5 BIG THREATS TO A SECURE RETIREMENT

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The Dilemma

The days of the gold watch and generous company pension are gone. Today, most private companies no longer provide traditional retirement plans and instead offer 401(k) or similar plans funded largely by the employee. As the costs associated with employer-provided retirement plans have gone through the roof, even government pensions are being called into question as budgets are strapped for resources. Not even Social Security is immune from this trend since the ratio of contributing workers to claiming beneficiaries is decreasing with Baby Boomers retiring in record numbers. Many question whether Social Security benefits can remain at current levels.

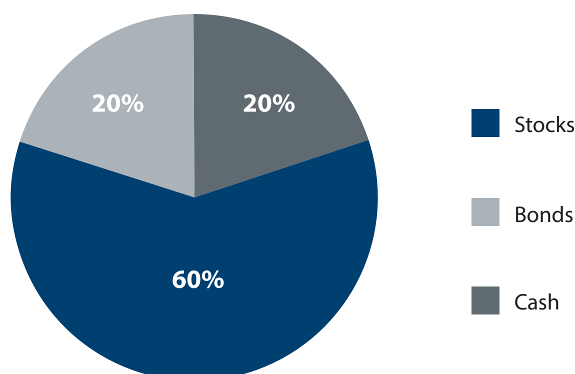
What does all this mean if you are recently retired or approaching retirement? It means you will need to rely more on your own efforts and assume responsibility for the management of your financial future. You must find ways to preserve the assets you have accumulated and identify opportunities to generate guaranteed lifetime income so you do not run out of money too soon.[1]

Traditional Approaches to Investing – Not as Useful As You Approach Retirement

There are many ways to invest your retirement assets. The most common asset accumulation and growth strategies involve a combination of stocks, bonds, and cash as shown in Figure 1. Your retirement portfolio most likely contains some combination of these types of assets.

While the traditional asset allocation models may be appropriate during your working years, they do not solve the wealth preservation problem or guarantee consistent monthly income in retirement.[2] Here are several risk factors that threaten the effectiveness of traditional strategies for your personal retirement plan.

Figure 1: A Typical Example of Traditional Asset Allocation Model



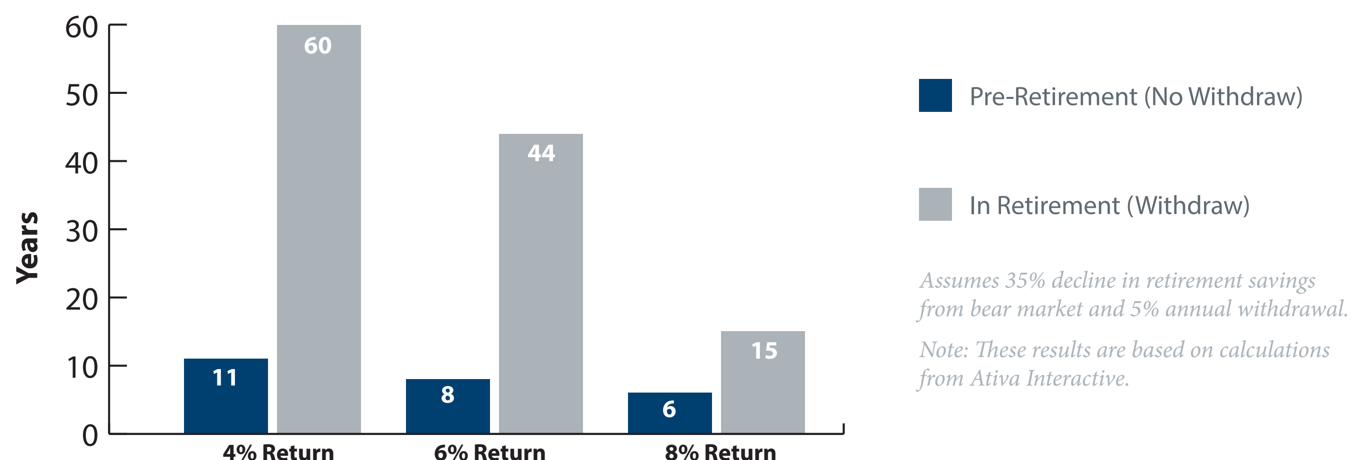
This model is hypothetical and does not reflect any particular investment portfolio.

Beware of the Bear…Market

One risk with traditional asset allocation is a "bear market," defined as a period of time where the market frequently drops 20% or more from peak to trough.[3] Bear markets eat away at the stock and bond portion of your retirement portfolio. According to research by Ativa Interactive, from 1900–2013, there were 32 bear markets, or about one every 3.5 years.[4] It takes an average of 24 months for the stock market to recover from a bear market. It could take much longer, depending on how your assets are invested. Suppose your portfolio declined 35% from $100,000 to $65,000, at a 4% annual return it would take 11 years for your portfolio to recover to your initial value of $100,000. At 6% annual return, it would take 8 years to recover, while at 8% it would take 6 years before you are back to the point where you started.

