

## Chapter 9

# PLAN YOUR EXIT STRATEGY

You've saved diligently and invested wisely. You've maxed out on every tax-advantaged retirement savings plan known to man and you've built a tidy retirement nest egg. In short, you've reached the end of the yellow brick road of retirement planning. The hard work, at least from a financial point of view, is pretty much over. Now it's just a matter of relaxing and living off the assets you worked so hard to accumulate. What could be simpler?

Not so fast. Yes, one phase of retirement planning has pretty much come to an end—the accumulation stage—but that's only half the equation. The other half is the drawdown phase, during which your goal is to tap your assets in such a way that you don't run out of money before you run out of time. For most of us, this is the part of retirement planning we think about the least and do virtually no advance planning for. Which is kind of ironic because in many ways the drawdown phase can be even more of a challenge than the accumulation stage. The main reason is that you've got a lot less wiggle room than when you're saving for retirement. Think about it. While you're building your nest egg, you've got plenty of time and opportunity to make up for mistakes or market setbacks. You can increase the amount you save, you can invest more aggressively,

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and, of course, you've got time on your side. You know that if you hang in long enough, rising stock prices can make up for bear market setbacks or lousy returns from poor investments.

But once you've retired and you start pulling money out of your portfolio, there's much less room for error. If the value of your portfolio sinks, you're not likely to have new savings that you can pour in to shore it up. And time is no longer your ally, at least not as much as it was when you were in your thirties or forties. To put it bluntly, your margin of error when managing your money during retirement is much smaller than during the accumulation stage. So you've got to be especially careful about the strategy you set and the specific decisions you make to carry out that strategy.

In this chapter, we're going to take a look at the various options and strategies you have for transforming your retirement stash into an income that will support you for the rest of your life. As in the accumulation stage of retirement planning, there's no single strategy that works best for everyone. The approach you take will depend on such factors as how much money you've accumulated, how much income you need to draw from your assets to live on, how much of that sum will come from Social Security and other pensions, how much you plan on leaving to your heirs (deserving and undeserving), your estimate of how long you'll live, and how concerned you are about outliving your money. As if that's not enough, you'll also have to deal with issues such as deciding whether to tap assets in 401(k)s, IRAs, and other tax-advantaged accounts or in taxable accounts first. And, of course, there are the government's required minimum distribution rules (or RMDs, as they're known in benefit circles), which whack you with onerous fines if you fail to withdraw certain amounts from your IRA and other savings plans by a certain age.

There are a lot of variables here, and I'll be the first to admit that things can get complicated in a hurry. But not to worry. The drawdown phase is entirely manageable if you're willing to set a thoughtful strategy, monitor it, and make appro-

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priate adjustments along the way. And after reading this chapter you should have a good foundation for creating a sound strategy for this phase of retirement.

One more thing before we get into the nuts and bolts of this chapter. If you're under age fifty and retirement still seems more like a far-off mirage than a looming reality, you might be tempted to blow this chapter off. I mean, why worry about converting assets to income when your main focus is still trying to accumulate assets and invest them for the future? First things first, right? Think again. Fact is, the accumulation and withdrawal phases of retirement planning are inextricably linked. The sooner you come to grips with the fact that living off retirement savings for a span of three decades or more may be more difficult and require a larger stash than you think, the more incentive you'll have to save now. If nothing else, I hope that reading this chapter will give you a more realistic sense of just how much money you need to support a retirement that can easily stretch for thirty years or more. It's a rude awakening on the eve of retirement to find that the 401(k) balance that seemed so huge—\$500,000—won't go nearly as far in retirement as you might suppose. Better to come to that realization well *before* you retire, so you still have a chance to increase the size of your nest egg, not to mention the odds of it supporting you through retirement.

### Can You Say "Longevity Risk"?

When we're accumulating money for retirement, most of us are aware that we're taking on investment risk, that is, exposing ourselves to the possibility that our stocks, stock funds, bonds, bond funds, and other investments might lose value rather than grow. During the late 1990s a lot of us began to overlook this risk as stock prices seemed to march inexorably upward. But the bear market that decimated stock prices in early 2000 reminded us that when it comes to investing, risk and reward are inseparable, and the higher the reward you shoot for, the more risk you've got to accept.

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What many of us don't know, however, is that there's an additional dimension to risk when we enter the drawdown phase of retirement planning: longevity risk. Basically, this is the all-too-real possibility that we'll outlive our money. In other words, after all our careful saving and investing, we may run through our retirement stash before we pass into the great beyond, leaving us to live out our golden years in a less than golden fashion. And even if we're aware enough to consider this risk, chances are we greatly underestimate it, much as we misjudged investing risk in the 1990s. Unfortunately, the consequences of overlooking or underestimating longevity risk can be as bad, if not worse, than the consequences many investors suffered from overlooking investing risk in the previous decade.

One of the reasons we either disregard or miscalculate the seriousness of longevity risk is that few of us have a real understanding of life expectancy statistics. So we tend to underestimate just how long our retirement portfolio is going to have to support us. And if your portfolio will be supporting you and another person—a spouse, a friend, a partner, whatever—then it's got to last even longer. One of the peculiarities about the actuarial calculations surrounding life expectancy calculations is that the odds of at least one member of a couple being alive at some point in the future are higher than the odds of either member of the couple alone. For example, while the odds of a sixty-five-year-old man living to age ninety are 30 percent and the odds of a sixty-five-year-old woman living to ninety are 41 percent, the odds that at least one member of a male-female couple both age sixty-five today will be around at age ninety are nearly 60 percent. All of which is to say that unless you know you've got a fatal condition or you're certain you're genetically programmed for a relatively short life, your assets have probably got to last you a good twenty-five to thirty-five years, possibly more, after you retire.

This has some profound implications on a practical level. At the very least, for example, it means that we've got to take care to factor inflation into our withdrawal strategy. Let's say,

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for example, you figure you'll need to withdraw \$40,000 a year from your portfolio so that, combined with Social Security and any other pensions, you'll have enough money to meet your living expenses in retirement. But if you continue to withdraw just \$40,000 year after year from your portfolio, you will eventually lose substantial purchasing power. Assuming economists don't find a way to do away with inflation, prices of goods and services will rise over time, so you won't be able to buy for \$40,000 at age eighty-five what you were able to get at age sixty-five, and you won't be able to get at age ninety-five what you could get at age eighty-five. In other words, just to be able to buy the same level of goods and services, you will have to increase the amount you withdraw from your portfolio each year.

The amount of increase you need to stay even will depend, of course, on the rate of inflation. But even at modest levels of inflation, I think most people would be surprised at how much their withdrawals would have to increase. For example, if you begin withdrawing \$40,000 a year from your portfolio at age sixty-five and inflation averaged just 2 percent a year—which is lower than the average of 3 percent or so we've experienced since the 1920s—then by age eighty-five your withdrawals would need to be just over \$59,000 just for you to stay even. And by ninety-five, you would need to withdraw more than \$72,000. If, on the other hand, inflation came in at its historical 3 percent average, then your annual withdrawal would have to total more than \$72,000 at eighty-five and just over \$97,000 by age ninety-five, or more than twice as much as your original forty grand. Clearly, increased longevity puts a strain on the assets in your portfolio.

