out-of-sync with your Risk Style, you will suffer emotionally.
- ❑ The 3 risk styles are Risk Taker, Risk Avoider, and Risk Manager.

CHAPTER 8

THE RISK MANAGER'S PRIM

PRIM building for Risk Managers requires that they use a *measured risk* strategy comprised of 4 key elements:

1. **Plan** – The measured risk strategy is always based on a plan, along with the Risk Manager’s resolve to follow it.
2. **Data** – The plan design is based on data, evidence and research. Selection of product is a result, not the focus, of the plan.
3. **Time** – Asset allocation in the measured risk strategy is based on the length of time available for investments to grow before they are needed for consumption.
4. **Balance** – The measured risk strategy recognizes the best traits of the Systematic Withdrawal Technique and the Flooring Technique and combines them for balance and efficiency of income creation.

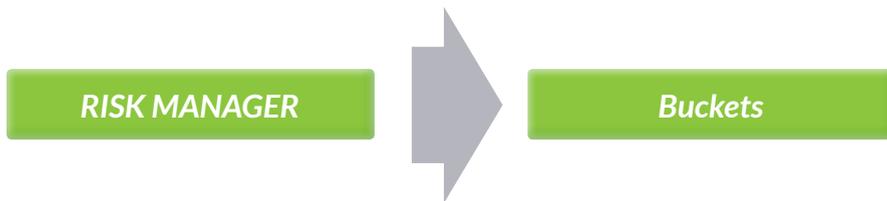
The Risk Manager’s PRIM is constructed utilizing both drivers.

The Risk Manager’s Basic Balanced PRIM



FUELING THE RISK MANAGER'S PRIM

The *Bucket System* is used to produce income for the Risk Manager.



The advantage of the Bucket System is that it allows you to integrate future income needs at specific future periods of time with how you allocate your assets. We call this strategy Consumption Allocated Investment Buckets. This means you will pick the appropriate investment tool (fixed annuity, bond, mutual fund, etc.) for the time horizon when you plan to consume the money. The technical term for planning income this way is called **Consumption-Based Asset Allocation**. This is a foundation of the Bucket System and will become clearer as we lay it out for you.

Research from one of the world's largest independent actuarial and consulting firms, Milliman, Inc., concludes that "indeed, at least two product categories, mutual funds and fixed indexed annuities ... will be required to maximize the sustainability of one's retirement income." This combination of mutual funds and fixed index annuities is the foundation of the Bucket System.

There are two steps to creating the Risk Manager's PRIM. First, determine your Income Floor and, second, fuel the Consumption Allocated Investment Buckets.

"Consumption-based Asset Allocation introduces a new generation of asset management methodologies that utilize fundamental attributes of the investor, not the investment, as the primary determinant for all asset allocation decisions."

THE FUTURE OF ASSET MANAGEMENT The Willis Group 2009

STEP #1 - DETERMINE YOUR INCOME FLOOR

First, you need to solve for your *Income Floor*, your *baseline income need*, and determine how much of your Fuel (Assets) you need to allocate to the Guaranteed Income Driver.

We will now assume that Maggie and Stan have mutated into Risk Managers, and they have set out to determine their *Income Floor* need by developing a spending budget.

There are many ways to calculate *Income Floor*, as it is a very personal thing. Some people may only cover fixed living expenses, such as the following:

- **Mortgage**
- **Taxes**
- **Food**
- **Gas/Electric/Water**
- **Insurances**
- **Credit Card Payments**
- **Auto/Gas**
- **Any other expenses that are a necessity**

Others may determine it is essential that they maintain a golf membership or pay dues for a club, and therefore those extra expenses will be part of their *Income Floor*.

Whatever the case may be for you, it is important to come up with a base number that needs to be guaranteed for you to have peace of mind about the future. This is the amount that will be generated by your Guaranteed Income Driver as your *Income Floor*.

