Krosnowski & Scott LLC
Investment & Retirement Planning Specialists

Retirement Income Investment Strategy

by Andrew J. Krosnowski

Step 1- **Income Needs**-When formulating a successful strategy to generate income during retirement we feel that it is important to start by identifying how much income that you will need to live comfortably in retirement. We can provide you with a budget page to assist you in this process.

Step 2- **Investment Comfort Level**- Next you will need to assess your investment comfort level regarding different types of financial instruments. Some investments provide fixed returns while others provide variable returns. Normally fixed return investments, such as fixed or immediate annuities and bonds, provide greater peace of mind when the stock market is declining as well as lower returns. Stock investments are more volatile but historically provide higher returns over the long term. Balanced investments attempt to combine attributes of both fixed income and stock investments. They may provide steadier returns and more income than stocks and greater return potential and more volatility than fixed return investments.

Step 3- **Fixed Return Allocation**- In addition to your Social Security Income, you will need to decide what amount of your retirement assets that you would like to allocate to fixed income investments such as immediate or fixed annuity investments that may provide you with a guaranteed stream of income for your single life or joint lives. The guarantee is provided by the insurance company that manages your annuity assets or by your employer's pension fund. To manage your insurance company default risk exposure, it is suggested to be aware of your state provided insurance provisions for investors in fixed annuities. State governments typically provide around $100,000 per policy per insurance company for fixed annuities. To view your state insurance coverage on fixed annuities, please visit: www.nolhga.com. You can think of this category as the "bird in the hand."

*Please see the section below titled "**Employer Pension Annuity versus Insurance Company Fixed Annuity**" to review the pros and cons of receiving your corporate pension benefits as an annuity or as a lump sum and investing a portion of the assets in a fixed annuity through an insurance company.

Step 4- **Variable Return Allocation**- Your remaining assets can be allocated to conservative bond and stock investments for income and growth potential to protect the purchasing power of your retirement assets from inflation. We suggest an income distribution or withdrawal rate of 5% or less on your retirement balances. Presently, there are low cost balanced investment portfolios that combine lower volatility, higher dividend paying stocks and with both corporate and government bonds that pay an income yield of around 4% [1]. You can think of this category as "the tortoise in the bush." As a general rule, in our practice we shy away from variable insurance products due to their complexity and high cost structure.

Please review the section below titled "Retirement Income Distribution Case Study"** on page 3.

Hypothetical Retirement Situation[2]- Here's a retirement income formula review for a retired couple who have $1,000,000 in retirement assets (pension lump sum $600,000 and 401k Savings Plan $400,000):

Step 1- Identify Your Retirement Annual Income Need- $72,000 (gross income before taxes)

Step 2- Determine Your Investment Comfort Level (Risk Tolerance) = Moderate to Conservative

Step 3- Determine your time horizon or date when you need to begin to receive income distributions from your retirement assets. Having liquid assets such as bank accounts set aside may enable you to delay when you have to start to begin to draw on your retirement assets. This may improve your chances of investment success.

Step 4- Determine what percentage allocation of Annual Retirement Income that you wish to receive from fixed sources:
Social Security Income (SSI) = $30,000 (annual income for retiree & spouse)
Retiree Fixed Annuity Income ($350,000/35% Allocation) = $18,000*
Total=$48,000 divided by $72,000 or **66.6%**

*provided through investment in an immediate fixed annuity through an insurance company or through one of your company pension annuity payout options.

Step 5- Verify your variable return investment balances ($650,000/65% Allocation) = $24,000 (annual income at a 3.7% distribution rate)
Total=$24,000 divided by $72,000 or **33.4%**
The $650,000 IRA balance is derived from rolling over the $250,000 and $400,000 balances from the retiree's 401(k) Savings Plan and pension lump sum respectively into an IRA.

Depending on Federal and State income tax rates, in this example, the retired couple could meet their income needs through a combination of SSI and conservative fixed and variable return investments which may provide them with income and growth potential to protect against inflation.

Step 6- Review Your Retirement Income Source Allocations- In this example, two thirds of the retiree's income needs are supplied by fixed sources of income and one third by variable return sources. The key to this analysis is to assist retirees in choosing a ratio between these sources that meets their investment objectives and comfort level.

__Retirement Income Distribution Case Study__- In 2006, Fidelity Investments conducted an analysis which is illustrated in a document titled "Insights-Retirement Income Planning." In the study, **longevity** of investment balances invested in a **Balanced Index** (comprised of 50% S&P 500 Stock Index, 40% Bond Index and 10% Money Market) were compared with varying inflation adjusted **distribution rates** over a recent thirty year time period. The results of the analysis had a **90% confidence** level based on **Monte Carlo** simulations. The following was the outcome of the study:

***Income Withdrawal Rate**	**Number of Years until Asset Depletion**
8%	12 Years
6%	17 Years
4%	26 Years

***Inflation Adjusted** (Since 1926, according to Ibbotson & Associates, inflation has been averaging close to 3.0% annually).