### **Beware the Average Solution**

Despite this harsh reality, many of us still seem to have this unrealistic notion that our retirement portfolio is a bottomless pot we can dip into for relatively large sums of money year after year for spans of thirty years or more. I suspect that one of the reasons for this is that the relatively high average returns we've

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had in financial assets over the past two decades give us an inflated notion of what kind of withdrawals our portfolio can sustain without running dry. But basing a withdrawal strategy on average returns can be dangerous.

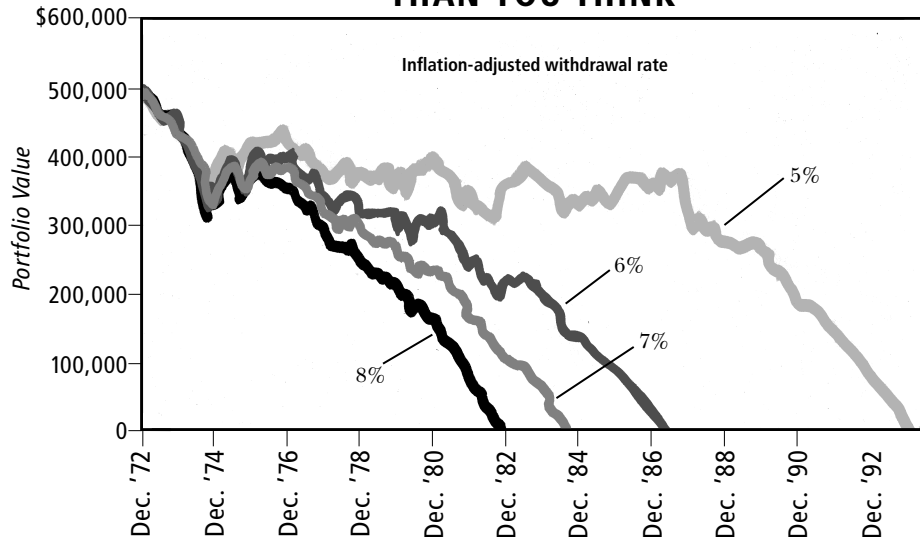
To get an idea of just how dangerous, let's look at an example. Assume you've retired at age sixty-five with a \$500,000 portfolio, 60 percent of which is invested in large-company stocks like those in the Standard & Poor's 500 index and 40 percent in intermediate-term government bonds. And let's further assume you want your retirement portfolio to support you at least thirty years, or until you're ninety-five. Considering that even after the bear market that began in early 2000 large-company stocks delivered an annualized return of more than 12 percent for the twenty years through 2002, that intermediate-term bonds returned roughly 9 percent, and that inflation averaged about 3 percent, you might assume that you could easily withdraw, say, 8 percent, or \$40,000, from your portfolio and increase that amount for inflation each year without having to worry about running out of money.

But as the chart on page 250 shows, if you had embarked on exactly this strategy at the end of 1972, you would have run out of money in *less than ten years*, or before you hit age seventy-four. In fact, even if you lowered your withdrawal to what some people might consider a stingy rate of just 5 percent—an initial withdrawal of just \$25,000—the money runs out in just under twenty-one years. In other words, your bank account will be empty just about the time when there's almost a 50 percent chance you'll still be alive and kicking for years to come.

How is it possible that an inflation-adjusted withdrawal rate even as small as 5 percent could fail so spectacularly? Well, the problem was a little thing known as the 1973–1974 bear market, which knocked the stock market for a 43 percent loss very early on in this example. That big loss in combination with the inflation-adjusted withdrawals put such a big dent in the portfolio that it wasn't able to recover in time to participate in the bull market that began in August 1982. The moral: Basing your withdrawals on average returns can be misleading. When you're

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pulling money out of your portfolio, it's the combination of those withdrawals and the actual year-by-year returns, not the average return the portfolio earns over any period, that determines how long your portfolio will last. The big danger is that if you run into a period of lousy returns or an outright market downturn early in retirement, you could lose so much capital that your portfolio can be depleted much more quickly than you expect.

### Keep It Real

So how do you set a withdrawal rate that can give you reasonable assurance that your money will last as long as you do? The single most effective thing you can do is to start out with a low withdrawal rate, probably something on the order of 4 percent. Now, that may seem awfully low, but let me be clear about what I mean. I'm talking about an initial draw of 4 percent of the value of your portfolio and then increasing that amount every year for a cost-of-living increase or inflation. So, for example, let's say you have \$500,000 in retirement savings. If you set a

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4 percent withdrawal rate, that would mean starting with a \$20,000 withdrawal from your portfolio the first year. In subsequent years, you would increase this \$20,000 to maintain your standard of living. You could do that by increasing the \$20,000 by the previous year's rate of inflation, that is, the change in the consumer price index (CPI), which is widely reported in the consumer press or available at the Bureau of Labor Statistics website ([www.bls.gov](http://www.bls.gov)). Or you could set a reasonable inflation estimate, say, 3 percent, and increase your initial withdrawal amount by that percentage each year. If you find inflation is trending higher or lower than your estimate, you can make appropriate adjustments. Thus, if you started with a \$20,000 withdrawal and increased that amount by 3 percent annually, your withdrawal would grow to \$20,600 the second year, \$21,218 the third, and so on, rising to just under \$27,000 at the end of ten years.

Of course, an initial withdrawal rate of 4 percent might not give you as much income from your investments as you want or need. I'm sure most people would expect to be able to get more than \$20,000 a year out of a \$500,000 portfolio. (And I'm talking pretax dollars for the purposes of these examples. You would have to withdraw more than \$20,000 to end up with \$20,000 in spending money after taxes.) You've got to remember, though, that the higher you set your withdrawal rate, the greater the chances are that you will run out of money over the course of retirement. Tilting your portfolio mix toward stocks can somewhat lower the odds of running out of money because stocks have a good shot at raising your portfolio's return.

But as the chart on page 252 shows, increasing the percentage of stocks in your portfolio can do only so much. True, at higher withdrawal rates, the stock-heavy portfolios have lower odds of running dry within thirty years than bond-heavy portfolios. But even for an all-stock portfolio the odds are still what I think most people would consider unacceptably high—more than a 50 percent chance of running out of money. Look what happens, though, when you lower your withdrawal rate. All the portfolios do much better. Indeed, at a 4 percent withdrawal



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rate, portfolios with as little as 15 percent stocks have about the same odds of lasting thirty years as ones with 100 percent stocks. In short, by setting a low withdrawal rate, you can get decent odds of your money lasting through a long retirement without having to accept the huge ups and downs you would experience with an all-stock portfolio. Which is why I believe that the single best move you can make to increase the odds of your portfolio supporting you throughout retirement is to *set a low withdrawal rate*.