Figure 2 compares two sets of data: the average number of years it takes to recover from bear markets during your working years while you are still accumulating assets, and the number of years it takes during retirement, when you are withdrawing money at 5% per year. As you can see, it is much easier to recover from a bear market when you are working and accumulating money than when you are retired and taking money out of your retirement savings.

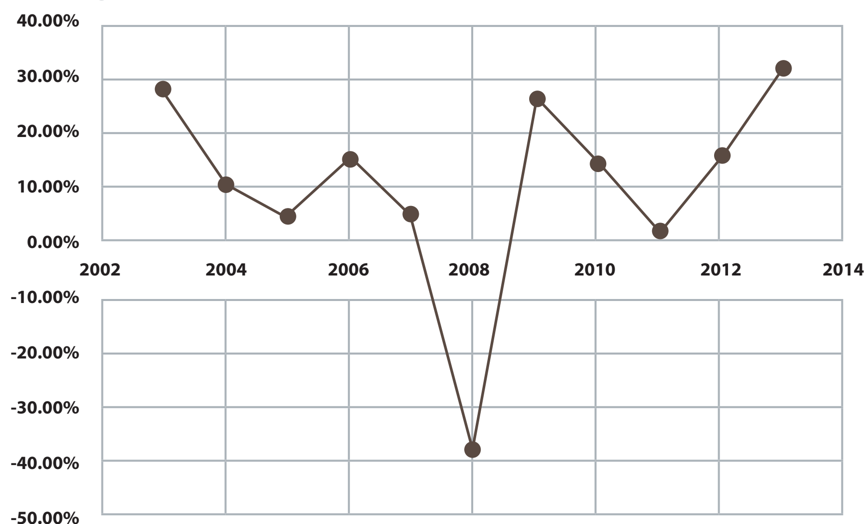
Figure 2: Years to Recover From Bear Market with Initial Value of $100,000
Assumes 35% decline in retirement savings from bear market and 5% annual withdrawal



Volatility: Riding the Market Rollercoaster

Even if you are not bitten by a bear market when you put your money in stocks or stock mutual funds, your income will depend on stock performance, which tends to be volatile. Figure 3 shows the returns for S&P 500[5] from 2003 to 2013. Referencing the graph, you can see that although the broader market is recovering from the 2008 financial crisis, stock returns are still unpredictable because of market fluctuations and other variable economic factors. This will put your income at risk. These fluctuations may not be of much concern while you are working and accumulation money, but can keep you awake at night when you are retired and distributing money. Since stock prices are inherently changeable, achieving a consistent flow of income is almost impossible. More importantly, you don't want to spend your days obsessing on the stock ticker. You want to be enjoying your friends and family.[6]

Figure 3: Stock Returns for S&P 500 (2003–2013)

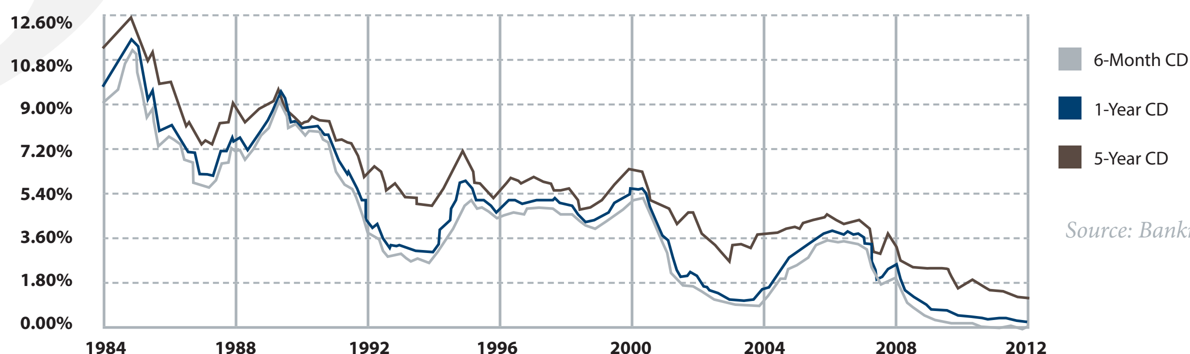


Source: Google Finance. "Standard & Poor's", "S&P 500", and "Standard & Poor's 500" are trademarks of the McGraw-Hill Companies, Inc.

