Securing Income After Retirement — Harder Than Ever, But It Can Be Done!

Here's how to maximize your nest egg

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You made it! After years of hard work, you've reached retirement with some money set aside to provide a steady income now that you're no longer working. Time to sit back, put your feet up, and enjoy the fruits of your labor! Right?

Well… not quite. While you certainly should enjoy retirement to the fullest (you've earned it!), this is not the time to stop managing your money. In fact, since you will now be withdrawing more money than you save, careful financial planning is critical. Remember, your money may need to last for 30 years or more!

Essentially, there are two main concepts you'll want to address:

• How to protect and grow your money so that it will keep up with inflation and last as long as you do.

• How to plan your withdrawals so that you won't deplete your retirement savings too soon.

INVESTING

Many retirees are so concerned about protecting their assets that they take an extremely safe position, limiting themselves almost entirely to bonds and perhaps a small amount of dividend-paying stocks. However, while preservation is certainly important, you also need long-term growth. "Safe" investment vehicles such as banks and CDs no longer provide the four to five percent return necessary to keep pace with inflation, so how do you grow your money while still keeping risk low?

There's no "one size fits all" combination of stock and bonds, and no investment is risk-free. However, some thoughtful planning can help you achieve your goal of safety and growth. A good starting point is to establish a mix in your portfolio of 40 percent stocks and 60 percent bonds. The stock portion should be spread among a diversified group of stocks and/or stock funds that include large-cap, small-cap, various industries, growth stocks, and value shares, including dividend-paying stocks. A small percentage of highly-rated international securities should also be considered. By investing a healthy – but not overly large – percentage of your money in stocks, you can have access to the growth potential stocks provide while still spreading your nest egg across multiple baskets. The point is to create a diversified portfolio which may help keep your overall volatility low and provide you the growth you need to make your money last.

The bonds in your portfolio should also be diversified. Try to include a variety of different types of bonds such as treasuries, high-grade corporate, high-yield, and, depending on your tax bracket, possibly municipals. Also, remember that all bonds have a maturity date – the date you receive your initial investment back. Most retirees will want to stick to bonds with maturities in the short-to-intermediate range. This way you won't have to wait an extremely long time before your bond matures. That's important, because the longer the maturity date, the more likely your bonds will be subjected to rising interest rates.

As you age, you may want to reduce the percentage of your stock holdings so that the volatility of your overall portfolio will decrease as you get older. You don't need to change your mix every year, but you should re-position about every five years. For example, you might start with a 40 percent stock/60 percent bond mix at age 70. When you reach 75, you could re-align your portfolio to a 30 percent stock/70 percent bond mix; at 80, you could adjust your stock position down to 25 percent, then move down to 20 percent at age 85.

Why not just move everything into bonds? Simple — even when you reach your 80s, you could still live another decade or longer, which means you will still need some growth in your portfolio. For this reason, you may not want to ever reduce your stock holdings below 20 percent.

WITHDRAWING

When establishing a withdrawal plan for your retirement savings, your goal should be to set a withdrawal rate that provides a reasonable stream of cash but also a good level of assurance that your portfolio will last for 30 years or more.

To accomplish that goal, a withdrawal rate of approximately four percent would be a good recommendation. That might sound like a low percentage, but it's a prudent guideline when you consider the effects of inflation over a long retirement.

For example, if you have a $500,000 nest egg and you set up a four percent withdrawal rate, you would take out $20,000 the first year of retirement. If inflation remained at three percent annually – which is about what it's been for the last 75 years – then your $20,000 withdrawal would increase to more than $36,000 in 20 years, and nearly $49,000 in 30 years.

Another reason to maintain a limited withdrawal rate is that a downturn in the market is much more damaging to your portfolio during retirement than when you're working and accumulating assets. In the event of a downturn, your portfolio would lose value because of negative returns, then shrink even more because of your withdrawals, leaving you with less money to invest to recoup your losses for when the market rebounds.

There are other ways to secure income after retirement which are beyond the scope of this article. If you would like to know more, please contact me at the number listed below.

ERRORS TO AVOID

Required Minimum Distribution

If you have assets in a Traditional IRA or 401(k), you must begin taking required minimum distributions by April 1 of the year after the year you reach age 70 ½. If you don't take your RMD on time — by December 31 of each year once you've started them — the IRS can charge you for the income tax on the distribution and a 50 percent penalty on the amount you should have taken but didn't!

If you're concerned about missing an RMD, you may want to set up a pre-scheduled distribution on a monthly, quarterly, or annual basis. If you select this option, make sure that you maintain sufficient liquid investments to cover your distributions so you won't be forced to pull money from a long-term investment.

Medicare Enrollment

Many people defer the start of their Social Security benefits past their full retirement age in order to increase their benefit amount. However, regardless of the date you start taking Social Security, it is important to sign up for Medicare at age 65. If you postpone, your Medicare Part B premiums may be permanently higher — and increase for each year you delay — than they would have been if you signed up at age 65. If you wait until you reach age 70 before signing up for Medicare, your premiums could be 50 percent higher! To avoid this mistake, be sure to sign up for Medicare three months prior to your 65th birthday, regardless of when you plan to begin claiming Social Security benefits.

CONCLUSION

Retirement is a time to achieve your dreams, pursue your hobbies, and enjoy the life you've worked so hard to build. But it is not a time to stop prudently managing your money. It's true that the way you manage money after retirement is likely to change, but the need to manage your money never goes away. As you can see, there are many decisions to make and mistakes to avoid.

Many of the most successful retirees realize they have neither the time nor the inclination to master all the intricacies of money management. Fortunately, there is a solution. A professional, experienced financial advisor can help you spend your time enjoying retirement instead of wondering how to pay for it.

If you have questions about how to keep your money safe while also ensuring that it lasts, please contact me at 610.478.9500 or e-mail me at contact@paulfair.com. I have been helping people with their retirement planning for over 25 years and would be happy to share my expertise with you.

Remember: the best time to put locks on your doors is before a break-in. The best time to wear a seat-belt is before an accident. And the best time to secure your income is before something unexpected happens. Start securing your income today!

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