Chart A below, shows that Social Security and pensions give Maggie and Stan \$45,000 of fixed income. However, we know that their total required need is \$85,000, leaving them \$40,000 short.

After reviewing their baseline needs, they determine that they want an Income Floor of \$75,000 and that they will get the balance of their income need, \$10,000, from their Consumption Allocated Buckets. Since they already have \$45,000 from their Social Security and Pension, they calculate that they are short \$30,000. See **Chart B**.

Chart A

Current Fixed Income	Amount
Social Security*	\$ 35,000
Pensions	\$ 10,000
Other	\$ —
Total Current Fixed Income	\$ 45,000

Chart B

Income	Amount
Required Total Income	\$ 85,000
Minimum Desired Income Floor	\$ 75,000
Current Fixed Income	\$ 45,000
Floor Income Gap to be Guaranteed	\$ 30,000
Income from Buckets	\$ 10,000

CALCULATE ANNUITY PREMIUM NEEDED

Maggie and Stan now need to determine how much fuel they will need to fund their annuity. To do that they will need to divide the baseline need by the *INCOME FACTOR* based on their age(s):

TYPICAL INCOME FLOOR FACTORS

Age	Approximate Income Factor
60 – 65	.050
66 – 70	.055
71 – 75	.060
76 – 80	.065

Note: Income Factors vary by product and may be higher or lower than the illustrated Factors above.

Maggie and Stan are 66-years-old, so they would make the following calculation to determine the amount of fuel (assets) needed for the fixed annuity to be included in their Income Floor:

$$\text{\$30,000} / .055 = \text{\$545,454}$$

Maggie and Stan now know that they need to use \$545,454 of their assets as fuel for their Guaranteed Income Driver. These funds serve to purchase a Fixed Annuity with an Income Rider that will pay \$30,000 guaranteed for their lifetime. The combination of Social Security (\$35,000), their pension (\$10,000), and the annuity (\$30,000) gives them an **Income Floor** of \$75,000. Social Security grows over time with a cost-of-living adjustment (we have assumed 2%), therefore, the Income Floor grows over time as well.

NOTE: To keep things simple, we're illustrating the fixed annuity floor income without increases over time. There are products that offer increasing income. We encourage you to compare those options with fixed payment income riders.

Risk Manager's Income Floor

	FA - Fixed Annuity	INCOME FLOOR: SS - Social Security		P - Pension	
Fixed Annuity \$ 545,454	FA \$ 30,000	FA \$ 30,000	FA \$ 30,000	FA \$ 30,000	
PRE-FUELED INCOME	SS \$ 35,000	SS \$ 38,642	SS \$ 42,663	SS \$ 47,103	
YEARLY INCOME FLOOR	P \$ 10,000	P \$ 10,000	P \$ 10,000	P \$ 10,000	
	\$ 75,000/Year	\$ 78,642/Year	\$ 82,663/Year	\$ 87,103/Year	
	↓	↓	↓	↓	
TOTAL INCOME GOAL	\$ 85,000/Year YEARS 1-5	\$ 98,538/Year YEARS 6-10	\$ 114,233/Year YEARS 11-15	\$ 132,427/Year YEARS 16+	

STEP #2 - FUND THE REMAINING CONSUMPTION ALLOCATED INVESTMENT BUCKETS

Use the remaining funds to fuel Buckets 1 – 4 using the *Consumption Allocated Investment Bucket Strategy* (investing assets to support income during specific future time periods). Note that while these buckets are fueled at the same time, they are accessed for income at different times in the future.

To simplify this example, we are going to assume 3% annual inflation but only give Maggie and Stan their Cost-of-Living adjustment every 5 years. By addressing inflation in this manner, it provides a clearer picture and understanding of inflation-adjusted income, allowing us to add the *Inflation Income Booster* to their PRIM.