Low Interest Rates: That Sinking Feeling

From the previous section, you can see that if you invest in the stock market your income will fluctuate, and if we enter a bear market it can eat away your portfolio in a short period. In such a situation, you may think that the easiest way to get guaranteed income is to put your money in a bank CD.[7] However, Figure 4 shows the CD rates from 1984 to 2012. As you can see, CD rates have decreased precipitously in the past 30 years. You probably noticed that in your bank or money market statements. Saving assets in a bank CD may have been a good idea before 1990, since they were paying out at around 7% per year. Now, with CD rates lower than 1.8%, it would be a bad idea to count on a bank CD for retirement income. You would need over $500,000 in the bank to generate just $9,000 per year in income![8]

Figure 4: CD Rates in United States (1984–2012)



Source: Bankrate.com

CREATE A SECURE RETIREMENT

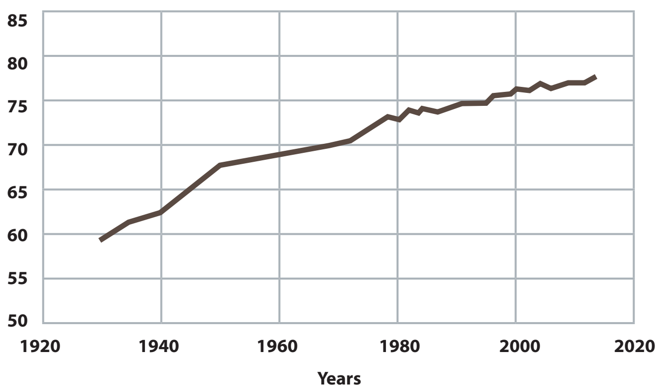
Longevity: The Longer You Live, The More Money You Need

One hundred years ago, it was unusual to know someone who was older than age 80. Today, the average life expectancy for most Americans is 80, or even older. According to MarketWatch, for a married couple both aged 65, there is a 1 in 4 chance that one spouse will live for another 30 years. You want to make sure your retirement savings will support your lifestyle for that long of a period of time once you start taking distributions. Running out of money too soon has become a legitimate concern, as projected life expectancy is extended.

Living longer is a blessing. While you are working and accumulating assets, time is your ally. However, once you are retired, from a financial standpoint, it can be a risk and a challenge: you may need steady retirement income for 30 years or more. Longevity increases the likelihood that you could outlive your money. Figure 5a shows the life expectancy for individuals living in the United States—notice the steady increase. By contrast, Figure 5b shows the value of a hypothetical retirement portfolio. This illustration assumes you have $250,000 at the beginning of retirement and you will withdraw $20,000 per year. It also assumes an average return of 2.5% per year from a bank CD or similar low risk investment. Unfortunately, in this typical scenario you will run out of savings in just 15 years. So, if you live longer than 81 years old, which is quite possible, you will have nothing left to cover your daily living expenses.

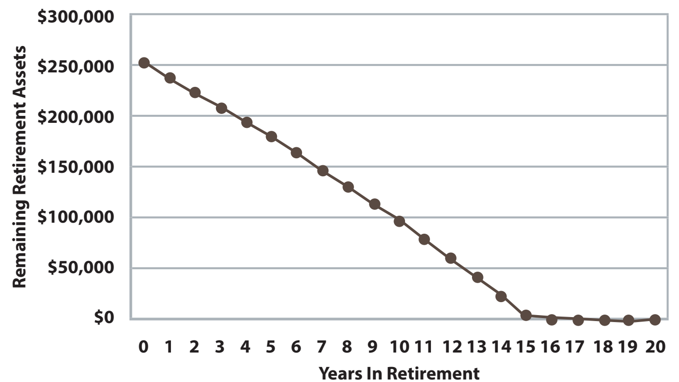
Traditional investment vehicles (stocks, bonds, mutual funds, or bank CDs) do not guarantee lifetime income.[1] You risk running out of money with these investments.[8]

Figure 5a: Life Expectancy of United States (1920–2014)



Source: Centers for Disease Control and Prevention

Figure 5b: Depleting Savings in Retirement



Assumptions: At the beginning of retirement: $250,000

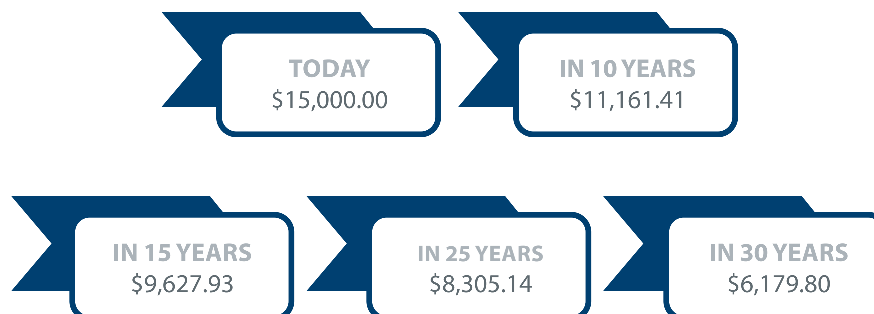
Withdraw: $20,000 per year. Average return from a CD[7] or low risk investment: 2.5% per year annual rate of return.

