TERRY'S TIPS

Accumulation vs. Distribution August 2016

The Meaning of Accumulation Phase

There's an article on Forbes.com that summarizes the accumulation phase rather nicely, stating that "this period begins when you enter the workforce and begin setting aside funds for later in your life, and ends when you actually retire."

Basically, if you're still working, you're still in the accumulation phase, building wealth to get you through retirement.

Why the Accumulation Phase is Important

The importance of the accumulation phase to your retirement should be pretty obvious. It is during this time that you're building wealth and resources to provide an income source for yourself in retirement.

Examples of income streams that you can build during the accumulation phase include:

- **Social Security.** A contribution that gets taken from every paycheck you receive. For many retirees, even millionaires, Social Security pay will be a significant income source in retirement.
- **401ks.** An optional tax-deferred investment that you can make each year if your employer offers such a program. It's important to make contributions to your 401k each year, as the more you save, the more you'll have for retirement.
- **IRAs.** Each tax season, you have a chance to contribute money to an Individual Retirement Account, or IRA. It may be either pre-tax or after tax depending on the advice of your tax preparer. This money can then grow until the time comes to withdraw it in retirement.
- **Investment Portfolio.** Personal stock portfolios are a popular option for building wealth for retirement. During the accumulation phase, many treat the stock portfolio as a wealth building tool, focusing on higher-risk, higher-reward investments to increase the portfolio's value.
- **Deferred Income Annuities.** A deferred income annuity, sometimes abbreviated as DIA, has you making a lump-sum payment to an insurance company in exchange for guaranteed income at a later date, usually ten years or more.

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What is the Distribution Phase?

When you actually retire and start collecting money from the retirement income sources you set up during the accumulation phase of your life, you can be said to have entered the distribution phase.

Basically, the distribution phase is the time in your life when you start collecting on the various investments and retirement savings accounts you've set up throughout the rest of your life. You are no longer building wealth, but using the wealth you've accumulated to fund your retirement.

Getting Ready for the Distribution Phase: The Retirement Income Planning Phase

Towards the end of the accumulation phase, about 10 years from retirement, it's important to make sure that you've established enough income streams to cover your needs in retirement. We like to call this the Retirement Income Planning Phase, and it's kind of a transition phase between the Accumulation and Distribution Phases. This phase is all about nailing down a budget for retirement, evaluating your best Social Security collection strategies (so that you don't leave $50K or $100K on the table) and creating other streams of "guaranteed" income that, together, meet your income needs in retirement.

A good place to start is establishing a monthly budget and checking your retirement income against it. This can help you check to see if you're ready to move on from the accumulation phase and into the distribution phase.

How much should you save before you reach the distribution phase and how much in dollars is this? There's no blanket answer to this question, unfortunately. As stated in a Forbes.com article on the subject, "Some advise saving as much as 20%... A 'one size fits all' approach, however, is often not helpful" and that "how much one should save will vary considerably based on circumstances."To calculate just how much you should save, consider the following example from the previously mentioned Forbes article, which is based on the 4% Rule where you take out 4% of your investment portfolio each year as income: "an individual planning to spend $75,000 a year (including taxes) would need to accumulate $1,875,000 ($75,000 / 4%)." To adjust this number for your own needs in retirement, plug in your expected yearly budget and divide it by 4%.

Using the math from the example, you would adjust your savings rate so you could meet your total savings goal by the time you retire. However, even using this example might not be enough, as there are countless variables that can affect your budget needs in retirement, such as inflation or medical expenses.

Also, the Forbes example assumes that ALL of your income would come from your stock portfolio, but there are other sources of income you could draw on to pay for your retirement if you plan ahead, not the least of which is Social Security, a source that will make up more than half the income of many retiree households.

The key point here is this. Rather than putting all of your eggs in the Wall Street basket where you are relying heavily on the market performance of your retirement portfolio to cover your retirement income needs, you might want to diversify your income sources to limit your risk of running out of money just like you've probably been told to diversify your investments. This is a different way to look at preparing for retirement and is the foundation of Retirement Income Planning.

Of course, there is a lot more to retirement income planning than what we have covered here. I hope that this information helps you plan for retirement, so that you can retire comfortably.

Source: https://www.thayerpartnersllc.com/blog/what-do-accumulation-phase-and-distribution-phase-mean-for-retirement