## THE ODDS OF RUNNING OUT OF MONEY DURING A THIRTY-YEAR RETIREMENT

WITH- DRAWAL RATE*	STOCKS-BONDS MIX					
	100% Stocks 0% Bonds	80% Stocks/ 20% Bonds	60% Stocks/ 40% Bonds	40% Stocks/ 60% Bonds	15% Stocks/ 85% Bonds	5% Stocks/ 95% Bonds
4%	13%	12%	10%	10%	13%	63%
5%	26%	25%	30%	40%	74%	100%
6%	43%	47%	57%	74%	99%	100%
7%	61%	68%	80%	94%	100%	100%

Source: T. Rowe Price

\*Withdrawal rate is percentage of portfolio withdrawn the first year. That dollar amount is then increased 3 percent per year for cost-of-living adjustments. Probabilities are based on computerized simulations of historical performance of stocks and bonds over many decades.

Of course, if the financial markets deliver the generous returns we enjoyed during the 1980s and 1990s, a portfolio that's loaded with stocks not only might last the rest of your life but also could grow into a much, much larger sum. But there's no guarantee the future will deliver returns of the same magnitude we enjoyed during those boom decades. In fact, I think it would be foolish to count on it. And you've also got to remember that the higher the concentration of stocks or stock funds in a portfolio, the more its value will drop during market setbacks. Experiencing a huge setback during retirement can be especially

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frightening. Indeed, I'm sure many retirees who entered the bear market of 2000 with 80 percent or more of their portfolio in stocks probably wish they'd played it a bit more conservatively. All of which is to say that while an aggressive portfolio does better in computerized simulations, it's not necessarily the best way to go in real life. I would imagine that for most retirees, a stock position of 60 percent or so would probably be about as aggressive as they would want to go. Certainly anyone going beyond that percentage should do so only if he or she is aware of the risk and willing to accept some pretty steep downturns along the way.

Of course, there's no way to know in advance exactly what mix of stocks and bonds will make your portfolio last the longest or how you can set a withdrawal rate just high enough to give you the most income without your nest egg expiring before you do. In order to do that we would need to be able to predict the returns the financial markets will deliver year by year (or even month by month) over several decades, and we would need to know our precise life expectancy. We don't know either one of these things, let alone both.

But there are a few sophisticated tools on the Web that can help you set a withdrawal strategy that's at least realistic in terms of what we know about stock and bond returns based on the way they've behaved in the past. I'll mention one here that I've often used, and which is free: the Retirement Income Calculator in the Tools & Calculators section of the T. Rowe Price website ([www.troweprice.com](http://www.troweprice.com)). You start by entering such information as your retirement age, how long you think you'll live after you retire, and the amount you would like to withdraw from your portfolio each month. You then select one of several model portfolios that range from as little as 5 percent to as much as 100 percent in stocks. Finally, you select a success rate—basically the odds that your portfolio will be able to deliver the income you want for as long as you would like. The success rate you pick can be as low as 50 percent (if you're a risk taker or have resources other than your portfolio to fall back on) or as high as 99 percent (if you really can't afford for your

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portfolio to run out). Hit the Calculate button, and bingo! The calculator runs computerized simulations that immediately tell you whether you're likely to achieve your goal. By tinkering with this calculator, you can see how dramatically the odds of your money lasting for, say, twenty-five or thirty years can change depending on the amount you withdraw and how you structure your portfolio. Or you can see how your odds of sustaining a specific withdrawal change depending on the mix of stocks and bonds in your portfolio. In short, you can get a pretty good idea of what combination of withdrawals and investment strategies makes the most sense for you considering how big or little a risk you're willing to take that your portfolio might expire before you do.

### **Annuities Can Help**

There is a way to virtually ensure you'll always have money coming in no matter how long you live, and that's to buy an annuity. Yes, I know I was tough on annuities back in Chapter 4. But here I'm talking about using annuities for something different from accumulating a nest egg. I'm talking about using them for the purpose for which they were originally designed and have been used for thousands of years, namely, converting assets into income, in this case turning assets that you've accumulated for retirement into an income that can last the rest of your life. And when it comes to this purpose—converting assets into a steady income stream via a process called annuitizing or annuitization—I think annuities can actually play a valuable role, although you still have to be careful about which particular annuity you choose and what you pay in ongoing fees.

Annuities that provide a regular stream of income are known as payout or immediate annuities. And although annuities can get brain-numbingly complex in their little details and fine print, the basic premise of an annuity that makes regular payments is pretty simple. Basically, a payout annuity works like a life insurance policy in reverse. Instead of making regular premiums to an insurance company that pays a lump sum upon

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your death, you give the insurer a lump sum of cash in return for regular income payments you receive until you die or for a specific period. When it comes to payout annuities, you have two basic choices: a fixed payment that remains the same for life or a variable payment that fluctuates with the market but offers the possibility of a rising income over time. Each has its advantages and disadvantages, so it's important that you understand how both types work and what they can—and can't—do for you in terms of providing reliable retirement income.

#### **Annuity Income Options**

The size of the payments you receive from an annuity—and how long you get them—depends on which payout option you choose. The type of payout also determines whether your heirs receive money from the annuity after you die. Although most people opt for monthly payments, you can usually choose quarterly or even annual payments if you wish. Here's a rundown of the main choices as well as examples of how the payment changes depending on the option you chose.

TYPE OF PAYMENT	SIZE OF MONTHLY PAYMENT ASSUMING \$100,000 INVESTMENT*
<b>Lifetime income:</b> You receive payments for the rest of your life. When you die, the payments stop and your heirs get nothing. This option usually provides the highest income because you assume the risk of being paid very little if you die well before the end of your life expectancy.	65-year-old man: \$669 65-year-old woman: \$630
<b>Life with period certain:</b> The annuity makes payments for the rest of your life or for a specified period, whichever is longer. So, for example, if you choose a lifetime income with a ten-year period certain and you die two years after buying the annuity, your beneficiary would receive the payments for eight more years (or, in	65-year-old man (10-year certain): \$646 65-year-old woman (10-year certain): \$616

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many cases, have the option of taking the value in a lump sum). Your payment with this option is lower than with a straight lifetime income. Still, if you're in your sixties and choose a relatively short period—say, ten years—the difference in payments can be fairly small because your odds of dying within a few years are low. This option can be a relatively inexpensive way to ensure that your heirs would receive something were you to unexpectedly die soon after purchasing the annuity.

<p><b>Joint survivor:</b> The annuity makes payments as long as you or your designated survivor (typically a spouse, although it could be another relative or a friend) is alive. People typically choose this option to ensure that a surviving spouse will continue to receive income. Payments are lower than under a lifetime income option for one person. You can increase the size of the payment under this option, however, by stipulating that the survivor receive, say, only 50 percent of the original payment (50 percent option) rather than the full payment (100 percent survivor option).</p>	<p>65-year-old couple (100% survivor): \$580 65-year-old couple (50% survivor) \$666 while both are alive; \$333 to survivor</p>
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*Source:* [www.immediateannuities.com](http://www.immediateannuities.com)

\*Payments are for fixed payout annuities as of October 2003. You may find higher or lower quotes depending on the current level of interest rates. Quotes can vary substantially from insurer to insurer.