Inflation Rate: Prices Go Up, But Will Your Income?

Another important risk factor that may impact your financial picture after retirement is the inflation rate. Inflation is the gradual increase in the cost of goods and services over time. During the last two decades, the inflation rate has increase almost 3% each year.[9] Many of the items affected by inflation are things you cannot live without, such as: fuel costs, medical care, and food. According to the Massachusetts Department of Energy Resources, in 1999, the price of the gasoline was $1.31 per gallon, but in May 2014, the price is $3.71 per gallon. From Figure 6, you can see how inflations can be devastating to your ability to meet your basic living requirements. Even if the inflation rate is only 3%, it will erode your purchasing power from $15,000 to $6,179 in 30 years. When you are working and accumulating retirement savings, inflation may not be a huge problem if your salary goes up and you can boost your retirement contributions. In retirement; however, you are already taking money out and inflation can deplete what you have even faster.

Traditional investment strategies may not offer a secure hedge against inflation. Stocks expose you to market volatility, and less risky investments such as bank CDs may not keep up with inflation.

Figure 6: How Inflation Erodes Purchasing Power



1 Guarantees are subject to the claims paying ability of the issuing insurance company.
2 Asset Allocation is a method used to help manage investment risk. It does not ensure a profit nor protect against losses in a declining market.
3 Historically, average stock market returns are not that low. However, there have been extended periods where growth has been flat.
4 See "Time to Recover From a Bear Market", available at http://www.ativa.com/time-to-recover-from-a-bear-market
5 The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading industries of the U.S. economy.
6 An index is a composite of securities that provides a performance benchmark. Indexes are unmanaged, do not incur management fees, costs and expenses, and cannot be invested in directly. Past performance is not a guarantee of future results.

Working With IAMS Wealth Management

Traditional planning strategies may not be structured to generate lifetime income and preserve assets. Stocks and mutual funds can be very useful during your working years. While you are accumulating assets, you still have plenty of time to recover from a downturn in the market or a period of low return. The key to retirement security is to find an advisor who focuses on retirement income planning, rather than just growing an asset based through investments.

There are several different types of financial advisors who are trained to accomplish specific objectives in helping you manage your finances. Some advisors are focused primarily on managing investments, and they will help you make stock and bond purchases or invest in mutual funds that are appropriate for your objectives and your status in life. Other advisors take a different approach and are trained to help you create a stable source of income during your retirement years to make sure that you do not run out of money too soon. Finding the best advisor for the type of planning you need enables you to have a comfortable retirement. After all, when you have a heart condition you need the right specialist so you go see a cardiologist, not a neurologist!

If you are approaching retirement it is likely that you are in need of an advisor who is focused on retirement income planning. We will help you put a strategy in place that may provide income guarantees so you will have enough money to meet your daily living expenses for the rest of your life.[1]

You Have Nothing to Fear

As you approach retirement, you need to be able to manage the five risks we discussed:

BEAR MARKETS Which May Reduce Your Savings

MARKET VOLATILITY Which May Keep You Up at Night

LOW INTEREST RATES Which May Hinder Your Growth

LONGEVITY Which May Cause You To Run Out Of Money

INFLATION Which May Reduce Your Purchasing Power

While these risks may appear daunting, you should have nothing to fear. By sitting down with an advisor who specializes in retirement income planning, you can devise a strategy using the right financial products to overcome these risks and provide you guaranteed income for life.[1]

7 Certificates of Deposit (CDs) are time deposit accounts that entitle the CD owner to a specified annual interest rate over a specified period of time. CDs are FDIC insured up to $250,000. Conditions and restrictions apply.
8 Unlike a CD, which an FDIC-insured bank product, an annuity's guarantee of principal and interest are only as strong as its financial position. Consult an insurance company's rating for it's financial strength.
9 Available at www.vsinflationcalculator.com/inflation/historical-inflation-rates
Violating the terms and conditions of the annuity contract may void guarantees.
Examples are intended for illustrative purposes only and are hypothetical in nature. It is not intended to illustrate any specific individual's financial situation. Your actual circumstances could vary significantly from the illustrated example.

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