

# Moving to Tibet

Prepare your clients now for the land of retirement-income distribution.

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Imagine if you just found out that you had to live the remainder of your life in Tibet. You leave the language, freedoms and culture of the United States and enter a country with a troubled history and remote, raw natural beauty. How would you adapt to this new environment?

For your clients, moving into the retirement income distribution phase of their lives can seem like moving to Tibet. All the old rules for successful retirement planning must be thrown out of the window because those rules were developed for use in the Land of Accumulation. Millions of Americans are either in the Land of Income Distribution or rapidly getting there. Unfortunately, too many are unprepared for how different this new phase will be. Tried-and-true tactics that worked in the Land of Accumulation, such as dollar cost averaging, asset allocation and tax deferral, may not make sense for clients in the Land of Distribution and could be detrimental to achieving long-term retirement security.

For example, you may recommend to a recently retired 65-year-old client that he select a withdrawal rate that is no higher than the average rate of return earned by his accumulated retirement assets. You assume this approach is a safe way to ensure that your client never runs out of assets. But is your assumption correct? If your client had \$100,000 of assets earning an average 12 percent rate of return in a hypothetical large-cap stock

portfolio over a 10-year period, and if he withdrew only \$12,000 annually, would the investment balance be \$100,000? Will the 12 percent annualized rate of return be enough to satisfy a 12 percent annual withdrawal? Or is there a chance that the assets could be worth a great deal less?

The only way to know for sure is to answer two questions: Were there any years in which the market had a negative rate of return? And when did the loss occur? If you assume that the loss took place in the first year and that it was an “average” loss of 10.5 percent, then here’s what can happen to your client’s \$100,000 nest egg:

Table 1 shows the peril in basing a retirement-income strategy on a withdrawal rate. It may strike you as remarkable that only a single loss in year one causes a loss of nearly 60 percent of that \$100,000 asset, even though the loss is followed by nine consecutive years of gains of 14.5 percent. Also, history has shown that

you should expect at least one additional loss year sometime during the 10-year period. All of a sudden, a “safe” retirement-distribution strategy doesn’t look very advantageous because it is based on taking withdrawals for income from a growth vehicle—large-cap stocks.

## Preparing for income distribution

The better way to prepare for the Land of Income Distribution is to stop using strategies that hinge on rate of return and focus on a time-weighted, systematic approach that relies on guaranteed, inflation-adjusted income over a long period—20 or more years. This way, you’ll also remove your clients’ investment fears from the planning process and create a legacy for heirs if the income generated is not spent during retirement.

## THE OLD RULES FOR SUCCESSFUL RETIREMENT MUST BE THROWN OUT OF THE WINDOW.

Here’s how you can turn your client’s retirement assets into an inflation-adjusted income for life. This approach divides a client’s retirement assets into six buckets, based on short-term income needs, long-term income needs and time horizons. Each bucket targets a rate of return ranging from 2 percent for Bucket 1 to 12

percent for Bucket 6, which is typically left to accumulate for a full 25 years. If the buckets yield their targeted rates of return, there will be sufficient assets accumulated to generate an increasing income based upon an annual inflation assumption of 3 percent.

Bucket 1 is invested in a fixed immediate annuity to guarantee a specific income stream for the first five years. Bucket 2, which is also relatively near-term money, is invested conser-

Table 1

YEAR	RATE OF RETURN	WITHDRAWAL	BALANCE
1	-10.5%	\$12,000	\$78,760
2	14.5%	\$12,000	\$76,440
3	14.5%	\$12,000	\$73,784
4	14.5%	\$12,000	\$70,742
5	14.5%	\$12,000	\$67,260
6	14.5%	\$12,000	\$63,273
7	14.5%	\$12,000	\$58,707
8	14.5%	\$12,000	\$53,480
9	14.5%	\$12,000	\$47,495
10	14.5%	\$12,000	\$40,641

**Table 2**

<b>BUCKET 1</b>	<b>BUCKET 2</b>	<b>BUCKET 3</b>	<b>BUCKET 4</b>	<b>BUCKET 5</b>	<b>BUCKET 6</b>
<b>2% target</b>	<b>4% target</b>	<b>6% target</b>	<b>8% target</b>	<b>10% target</b>	<b>12% target</b>
Immediate annuity	Fixed annuity or short-term bond fund	Equity-indexed annuity	Variable annuity, mutual fund or wrap account	Variable annuity, mutual fund or wrap account	Variable annuity, mutual fund or wrap account
Immediate	5 year	10 year	15 year	20 year	25 year

a duration of five years. As this process repeats itself every five years, monthly payments can increase over time if the buckets achieve their targeted rates of return.

Also, if Bucket 6 (the most aggressively invested bucket to achieve a targeted 12 percent rate of return over 25 years) performs as desired,

vatively—typically in a fixed annuity or short-term bond fund—to achieve a targeted 4 percent rate of return. Bucket 3 has a 6 percent target and Bucket 4 has an 8 percent target. Different investment vehicles can be used within the buckets to achieve their investment objectives over their specific time horizon.

The most aggressively invested assets are allocated to Buckets 5 and 6, as they can be invested over a longer period and

may be better able to weather the ups and downs of the equity market to achieve higher targeted returns. After Bucket 1 is paid out, the assets accumulated in Bucket 2 are used to purchase another immediate annuity, which allows a new guaranteed stream of income to kick in for the next five years.

As each successive bucket matures, it is converted to an immediate annuity with a guaranteed income stream, each with

the client’s investment could grow to its original value—assets that could then be used for a greater monthly income or to create a legacy for heirs. **AI**

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