Risk Manager’s PRIM with Inflation Booster



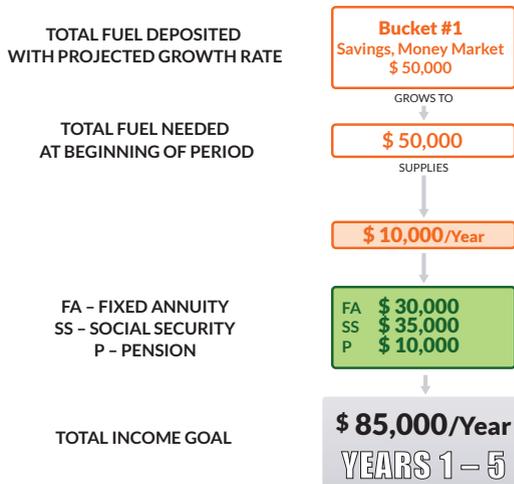
How do we determine how much fuel to put in buckets 1 – 4 and where to invest it? Take a look at the Total Income Growth in the next chart. That, plus some simple math, will make this much clearer.

Maggie and Stan plan to take \$10,000 a year out of Bucket #1 for the next 5 years, which means they will need a lot of liquidity and almost no risk. They will want to place \$50,000 in one or more of the following options:

- Money Market Fund
- Treasury Inflation Protected Securities (TIPS)
- Short term Investment-grade bonds

These choices offer a low yield, but they offer the most important features needed for this bucket: **safety and liquidity**.

Risk Manager’s PRIM with Bucket #1 Fueled



Bucket #2 is funded with money that will not be needed for 5 years. This means they should lock in a guaranteed interest rate in a fixed product that will be fully liquid at the end of 5 years. Maggie & Stan will want to place \$85,812 in the following:

- CDs
- Fixed Interest Annuity (Multi-Year Guaranteed Annuity or MYGA)
- Zero Coupon Bonds

We assume a 3% growth rate for the 5-year period during which

Maggie and Stan are growing the money. At the end of 5 years, they will have \$99,480 liquid, which they can then spend down from years 6 to 10 at a rate of \$19,896 per year.

Where did the \$19,896 come from? Okay, some more math ...

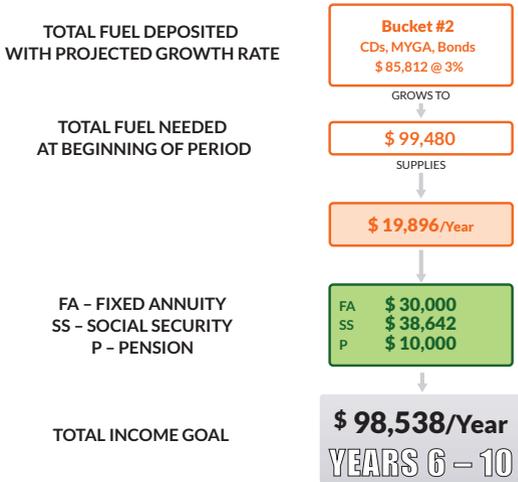
To calculate a *cost-of-living adjustment* for years 6 – 10, we had to take \$85,000 (the total income goal) and multiply that by 1.03 (3% inflation per year) 5 times to get their inflation-adjusted income goal of \$98,538.

Now we must add an inflation-adjusted Social Security payment of \$38,642 projected for year 6, \$10,000 from the pension, and \$30,000 from the annuity to get \$78,642 for the year 6 income floor.

When you subtract the year 6 income floor (\$78,642) from the year 6 inflation-adjusted income goal (\$98,538), you arrive at the year 6 gap of \$19,896. Which means we need a total of \$99,480 (\$19,896 x 5) at the beginning of year 6.

Using a fixed interest rate (3%) that is guaranteed, we can easily calculate that \$85,812 is needed today to grow to the \$99,480 needed in 5 years. This is what their program looks like now:

Risk Manager’s PRIM with Bucket #2 Fueled



Utilizing a fixed interest rate product for this bucket, combined with money market funds in Bucket #2, minimizes Sequence of Return Risk for a full decade after Maggie and Stan's retirement.