There is a **direct correlation** between **income distribution rates** and **asset depletion.** The **lower** your **income withdrawal rate,** the **longer** your **assets** may **last. The greater** your **income withdrawal rate,** the **faster** you may **deplete** your **assets.** Past performance is no guarantee of future results. Actual results may vary.

Probability of Retirement Success-

A. Your chances of not running out of assets during retirement may be improved by accumulating two years worth of your annual income needs in liquid assets. Doing so will provide your variable return investments with time to hopefully increase in value or weather a short term stock market downturn before you begin to receive income distributions from your assets.

B. Your odds of retirement financial success may also be enhanced by continuing to work part-time after you retire from your full-time occupation. This may enable you to delay when you begin to receive Social Security Income (SSI) payments from age 62 to 63 to age 65 to 66 enabling the amount of the benefits you will receive to increase from 80 to 100%.

Both of these strategies may enable you to withdraw less of your retirement funds which in turn may provide you with the potential for additional wealth accumulation.

<u>Summary</u>- In the example above, there is a trade-off between investing in fixed payout (higher certainty, lower return fixed annuities) versus variable return stock & bond investments that have greater return potential. <u>We encourage retirees to invest as much of their retirement assets in low cost, conservative balanced investments within their comfort level.</u> Unfortunately, due to the very low interest rate environment that presently exists, the payout rates on fixed (annuities) are very low. For this reason investors should be very careful before they decide to lock-in long term interest rates on fixed annuities. One way to combat low annual interest rates on fixed annuities is to invest in a fixed annuity that provides for cost of living payout adjustments.

The key to a financially successful retirement is to work with a financial adviser who can assist you in creating a healthy balance between both fixed and variable return investments to generate the retirement income that potentially meets your needs.

Please do not hesitate to contact us if you would like to discuss your retirement situation with us. We are here to assist you in making the process of retirement as simple and easy as possible.

Sincerely,

Andrew Krosnowski & Melissa Scott

* **<u>Employer Pension Annuity versus Insurance Company Fixed Annuity</u>**”

EMPLOYER PENSION ANNUITY vs. INSURANCE COMPANY FIXED ANNUITY

	ANNUITY SOURCE	
Annuity characteristics & features	Employer Pension Annuity (EPA)	Insurance Company Fixed Annuity (IFA)
Highest Payout	▪ Employer plans provide the highest income payout ▪ There are no COLA adjustments	Cost of living adjustments (COLA) can be factored in for an individual or a couple.
Payout options: Life only	Not an option	Annuity payments cease upon death.
Period certain option	15, 20 & 25 year terms available If you die, the payments will continue to be paid to your beneficiary for the remaining years in the certain period	▪ More expanded certain periods (5-30 years) ▪ Includes COLAs ▪ Payments continue to be paid to the annuitant for the remaining years in the certain period

Life with cash refund	N/A	If you die before the income received equals the initial premium, any remaining balance will be paid to your beneficiary(ies) as a lump sum ▪ COLA not available
Life with installment option	N/A	If you die before the income received equals the initial premium, the annuity payments will continue to be paid to your beneficiary until the total payout equals the initial premium invested. ▪ COLA not available
Joint with % payable to survivor	▪ No COLA ▪ When you die, the survivor receives the % of annuity payment selected	▪ COLA available ▪ When either you or the joint annuitant is deceased, the survivor will receive the % annuity payment selected for the remainder of their life (multiple beneficiaries are allowed).
Joint with % payable to spouse	▪ No COLA ▪ When you die, your spouse continues to receive a % of the joint payment for the rest of their life.	▪ COLA available ▪ Same as EPA
Joint with certain period % payable to spouse	▪ 5 year option only ▪ No COLA ▪ After a certain period, the spouse/survivor receives a % of the annuity payment for their life.	▪ Various options between 5- 20 ▪ COLA Same as company provided
Full or partial withdrawal	None	Yes, after a certain period that the contract is in force, full or partial distribution of the remaining cash value is available as a lump sum.
Surrender of Annuity	No	Yes, will receive lump sum minus payments

COMMENTS: The EPA provides retirees with the largest payout of annual income over the life of the retiree and their designated beneficiaries and is simple and straight forward. Investing in an IFA can enable a retiree to take any portion of the pension lump sum (from 0% to 100%) and invest part of the assets to receive fixed income payments for life while also having the flexibility to part of the assets in variable return investments. Some employer pension plans provide retirees with the option to receive their pension benefits 50% as a lump sum and 50% as an annuity.

IFAs have more flexible payout options that may enable retirees to custom design their retirement assets more than EPAs. IFAs offer COLA payout features as well as the ability to cash in the annuity for a lump sum refund of the amount of the unpaid original investment balance. The EPA does not offer these features.

[1] *Past performance is not a guarantee of future results.*
[2] *This hypothetical example is used for illustrative purposes only and does not represent any specific investment. Rates of return vary over time, particularly for long-term investments. Actual results will vary.*

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