### The Pros and Cons of Fixed-Payout Annuities

A fixed-payout annuity is by far the simpler of the two types to understand. If you wanted to turn \$100,000 into a guaranteed fixed income for life, for example, you would buy a fixed-payout or immediate annuity with your hundred grand, and the insurance company that issued the annuity would guarantee you a fixed payment as long as you live. (If you already had \$100,000 in an annuity you had been using as a tax-deferred investment as described in Chapter 6, you would annuitize your balance, which is essentially the same thing as buying an immediate annuity.) The size of the payment would vary based on factors such as the insurer's estimate of your life expectancy and how much

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the insurer felt it could earn investing your money, typically in intermediate- to long-term bonds.

An annuity offers more than just a guaranteed lifetime income, however. It also allows you to draw a higher annual income from your assets than you could manage on your own earning the same rate of return as an insurer. How is it possible for annuities to pay a higher income than you can get on your own from the same assets earning the same rate of return? The answer is that while you must base your payments on a single life—your own—insurers can base annuity payments on a pool of many lives. Insurers sell their annuities to thousands, in some cases millions, of people. And they know that while some of these people will survive to their life expectancy and beyond, many others will die earlier. So insurers are able to boost their payments by, in effect, transferring the money of those who die early to the ones who die late. This amounts to an extra return for those people who are fortunate enough to live long lives. In fact, some people refer to this extra dimension of return that annuities offer as a mortality or longevity return.

In order to make that transfer from those who die early to those who die late, however, people who buy annuities must agree to give up access to their original investment. If you buy a life annuity for, say, \$100,000, you no longer can get at that hundred grand, even if you need it for emergency expenses. You've turned it over to the insurer in return for the promise of a lifetime income. Similarly, if you die immediately after buying the annuity, your heirs would receive not a cent of your hundred grand. Any money you didn't collect from your annuity would constitute the mortality or longevity return that goes to the annuity owners who live beyond their life expectancy.

But even if you're willing to make the trade-off of access to your cash in return for a guaranteed fixed income, there's another factor you've got to consider. A fixed, guaranteed income may seem like the safest of all options, but even if prices were to rise at a relatively mild annual rate of 2 percent over the next twenty years, the purchasing power of your fixed annuity payment would decline by roughly a third.

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A few insurers have tried to address this shortcoming by selling annuities with payments that increase annually with the rate of inflation or that rise at a predetermined rate, say, 2 or 3 percent a year. But to provide this buffer against inflation, these policies usually offer initial payments that are 20 to 25 percent below what you can get in a regular fixed-payout annuity. Because of their lower initial payments, these inflation-adjusted or cost-of-living-adjusted annuities haven't been particularly popular with retirees.

### **The Pros and Cons of Variable-Payout Annuities**

There's a second type of annuity—a variable-payout annuity or immediate variable annuity—that doesn't offer the steady payments of a fixed annuity. Indeed, its payments fluctuate from month to month and can even go down under some circumstances. On the plus side, though, a variable-payout annuity has the potential of keeping the buying power of your lifetime payments ahead of inflation—and even offers the chance that your monthly payments could go up substantially over your lifetime, perhaps doubling or tripling.

The concept of an annuity whose payment can change over time isn't the easiest thing to get your mind around—hey, I warned you annuities can numb your brain—but here's a quick rundown on how variable-payout annuities work.

You start by choosing an assumed interest rate, or AIR, which is essentially a benchmark that, along with your life expectancy, determines the size of your initial payment. Some insurers allow you to pick your own AIR—typically within a range of 3 to 6 percent—while others assign a specific rate, often 3.5 or 4 percent. Next, you divide your investment among a number of subaccounts, which are essentially the same as mutual funds. Typically, you have anywhere from a half dozen to twenty or so choices, including growth, value, and large- and small-cap funds, as well as bond and international portfolios. If the subaccounts you've selected generate a higher return than the AIR, the payments from your variable annuity will increase.

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If your subaccounts earn a lower rate of return than the AIR you chose, then your payments will decline.

The higher the AIR you choose, the higher the initial payment you receive. For example, a sixty-five-year-old man who invests \$100,000 in a variable-payout annuity and chooses a 5 percent AIR might receive an initial payment of, say, \$657 a month versus \$566 with an AIR of 3.5 percent. So why not just go with the highest possible AIR? The reason is that the more your portfolio's return exceeds the AIR, the larger your future payments will be. So choosing a higher AIR will get you a higher initial payment, but it limits the potential for increases later on. Assuming your subaccounts earn 8 percent annually after expenses, for example, the \$657 monthly payment with the 5 percent AIR would climb to just under \$1,000 in fifteen years and a bit less than \$1,200 in twenty years. That same 8 percent net return, on the other hand, would boost the initial \$566-a-month payment under a 3.5 percent AIR to almost \$1,100 a month in fifteen years and \$1,325 a month in twenty years. So if you want more assurance that your income will keep pace with or exceed inflation, you're better off choosing a lower AIR.

Of course, this being annuities we're talking about, we've also got to take fees into account—and in the case of variable annuities, we're talking not one layer of fees but two. First, there are the annual portfolio fees for the subaccounts. The equivalent of mutual fund operating expenses, these charges typically run anywhere from 0.5 percent to nearly 2 percent in the case of some small-cap and international funds. Then come insurance charges, which usually run about 1.25 percent per year or more. Add the two types of fees together and total expenses can easily top 2 percent. Since it's the net return *after expenses* that determines your future payments, you'll likely see your payment grow more if you buy an annuity with low fees.

But even though variable annuities have a good chance of generating payments that will stay ahead of inflation, they also have some drawbacks you should be aware of. For one thing, payments go up and down each month depending on the per-



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formance of your subaccounts. That kind of uneven and unpredictable cash flow can make budgeting for living expenses tougher than if you're getting a steady income stream. What's more, payments can drop substantially over the short term if the markets go into a slump. For example, if you had been receiving monthly payments of \$1,000 from a variable annuity invested in a mix of 70 percent stock funds and 30 percent bond funds at the end of 1999, you could easily have seen those payments slide 25 percent to \$730 a month by the beginning of 2003 (although those payments would increase as the market recovered).

Insurers have been adding new features to variable-payout annuities to make them more attractive. Several insurers, for example, have designed annuities that give you access to at least some of your original investment even after you begin receiving lifetime income. Some annuities, for example, allow you to choose an access period of five to thirty years during which you can tap into the cash value of your annuity account should you incur unexpected expenses or simply want to indulge in a splurge. If you die during that access period, your heirs would be entitled to your account's remaining cash value. Others not only give you access to your cash but also guarantee that payments won't drop below a specified minimum—say, 80 percent or 85 percent of your initial payment—so your income won't be decimated by a prolonged market slump.