Two more Buckets to go.

Bucket #3 is funded using the same math principles, but this time the money will not be needed for 10 years, which means we can take measured risk in the market.

To give Maggie and Stan a Cost-of-Living Adjustment for years 11 – 15, we had to take \$85,000 and multiply it by 1.03 (3%) 10 times to get their inflation-adjusted income goal of \$114,233.

Maggie and Stan add up their inflation-adjusted Social Security payment of \$42,663 projected for year 11, \$10,000 from the pension, and \$30,000 from the annuity to get \$82,663 for the year 11 income floor.

If you subtract the year 11 income floor (\$82,663) from the year 11 inflation-adjusted income goal (\$114,233) you arrive at the year 11 gap of \$31,570. Which means we need a total of \$157,850 ($\$31,570 \times 5$) at the beginning of year 11.

Maggie and Stan will want to place \$90,906 in the following:

- 50/50 mix of stock and bond mutual funds.

The Market Holding Period is the length of time between an asset's purchase and sale. The longer the holding period, the higher the chance of achieving your investment goals.

This choice gives us the ability to take advantage of a long market holding period. Research shows that the longer you are invested in the stock market, the greater opportunity you have to reach your investment goals. Take a look at the chart on the next page showing positive and negative returns from 1926 through 2015. It shows that if you held your

money in the S&P 500 for any 20 year period, you would have experienced a gain 100% of the time. However, if you invested for only a day, there was a 46% chance you would lose money. By committing to a ten

year holding period in a 50/50 portfolio, you are playing the odds (94% historically) that you will have positive results. Therefore, we can use a **projected** average return of 5%, which would grow to \$157,850 over the full 10-year period from the time they make the investment.

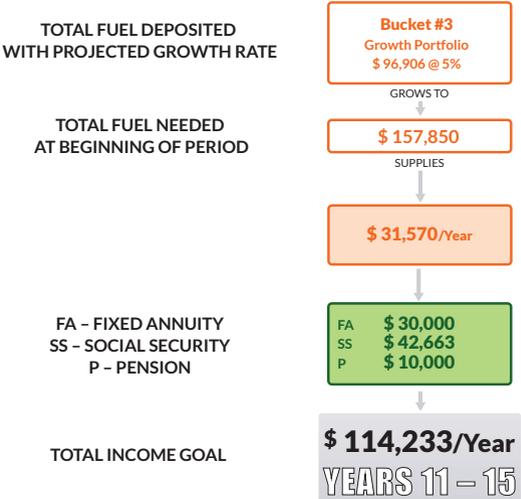
S&P 500: 1926 – 2015

Time Frame	Positive	Negative
Daily	54%	46%
Quarterly	68%	32%
One Year	74%	26%
5 Years	86%	14%
10 Years	94%	6%
20 years	100%	0%

Source: Returns 2.0

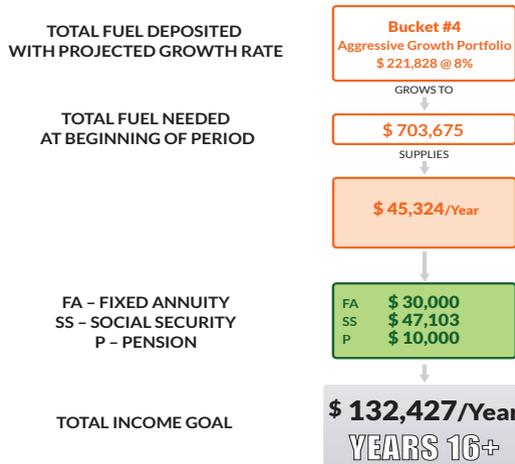
When they get to year 11, they can take the \$157,850 and move it to a safe, liquid place like they had in Bucket #1. They will then draw down those funds to provide income for years 11 – 15.

