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The money shift: moving clients from accumulation to distribution

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One of the most elegant words in the English language is segue. Its definition is to transition smoothly and unhesitatingly from one state, condition, situation, or element to another. A transition that will soon be undertaken by tens of millions of Americans seems destined to be neither elegant nor smooth. Too many Americans, millions, in fact, are both unaware of and unprepared for the financial challenges they will face in retirement. A mass segue ahead? Hardly. It's more likely to be a massive financial train wreck that derails the financial security of millions.

The good news is that financial advisors can segue, to a brighter and more prosperous future. Along the way they can help their clients achieve genuine retirement security. The key to doing so will be in leaving behind many of the financial strategies and techniques that have been counted on in the past. A new set of challenges is upon us and millions of our citizens need our guidance. If we step up to meet these challenges, we will become the beneficiaries of the greatest sales opportunity of our lifetimes. If we fail, we will become complicit in destroying the retirement security of many who could have benefited from our help.

The root problem has to do with people's retirement assets and the widespread lack of knowledge over how to properly transition these monies from an accumulation mode to a distribution mode. It's understandable. For decades workers and their financial advisors have grown up in a climate of "accumulation logic." Advisors became "Accumulation Specialists." Widespread adoption of strategies such as asset allocation, dollar-cost-averaging and tax-deferred growth helped fuel capital accumulation in millions of retirement accounts. But just as surely as these proven accumulation strategies helped grow retirement assets, reliance upon them in the distribution phase could spell doom for retirees.

The truth is the investment and tax strategies used to distribute wealth are inherently different than those used to accumulate wealth.

Here's an example. Conventional wisdom states that you will never run out of income if you select a withdrawal rate that is no higher than the average rate of return produced by your assets. So let's test the conventional wisdom by taking an example that focuses on large cap stocks which, according to Ibbotson Associates, have grown at a 12 percent annualized rate over the past 60 years (1944-2003).

Over this 60 year period there were 14 years in which the market lost money. The worst year, 1974, saw a loss of 26.47 percent. The smallest loss occurred in 1953 when large caps lost only one percent. The average loss over the 14 years was 10.5 percent., and the average number of "loss years" per decade was two.

So, knowing this, here's a quick question. If you had $100,000 in retirement assets earning an average 12 percent rate of return over a 10 year period, and if you withdrew only $12,000 annually, what would your investment balance be after 10 years? Would it be $100,000? That seems logical? A 12 percent annualized rate or return should be enough to satisfy a 12 percent annual withdrawal. Right?

Or, could your asset be worth far less? Is it possible to lose almost 60 percent of your money over 10 years while still averaging a 12 percent annualized rate of return?

The key is in knowing the answer to two critical questions: First, "Were there any years in which the market had a negative rate of return?" And second, "When did the loss occur."

Let's assume that the loss occurred in year one and that it was an "average" loss of 10.5 percent. The following table shows what happens:

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

Here we had a single loss in year one followed by nine consecutive gains of 14.5 percent and we still lost nearly 60 percent of the asset. Moreover, this example assumed only

one loss year, not the average of two per decade since 1944.

What should this example teach us? It's simply this: taking withdrawals for income from a growth vehicle is an ill-advised strategy.

What if we wanted to shift to a more risky asset class in the hope of making up the loss? Let's say we moved the asset to small cap stocks while still withdrawing the $12,000. If we hoped to make up the loss in one year, we would need to achieve a 49.8 percent rate of return. That's happened exactly once over the past 60 years. If we wanted to make up the loss over 10 years, we would need to achieve an average annual rate of return of 19.25 percent. That has happened only two times over 50 years, just four percent of the time. So, moving to a more risky asset class is no solution. The failure rate is 96 percent.

What then is a better approach to putting retirement assets into a distribution mode? The answer is shifting the focus away from rate of return and moving to a time weighted approach that allows assets to both remain invested over long periods of time and provide guaranteed streams of income in order to create both financial and psychological security. In this way it is possible to deliver a reliable, inflation-adjusted income over a long period. Such an approach (called The Income for Life Model™) has a high probability of creating genuine financial security for millions of Americans.

Let's take an example of a 60 year old who has retirement assets of $500,000 that are now going to be utilized to provide retirement income.

By strategically allocating the $500,000 across various "buckets" which are time weighted and which each have their own targeted rates of return ranging from conservative to aggressive, we can allocate the $500,000 across a spectrum of savings and investment vehicles. These include a single premium immediate annuity, a traditional fixed annuity, an EIA and one or more investments including a variable annuity, mutual funds or wrap account.

If the various "buckets" achieve their targeted rates of return, there will be sufficient money available to purchase a series of immediate annuities which will create successive guaranteed income streams, each with a duration of five years.

The table below shows what can be achieved with this approach. This $500,000 example shows an immediate, guaranteed income of $2,359 per month payable for five years. While this income is being paid, bucket two will have accumulated for five years. If bucket two achieves its targeted rate of return of four percent, there will be sufficient money accumulated to purchase an immediate annuity that produces an inflation adjusted $2,734 per month (based upon an annual inflation adjustment of three percent).

This process repeats itself every five years with the monthly income reaching a potential $4,250 per month in years 21-25. Importantly, if bucket six achieves its targeted 12 percent rate of return, the investment will grow back to its original value of $500,000 allowing for the creation of even more retirement income.

This time-weighted approach to putting retirement assets into a distribution mode runs dramatically counter to today's conventional approaches. However, it's a much safer approach than shopping for a withdrawal rate and hoping for the best.

This is an approach that is also more conservative than many currently being recommended. A full 74 percent of the assets in this model are placed in fixed vehicles.

This model also provides the best possible chance for the invested assets to achieve returns that reflect general market performance over a long period of time. On that basis alone its value cannot be overstated. Individual investors typically experience a truly disturbing level of sub-par investing results. This can be seen in the experience of mutual fund investors who, according to DALBAR Associates, have averaged only a 3.51 percent rate of return over the past 20 years.

Helping clients achieve financial security in retirement will require you to acquire knowledge and insights that you may not currently possess. Making the effort to acquire these skills, however, will catapult you into a leadership position in retirement income distribution and place you in the vanguard of "Distribution Specialists" who will own the future of retirement planning. ▲

$500,000 Investment

Bucket 1	**Bucket 2**	**Bucket 3**	**Bucket 4**	**Bucket 5**	**Bucket 6**
$138,705	$128,335	$101,155	$66,205	$36,185	$29,415
2% Target	4% Target	6% Target	8% Target	10% Target	12% Target
SPIA	Fixed Annuity	Equity-Indexed Annuity	VA, Mutual Fund or wrap account	VA, Mutual Fund or wrap account	VA, Mutual Fund or wrap account
Immediate	5 Year Hold	10 Year Hold	15 Year Hold	20 Year Hold	25 Year Hold
$2,358/mo.	$2,734/mo.	$3,169/mo.	$3,674/mo.	$4,259/mo.	$500,000