But while features such as a guaranteed floor on payments and access to the annuity's account value may make people feel more comfortable about buying an annuity, they also exact a cost. An access period option might add another 0.4 percent to the annual cost of the annuity, for example. And annuities that give you access to your money plus set a minimum on how low your payment can fall might add as much as an extra percentage point of costs. In short, you're adding yet another layer of expenses on top of the two layers of fees that are already built in. These higher expenses can significantly limit the amount your payments may rise when the market's cruising along to gains. Let's say, for example, you invest \$100,000 in a variable

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annuity, choose a 4 percent AIR, and receive an initial payment of \$628. If your subaccounts earn a steady 10 percent per year before expenses and your annuity deducts a total of 1 percent annually in fees, your payment would climb to \$1,577 in twenty years. If you earned the same 10 percent return but your annuity deducted 2 percent a year in fees, your payment would climb to just \$1,287, or *almost \$300 a month less*. Thus, by opting for protection against occasional market setbacks, you could be relegating yourself to roughly 20 percent less income in fifteen years.

### ***How Annuities Plus Other Investments Can Create a Retirement "Paycheck"***

Fortunately, there is a simple way to take advantage of the one feature annuities have that no other investment does—the ability to provide an income you won't outlive, without giving up too much of that income to high fees and without giving up access to all your retirement assets; in other words, a solution that gives you the security of annuities and the flexibility and control of managing withdrawals from your portfolio on your own. Basically, that solution comes down to this: invest a portion of your retirement portfolio in one or more low-cost annuities that provide a lifetime income but none of the expensive options I mentioned above, and keep the rest of your money in a portfolio of mutual funds and/or stocks and bonds that you can draw from as needed to meet your living costs or to pay for unexpected expenses or the occasional splurge.

What's great about this solution is that it allows you to get more income from your assets than you could by simply managing your withdrawals on your own, plus it reduces the chances that you will outlive your money. And, just as important, it allows you to effectively create a retirement "paycheck" that consists of the income from your annuities plus withdrawals from your portfolio.

To get an idea of how this approach might actually work, consider the following hypothetical scenario I created with the help of the Chicago investment research firm Ibbotson As-

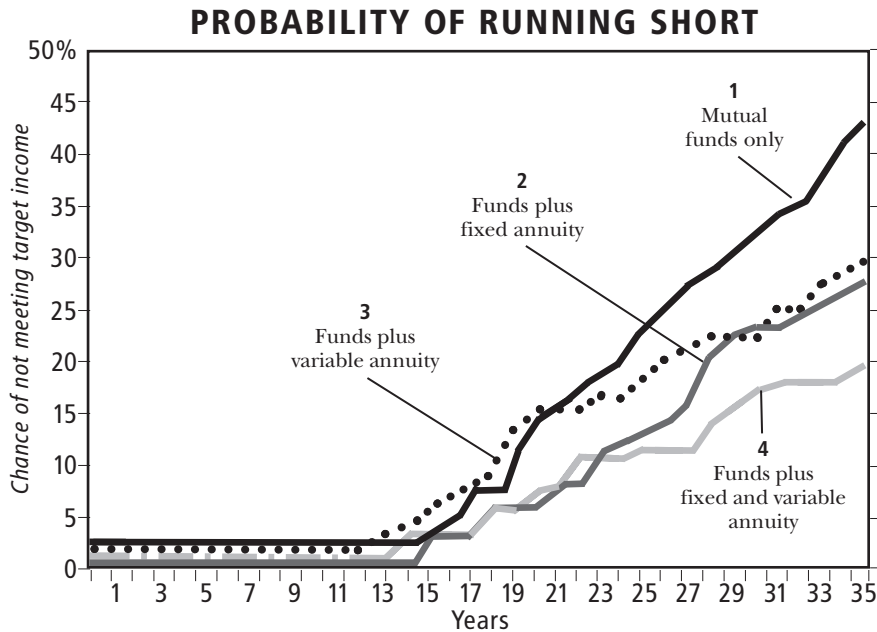
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sociates. Assume that a sixty-five-year-old man has savings of \$500,000, from which he would like to withdraw 5 percent, or \$25,000, in the first year of retirement and then increase that amount each year with inflation. And let's also assume this retiree has four different options for getting that \$25,000 income adjusted for inflation each year. He can simply pull the required amount from his portfolio each year, a process known as systematic withdrawal (for simplicity's sake, let's assume that the portfolio is invested in mutual funds, 70 percent in large-company stock funds and 30 percent in intermediate-term bonds). Or he can get a portion of the \$25,000 inflation-adjusted income by investing 25 percent of his assets in a fixed-payout annuity and the rest by taking systematic withdrawals from the remaining 75 percent of his assets that are invested in funds. Or he can get a portion of the \$25,000 inflation-adjusted income by investing 25 percent of his assets in a variable-payout annuity and the rest from the 75 percent of his assets in funds. Or he can get a portion of the income from investing 50 percent of his assets in annuities (25 percent each in fixed and variable annuities) and the rest from the remaining 50 percent of his assets in funds.

Ibbotson ran computerized simulations using long-term historical results for stocks, bonds, and inflation to gauge our hypothetical retiree's chances of getting that inflation-adjusted income for the rest of his life under each of the four options above. The idea was to see which of the options had the lowest chance of falling below the target income level. The graph on page 263 summarizes the results.

Notice how the option of just pulling money out of the portfolio (line 1) works just fine for the first ten to fifteen years. Trouble is, when our fictional retiree gets beyond age eighty, the risk of his money running out rises rather steeply. If our retiree is lucky enough to have a very long life span, the chances that he'll run out of money can get pretty high. There's more than a 30 percent chance, for example, that his portfolio will run dry by age ninety-five and a higher than 40 percent chance it won't make it to his one hundredth birthday.

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But look at how the odds of falling below the target level of income drop when our retiree puts a portion of his assets into one or more annuities. For example, putting 25 percent of his assets in a fixed annuity (line 2) lowers the odds of running short by age ninety-five to less than 25 percent and by age one hundred to less than 30 percent. Similarly, investing 25 percent of his money in a variable annuity (line 3) also lowers the odds of falling below the target later in life. And the fourth option—investing in both fixed- and variable-payout annuities plus keeping assets in mutual funds (line 4)—does the best of all, reducing his odds of falling below the target level of income to just a bit over 15 percent by age ninety-five and less than 20 percent at one hundred—a big improvement from a straight systematic withdrawal strategy. In short, adding the annuities can substantially reduce the odds that you’ll run short of money in retirement.

What’s more, the hybrid approach I’m recommending has other advantages you can’t see on the graph. If you rely solely on withdrawals from your portfolio and your portfolio runs dry,

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that's it. You're broke (although in reality you would probably begin taking smaller withdrawals before that happened). But when you own an annuity, the income never completely stops. You may fall short of your targeted withdrawals, but you will still get some income as long as you're alive. The graph also doesn't reflect the potential upside with a variable annuity. If the stock market delivers generous returns, it's possible the variable annuity payments alone could increase enough to provide your target income. Which means you could increase your target income and live a more lavish lifestyle—or you could let your regular portfolio's value rise and leave a nice legacy for your heirs.