Risk Manager’s PRIM with Bucket #3 Fueled



Bucket #4 is used for long-term growth and is able to take advantage of a much longer holding period in the market. It will help us keep up with inflation and build a buffer for emergencies or a change of plans. Therefore, Maggie and Stan can take measured risk by placing the rest of their money (\$221,828) in the following:

Risk Manager's PRIM with Bucket #4 Fueled



The Risk Manager's PRIM has the flexibility to be built more conservatively or more aggressively according to your Risk Style.

Understand that the Risk Manager's PRIM can be built more conservatively with additional buckets, or more aggressively with fewer fixed products according to your personal taste. Additionally, to keep things simple, we did not credit any interest during the payout phase of each bucket. You could reasonably expect to earn 1% – 3% per year on funds waiting to be paid out during any 5-year period. This would mean less money would be required for the earlier buckets, and more funds could be deposited in Bucket #5.

However, they are not done adding parts. The Sequence of Returns Booster can be added, because they have eliminated that risk by utilizing fixed instruments for income early in their retirement. Additionally,

they can add the Longevity Warranty because they are generating income that will last as long as they do.

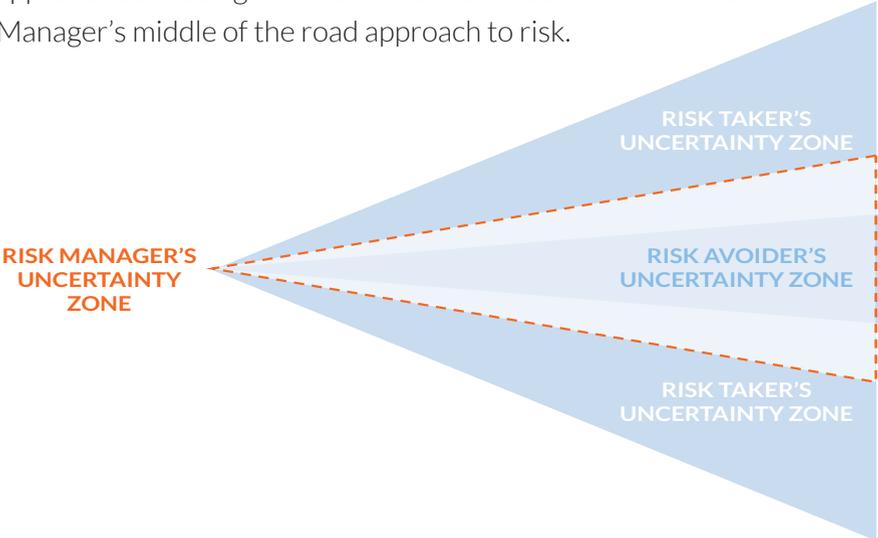
The Risk Manager’s PRIM performs exceptionally well in both up and down markets. Their inflation-adjusted income goal is met for life, and they have growth opportunities in their long-term buckets. Additionally, all the retirement income risks are covered:

- Longevity Risk—income will last as long as they do.
- Excess Withdrawal Risk—they have set up *consumption-based* asset allocation buckets, providing a planned withdrawal strategy.
- Inflation Risk—income is adjusted every 5 years to keep up with cost of living.
- Sequence of Return Risk—is minimized and pushed out a full decade.