Keep in mind, though, that these results are probabilities based on the types of returns the financial markets have generated in the past, not guarantees. If stocks and bonds deliver lower results in the future, the risk of running dry using my hybrid strategy will increase (although they'll likely increase even more if you rely solely on withdrawals from a conventional portfolio). This analysis also assumes you keep investment costs down by buying a low-cost annuity and that you invest in low-cost index funds in your regular portfolio. If you try this strategy with higher-cost annuities and higher-cost funds, your odds of falling below your target income will increase.

Remember, too, that this hybrid solution isn't all gain with no pain. In return for the security you get from investing a portion of your assets in an annuity, you give up control over some of your assets, which could restrict your financial maneuvering room in the future. And if you take the hybrid approach and you die before the end of your life expectancy, your heirs may end up with less than they would have gotten had you not allocated some of your money to an annuity.

How much money should you consider investing in one or more annuities to create a lifetime income? There are no handy rules of thumbs or guidelines that can lead you to a "correct" percentage. I can't imagine a scenario where it would make sense to annuitize all your assets, since that would be placing too large a bet on one investment. And since you would be

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giving up access to the assets you annuitized, you would be limiting your flexibility for dealing with life's unanticipated financial demands. Similarly, you may not need an annuity at all if you've accumulated so much wealth that your annual withdrawals would be so small relative to your portfolio's value that the chances are minuscule you would run out of money.

Beyond those extremes, however, deciding how much of your assets you might consider devoting to an annuity is largely a subjective affair. The percentage that's right for you depends on such factors as how much money you've saved, how much income you need, how long you think you're likely to live, how concerned you are about running short, and how much money you think you'll need on hand for unanticipated expenses and such. The greater you feel your chances are of living a long life and the more concerned you are that you might outlive your money, the more of your assets you would want to devote to annuities. Even then, however, you'll want to be sure to have enough money outside your annuities to meet unexpected expenses, to pay for the occasional vacation or other indulgence, or to leave a legacy to your heirs. One approach is to try to cover as much of your essential living expenses (the cost of food, clothing, housing, medical care, etc.) as possible with payments from regular sources of income such as Social Security, company pensions, and annuities, and then rely on withdrawals from the rest of your portfolio to fund discretionary spending and emergency expenses. All in all, however, I think it would be reasonable for most people who decide they need the stability of a reliable lifetime income to consider devoting somewhere in the neighborhood of 25 to 50 percent of their retirement assets to payout annuities.

Another major issue you must address if you think a payout annuity might be right for you is which assets to annuitize: the pretax money in accounts such as 401(k)s and IRA rollovers, or investments such as stocks and funds that you hold in taxable accounts. One argument for using taxable dollars to buy a payout annuity is that annuities offer a special tax benefit when they're funded with taxable dollars. A portion of each

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payment you receive is considered a return of your original investment rather than a gain on your capital, and thus it goes untaxed. This, in effect, increases the after-tax value of each payment. But annuities also have a tax disadvantage in that all gains are taxed as ordinary income, even long-term capital gains, which are normally taxed at lower long-term capital gains rates.

Because of this tax peculiarity, some financial advisers think you're better off using money in tax-deferred accounts like 401(k)s and IRAs to buy a payout annuity. They figure that the money you withdraw from such accounts will be taxed at ordinary income rates anyway, so why not use this money for the annuity and take advantage of the more favorable capital-gains treatment in your taxable accounts? Of course, when it comes time to retire, most of us will probably have the bulk of our retirement savings in tax-deferred accounts like 401(k)s and IRAs. So as a practical matter, these accounts will probably be the main source for any money we want to invest in an annuity. Still, if you have substantial assets in both taxable and tax-deferred accounts, you might consider having an adviser crunch the numbers both ways to see whether funding the annuity with taxable or tax-deferred assets, plus withdrawals from the remainder of your portfolio, works best in your situation.

### **Tips for Choosing an Annuity**

The variety of payment options and different layers of fees can make it devilishly difficult to know whether you're getting a good deal on an annuity. You'll increase your odds of getting the best value for your money by following a few guidelines.

#### ***Get Quotes from Several Insurers***

Since life expectancy estimates can and do vary among insurers, the payments you'll receive can also vary from insurer to insurer, often by 10 percent or more. Similarly, the initial payment you receive on a variable annuity can vary substantially. You can compare current quotes on fixed-payment annuities by

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going to the WebAnnuities.com site ([www.immediateannuities.com](http://www.immediateannuities.com)). For a quote on the initial payment on variable annuities, you typically have to contact each insurer separately, although you can find quotes from a handful of insurers by going to the Product Center of the AnnuityNetAdvisor site ([client.annuitynetadvisor.com](http://client.annuitynetadvisor.com)) and clicking on Annuity Payout Quotes.

### *Opt for Low Fees*

With a fixed-payment annuity, you don't have to worry about annual fees. The payment already reflects the fees. With variable-payout annuities, however, you receive an initial payment that goes up or down depending on investment performance net of two sets of fees—insurance charges (often listed separately as mortality and expense charges and administrative fees) and portfolio expenses. By opting for an annuity with low expenses, you increase the chance your payments will rise in subsequent years. To find both insurance charges and portfolio expenses, check the fees section of the prospectus. One caveat: Some insurers keep expenses low by waiving a portion of their insurance charges and/or portfolio fees. But the insurer still has the right to boost these fees in the future. Since you're effectively locked into an annuity once you begin receiving payments, you should think hard before buying an annuity where the fees could jump substantially if the waiver is revoked.

### *Stick to High-Quality Companies—and Diversify*

When you buy a payout annuity, you're counting on the insurer having the financial wherewithal to make those payments years and years into the future. (There are state guaranty funds to protect annuity holders, but their coverage is usually limited to \$100,000 and can sometimes take a while to kick in.) So limit yourself to solid, reputable companies that get high financial strength ratings from firms such as A. M. Best ([www.ambest.com](http://www.ambest.com)), Standard & Poor's ([www.standardandpoors.com](http://www.standardandpoors.com)), and Moody's Investors Service ([www.moody.com](http://www.moody.com)). For an extra bit of security, you should consider diversifying—that is, splitting your money among two or more annuities from high-quality



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companies. This way, should one insurer run into trouble, payments should continue without interruption from the others.

### *Don't Annuitize All Your Money at Once*

To give yourself more financial maneuvering room in the event your needs change, consider annuitizing your money in two or three chunks over a few years rather than doing it all at once. Besides, the payment you get from a fixed-payout annuity depends largely on the current level of interest rates. If you put all your money into an annuity when rates happen to be very low, you've essentially relegated yourself to a lifetime of low payments. Annuitizing in stages makes it less likely you'll annuitize all your money at the worst possible time.

## **Develop a Tax-Smart Withdrawal Strategy**

Ultimately, of course, your goal during retirement is to get as much income as possible out of the savings you've accumulated during your career—or, looked at another way, to make that money last as long as possible. One way you can squeeze the most out of your retirement portfolio is to draw on it as tax-efficiently as possible—that is, manage your withdrawals so that as little as possible gets siphoned off by the IRS and state tax authorities.

Again, there's no single strategy that guarantees you'll get the most income out of your portfolio or assures it will last the longest. But, generally, you have the best chance of minimizing the tax bite and leaving more money for you by following the following guidelines.

### *Start by Drawing from Your Taxable Accounts*

If you hold investments such as mutual funds, stocks, bonds, and CDs in taxable accounts, it's likely they are regularly throwing off some sort of taxable gains in the form of dividends, interest payments, and, in the case of mutual funds, capital-gains distributions that you're being taxed on every year. In general, it pays to make these assets your first source of income. For one

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thing, you're already paying tax on the dividends, interest payments, and gains themselves, so you might as well spend them. And second, if you hold these assets, they'll continue to throw off gains that are often taxable at the highest income tax rates. Selling them for income, on the other hand, allows other assets that do a better job of sheltering their gains from taxes to grow, giving you access to a larger source of income after your taxable assets run out.

But not all your assets in taxable accounts are equally vulnerable to taxes. Municipal bonds, for example, generate interest that is free from federal taxes and in some cases state taxes as well. Individual stocks can also be tax efficient, in that you don't pay any gain on the increase in its share price until you actually sell—and if you hold the stock longer than a year, you pay tax at long-term capital-gains rates, which are lower than the rates on dividends, interest, and short-term gains. Even certain types of mutual funds—index funds and tax-managed funds, for example—allow you to effectively shelter much of their gains from taxes both by holding on to them for a long time and by paying tax on your eventual gain at the long-term capital-gains tax rate.

So when drawing from your taxable accounts, look first to the investments that tend to generate the biggest tax bills and then move on to more tax-efficient assets such as muni bonds, individual stocks in which you have built up large long-term capital gains, and index and tax-managed mutual funds.

#### ***Next, Move on to Tax-Deferred Retirement Accounts***

After you've gotten as much as you can out of your taxable portfolio, you can then dip into tax-deferred accounts such as 401(k)s and IRAs. The reason it pays to avoid tapping tax-deferred accounts first if possible is that assets in tax-deferred accounts can grow more quickly than assets in taxable accounts because their gains aren't being eroded by taxes. Thus, the longer you leave your tax-deferred assets untouched, the more they can compound without the drag of taxes, and the larger a tax-deferred stash you'll have when you eventually begin

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drawing from it. Keep in mind, though, that at some point the government requires that you start pulling money from tax-deferred retirement accounts such as 401(k)s and IRAs (though not Roth IRAs). And if you don't withdraw the right amount, you can be hit with some staggering penalties. I'll deal with the required minimum distribution, or RMD, rules, on page 272.

Once you do begin taking money from these accounts, your withdrawals will be taxed at ordinary income tax rates. One exception: if you made nondeductible contributions to your IRA (or to a 401(k) that was then rolled into an IRA), then only the *gains* on those contributions are taxable. You've already paid tax on the nondeductible contributions themselves, so you aren't taxed again when that money is returned to you. Unfortunately, our tax laws don't allow you to withdraw all your nondeductible contributions first in order to create a tax-free income. If you have made nondeductible contributions, the IRS considers only a pro rata portion of each withdrawal a nontaxable return of your nondeductible contributions. After you've recouped all nondeductible contributions you made, the entire withdrawal is taxable.

### ***Save Money in Any Roth IRA Accounts for Last***

There are several reasons why you want to hold off as long as possible on tapping any assets you may have in Roth accounts. First, once you're over age fifty-nine and a half and the money has been in the account at least five years, all withdrawals from your Roth accounts are tax free. So not only are your investments in a Roth growing without the drag of taxes, neither those gains nor your original contributions will ever be taxed. Second, unlike a traditional IRA, which requires you to begin withdrawing money after age seventy and a half, Roths have no required withdrawals. So you can let the money rack up tax-free gains in the account as long as you want. Finally, Roth IRA assets can also be passed along to heirs free of income tax. Thus, the longer you let your money ride untouched in a Roth, the larger the tax-free stockpile of assets you will have in the future, either for your own retirement needs or to leave as a legacy to your heirs.

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Of course, things don't always work out quite so neatly in real life. You may face circumstances that might lead you to draw down your assets in a different way than I suggest above. For example, if your retirement savings are so large (or your income need in relation to your assets so small) that it's unlikely you'll deplete your portfolio in your lifetime, then you might want to consider spending tax-deferred assets first. The reason is that assets in tax-deferred accounts are generally taxed more heavily than those in taxable accounts upon your death. If you plan on leaving assets to heirs, you're probably better off leaving them assets such as stocks or mutual funds held in taxable accounts since the cost basis of those assets steps up to market value when you die. That means your heirs pay tax only on gains earned after they inherit the stocks or funds, not on the unrealized gains that accumulated during your lifetime. There may be other reasons related to estate taxes that might lead you to draw from certain assets before others. Federal estate tax rules get complicated quickly, not to mention the fact that the revisions to estate taxes enacted during the summer of 2001 have a unique reversion provision that could be triggered in 2011 and put all the rules back to the way they were years before. (Of course, Congress could change that reversion provision in the meantime, so you'll have to keep tabs on what our esteemed legislators do between now and 2011.) If you expect to leave a sizable estate—certainly anything over \$1 million—it's probably worthwhile to consult an estate tax attorney or financial planner who deals in such issues.

Similarly, there may be years in which you fall into a much higher income tax bracket than other years. In those years, you might want to sell stocks to produce gains that will be taxed at lower long-term capital-gains rates or, for that matter, take tax-free withdrawals from your Roth IRA to avoid paying additional tax at the high rate altogether.

There may also be opportunities for you to play the tax laws to your advantage by selling stocks or funds in your taxable ac-

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counts at a loss. You can then lower your tax bill by using that loss to offset other gains you may have taken; failing that, you may be able to apply as much as \$3,000 of the loss each year against ordinary income. One warning, though: It's easy to get tripped up by the regulations covering securities losses and taxes. So before you begin selling securities for tax purposes, I suggest you take a look at the IRS publication that details all the government's nitpicking rules: Publication 550, "Investment Income and Expenses" (available at the IRS's website, [www.irs.gov](http://www.irs.gov)). It's not exactly a scintillating read, but it's better to know the ins and outs of this area beforehand rather than find you can't deduct a loss because you ran afoul of some arcane provision of the tax code.

### Doing the Minimum

When you reach age seventy and a half, federal law requires that you begin pulling at least *some* money out of tax-deferred retirement accounts such as IRAs. (Roth IRAs are exempt from this requirement, and you can hold off taking distributions from your 401(k) as long as you're still working at the company.) This is *not* a matter of choice. You must withdraw at least the minimum stipulated by the IRS, or what is called your required minimum distribution (or RMD). If you fail to withdraw this amount, you can be hit with a big tax penalty—50 percent of the difference between what you should have withdrawn and what you actually withdrew.

It used to be that you practically had to be an actuary or a math whiz to figure out your RMD. But in a rare magnanimous gesture a couple of years ago, the IRS simplified the rules so that now even mere mortals can figure out how much they must withdraw each year. The new rules also require smaller distributions than in the past, which means that more of your assets can continue to grow free of taxes (assuming, of course, you can afford to withdraw only the minimum).