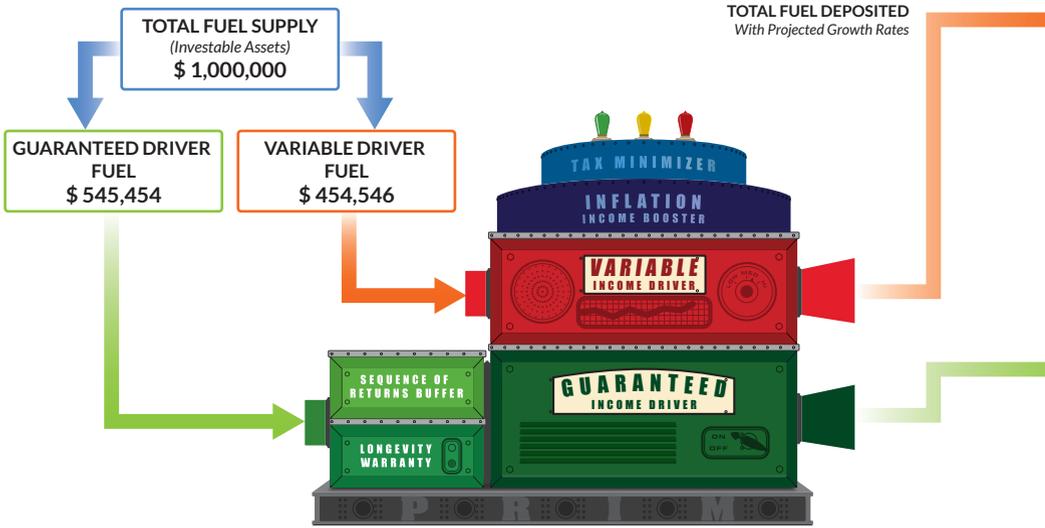
With all the Buckets filled with fuel, the Risk Manager’s PRIM looks like a highly productive income machine:

THE RISK MANAGER’S PRIM AND THE UNCERTAINTY ZONE

As you would imagine, the uncertainty zone for the Risk Manager falls in between that of the Risk Taker and the Risk Avoider. Its balanced approach between guaranteed and measured risk fulfills the Risk Manager’s middle of the road approach to risk.



READY FOR ACTION!



WHAT ABOUT TAXES?

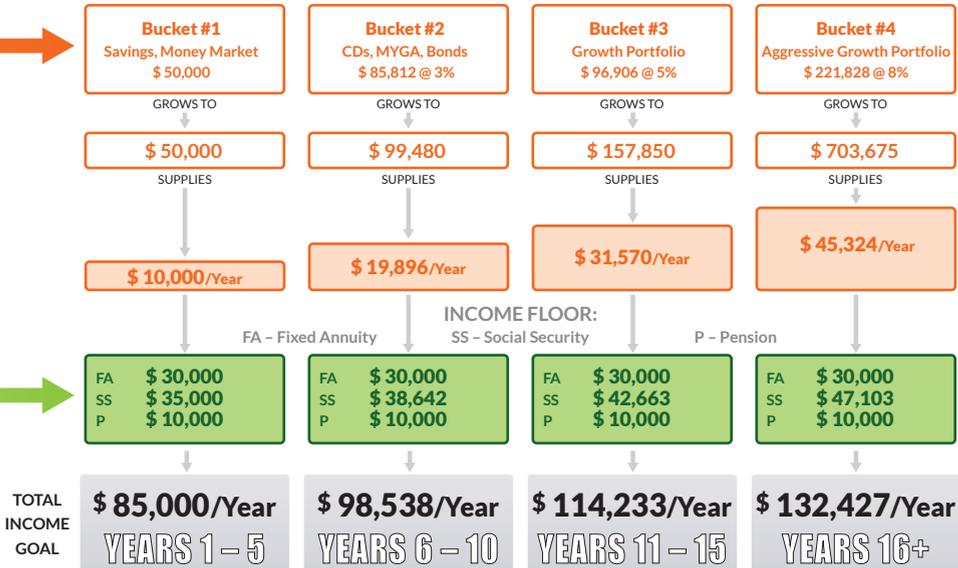
Income Sequencing is the strategy for selecting the sequence of withdrawing funds from savings vehicles during retirement.