So, how do you determine your RMD? One way is to use the table on page 274. Let's say, for example, you reach age seventy

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and a half early in 2004 and will turn seventy-one that same year. By law, you must begin withdrawals from your 401(k) or IRA, although you can actually postpone making that first withdrawal until April 2005. To determine the size of your withdrawal, you take the balance of your IRA at the end of 2003 (the year before the required withdrawal) and divide that balance by the appropriate life expectancy figure in the table on the next page. In this case, the figure would be 26.5 years, since you turn seventy-one the year your required withdrawals begin. So if your IRA balance had been \$100,000 at the end of 2003, you would divide \$100,000 by 26.5 to come up with a required withdrawal of \$3,774. As I said, you can wait until April 2005 to actually make that withdrawal. But if you do, you will still also have to make your withdrawal for 2005 by the end of 2005. In that case, you would take your IRA balance as of the end of 2004 and divide by 25.6, the life expectancy figure for age seventy-two.

There are a few other wrinkles you should know about. You use a different table to figure your minimum if the sole beneficiary of your IRA is a spouse who is more than ten years younger than you or if you are withdrawing money from an IRA that you've inherited. If you fall into either of those categories, you'll find the appropriate table in IRS Publication 590, "Individual Retirement Arrangements," which is available at the IRS's website ([www.irs.gov](http://www.irs.gov)). If you have more than one IRA, you figure your required withdrawal for each one, although you can total the separate minimums and take the combined amount from any one or more of your accounts.

### ***Five Tips for Staying on the Yellow Brick Road of Retirement Security***

Ultimately, your goal once you've finally retired is to do everything you can to ensure that the various resources you've accumulated during your career—your Social Security, your pensions, your investments—support you in retirement as well as they can for as long as they can. At the same time, of course, you don't want to spend every minute of retirement obsessing

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**CALCULATING YOUR MINIMUM DISTRIBUTION**

<b>YOUR AGE*</b>	<b>DIVIDE YOUR IRA BALANCE BY THIS FIGURE†</b>	<b>YOUR AGE</b>	<b>DIVIDE YOUR IRA BALANCE BY THIS FIGURE</b>
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 or older	1.9

*Source:* IRS

\*Age based on your birthday in the year you become seventy and a half.

†Life expectancy in years; IRA balance as of end of year prior to year of required withdrawal.

about your finances and agonizing over every investment move you make. After all, retirement is supposed to be a time when you enjoy life a bit, a chance for you to get to do some of the things you didn't have time to do during your working days.

But if you've set the stage for retirement in the ways I've described throughout this book, you should be able to achieve

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your goal of financial security throughout retirement while still leaving yourself plenty of time and opportunity to make your retirement years fulfilling. Toward that end, I'll leave you with five final recommendations that, along with a bit of thought and not too much effort on your part, can maintain your retirement plan for the rest of your life. Think of them as my five tips for staying on the yellow brick road of retirement security.

#### ***Set a Modest Initial Withdrawal Rate***

You will vastly increase the chances of your retirement savings lasting for the rest of your life if you start with a conservative initial withdrawal rate—say, 3 to 5 percent of your portfolio. Granted, that may require you to live a bit less luxuriously than you might want to, especially if you've been looking forward to indulging yourself a bit after leaving the workaday world. But better to tighten your belt a little in the early stages of retirement than to find yourself with no retirement savings left at age ninety. Besides, if you're smart or lucky enough to earn good returns on your portfolio, so that its balance holds its own or even begins to swell, you always have the option of boosting the size of your withdrawals later on.

#### ***Take Taxes into Account***

Your investing decisions during retirement shouldn't be solely driven by taxes, of course. But by managing your withdrawals to play the tax code to your advantage, you can increase the size of the after-tax withdrawals from your portfolio and/or substantially reduce the odds of your portfolio running out of money. So set aside a bit of time on several occasions during the year—and definitely a month or so before the end of the year, so that you still have time to make last-minute changes—to consider how your tax situation is shaping up for the current year and might look in the year ahead. Maybe the withdrawal strategy that was the pinnacle of tax efficiency a few years ago no longer makes sense for you because of changes in the tax code or changes in your investment holdings. Or perhaps a review of your stocks and funds will reveal holdings that you may want to



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unload for a loss that you can use to reduce the tax on other gains. The important thing to remember is that every dollar you can avoid paying in taxes is another dollar that can help pay your retirement living expenses or stay in your portfolio to extend its life.

### *Make Periodic Reality Checks*

If there's one lesson we can all take from the experience of the last few years, it's that fast-changing conditions in the financial markets can have profound changes on one's retirement prospects. In the late 1990s, stocks were delivering such high returns and seemed so certain of continuing to do so that many retirees convinced themselves that they were sure to live out their golden years in luxury as long as they kept all or most of their money in stocks. That rosy outlook quickly turned much bleaker, however, when stock prices began their long slide in early 2000. But investment returns aren't the only variable that can change. Rising medical costs, a hike in property taxes, a spike in inflation, major house repairs—all these things and more can increase your living expenses and put unanticipated demands on your retirement savings. That's why it's crucial that you conduct periodic reality checks to see whether you're able to get by on the income you projected or whether your retirement income needs have increased. You'll also want to reevaluate the balance of your portfolio with an eye toward whether you can still manage the withdrawal rate you set originally. At the very least, you should go through the exercise I described earlier in the chapter of gauging the odds of your portfolio lasting the rest of your life given the amount of money you have remaining in your various investment accounts and how you have the assets in those accounts invested.

### *Make Adjustments Along the Way*

A retirement income strategy isn't something you can create and then just leave alone—at least not if you expect it to remain effective throughout retirement. The fact is that no plan, no matter how well thought-out and sophisticated, can foresee all

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the possibilities you might have to deal with. So in order to keep your plan on track, you should expect to make some adjustments along the way. For example, if the conservative portfolio mix of 50 percent stocks and 50 percent bonds you set isn't generating high enough returns to sustain your withdrawals over your lifetime, perhaps you need to take a bit more investing risk and increase your stock exposure. On the other hand, you might consider looking for ways to pare back your withdrawals a bit. You could also consider taking a part-time job so that you maintain the income you need but take some of the pressure off your portfolio. Or you might consider all three moves. What's most important, though, is that you address problems early on, when you have a better chance of solving them with small adjustments. The longer you wait, the greater the chance the problem will have grown so large that you may have to resort to drastic changes that could have a lower probability of success.

### *Have Fun*

With all the emphasis on the financial aspects of retirement planning, it's easy to overlook the reason we go through the process at all: so that we can enjoy ourselves in retirement. So by all means, take the time to plan, monitor your progress, and make appropriate adjustments to your plan so you can attain a good measure of financial security in this stage of your life. But retirement planning is a means, not an end in itself. So don't let the planning get in the way of living a happy and fulfilled life. You get only one retirement. Enjoy it while you can.