Your Income Drivers will be fueled with a combination of qualified funds (pre-tax money held in retirement related accounts) and non-qualified funds (any after-tax money held outside of retirement accounts). You will need to choose which funds to use early and which funds to draw down later in life. This is called **Income**

Sequencing: the strategy for selecting the sequence of withdrawing funds from savings vehicles during retirement.

For example, should you program your drivers to withdraw funds from the taxable account first, then the traditional IRA, and lastly your ROTH? Or would another sequence be preferable?

CONSUMPTION ALLOCATED BUCKETS



The conventional rule of thumb is that you should withdraw funds from taxable accounts before you take funds from tax-deferred qualified retirement accounts. The thinking is that by delaying use of 401ks or IRAs, for example, the compounding effect of tax-deferral will produce higher values in the future.

While this may sound logical, there are many exceptions. Here are some things to keep in mind:

- Time the withdrawal of funds from qualified accounts for those years when you are in a lower tax bracket.
- Be careful of the years when there are Required Minimum Distributions (RMDs) at age 70 ½ and beyond. If you have a substantial amount of assets in these accounts, your RMDs could drive you into a much higher tax bracket. In that case, it

would be better to reduce the amount in these accounts by taking withdrawals from them earlier in retirement.

- Keep an eye on taxes. Every dollar withdrawn from a tax-deferred account is a taxable event. If taxes are cycling higher, it would benefit you to take these funds now, when taxes are lower.
- Finally, if you have tax-free money available through a ROTH or through a LIRP (Life Insurance Retirement Plan), use these funds judiciously to keep your income in the lowest tax brackets or below a needed threshold.

THE PROS AND CONS OF THE RISK MANAGER'S APPROACH

The Pros are:

- Efficiently integrates timing of consumption-need with appropriate asset allocation.
- Combines a guaranteed floor of income along with inflation-adjusted income to help maintain purchasing power.
- Minimizes the impact of emotions by creating a systematic process for income and asset maximization that is not based on fear of arbitrary or poor decision making.
- Since some assets are dedicated towards guaranteed income, it allows other assets to be earmarked for more aggressive growth.
- Eliminates the Retirement Income Risks— Longevity Risk, Inflation Risk, Excess Withdrawal Risk, and Sequence of Return Risk.
- Increases holding periods on equities to realize the best possible chance of achieving projected market returns.
- Assures asset liquidity to produce income in tax-efficient sequences when needed at specific periods of time.

The Cons are:

- Transitioning from one bucket to another could require attention or assistance from a financial professional.
- Does not take advantage of the full upside potential of the markets as compared to the systematic withdrawal approach.
- Less money is fully liquid.
- This is a more complex system, and declining cognitive abilities could hamper the ability to manage the plan and investments over time.

Chapter 8 Wrap-Up

- ❑ The Bucket system is used to produce different types of income at different periods of time.
- ❑ You must determine your **baseline income need**.
- ❑ Fund the Income Floor with a fixed annuity. Calculate premium needed by dividing the **baseline need** by an **income factor**.
- ❑ Fund buckets 1 – 4 using consumption-based asset allocation.
- ❑ Simplify adjusting for inflation (Cost of Living) by adjusting income for every five year period instead of for every year.
- ❑ Bucket #1 is invested in very safe products and is consumed years 1 – 5.
- ❑ Bucket #2 is invested in a 5 year CDs, MYGA, or Zero Coupon Bonds for guaranteed growth which is completely liquid after 5 years and consumed years 6 – 10.
- ❑ Bucket #3 is invested in a 50/50 stock and bond mutual fund for 10 years and consumed years 11 – 15 after it has been moved to a fixed account.
- ❑ Bucket #4 is invested in an 80/20 to 100/0 stock & bond mutual fund for 15+ years and the process continues.
- ❑ The Bucket strategy can be built more conservatively or more aggressively according to personal taste.
- ❑ Taxes require special consideration to minimize their effect and maximize income.
- ❑ **All Retirement Income Risks are solved.**