ABOVE THE CANOPY

5 Steps to Ensuring a **Comfortable Retirement**

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About Us

educate you on the many retirement and investment decisions you'll face. We love to work with:

- Entrepreneurial people and families: small business owners, business executives, physicians, attorneys, and anyone else who's focused on defining their career and their life
- People seeking to reduce stress when it comes to financial decision making
- People seeking to simplify their life by organizing and improving their finances
- Small to mid sized businesses. I help build and manage 401(k), 403(b), profit sharing, and other retirement plans.

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every month...

5 Steps to a Comfortable Retirement

Transitioning into retirement is one of the biggest life changes you'll ever experience. You'll likely spend far more time on your personal interests than in a structured work environment. But as appealing as seeing family, playing golf, and pursuing your other hobbies sounds, the psychological transition can be daunting.

During your working years you're probably collecting a somewhat steady paycheck. This money is used to fund your monthly living expenses & pay taxes, with whatever is left over padding your savings. With each deposit your savings, retirement nest egg, and net worth rise. You are in the accumulation phase of life. When you **stop** working, so do the additions to your net worth. Rather than padding your accounts with each paycheck, you'll instead need to withdraw from them to pay your living expenses.

This transition from the accumulation phase into retirement is a ***massive*** change, and requires thoughtful planning to navigate successfully and avoid disaster. Retiring
mean you'll need to return to work in the middle of your retirement. Or worse, rely on your kids or other family members for support.

The hardest part about making the transition is that you can't know exactly how much you'll *need* in retirement. How long will you live? What will your healthcare costs be in 20 years? What if there's

an emergency? How do you know you've saved enough? These are all important questions that are impossible to answer.

Fortunately, diligent preparation can ensure you have an adequate safety net and high probability of success in retirement. While you can't know exactly how long you'll live or what your monthly expenses will be in 20 years, you can create a retirement plan that will succeed even in the very worst market conditions.

This 5 step guide will help you do just that – create a retirem

her you've saved enough to retire with
well on your way.

1. Estimate Monthly Expenses in Retirement

to fund your retirement is determining what you expect to spend each month in retirement. There are two main ways to produce this estimate:

1 *Start From Scratch*

Grab a blank piece of paper and start jotting down everything you think you'll spend money on in retirement. Make sure to include all your housing costs, utilities, food, travel & fun money, and expected healthcare costs. If you're expecting to make major lifestyle changes with your additional free time, make sure to incorporate those as well. Spending an extra 3 days on the golf course every week can add up quickly.

2 *Start With Your Current Take Home Pay*

You can also start with your current income after taxes and make adjustments. If there are expenses currently coming out of your paycheck that you'll be responsible for in retirement, add those to the total. Also add the additional costs of other lifestyle changes.

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Then, subtract any of your current expenses that will stop once you retire. This might include mortgage payments, commuting costs, or take home pay you're currently saving in a brokerage account or IRA.

Here's an Example:

John makes $120,000 at his job, which he and his wife Jane use to pay their bills and fund their retirement savings. He plans to retire later this year. Their employer shares the cost of health care, and John's share is deducted from his take home pay. After he retires, he and Jane will enroll in Medicare.

Currently they save $500 per month for John's upcoming retirement. Afterward, they plan to take
e frequently, and Jane would like
to attend yoga each morning. John will no longer have commuting costs, and they expect all their other living expenses will remain the same.

Current	Monthly Income Before Taxes	$	10,000
	Take Home Pay After Tax & Deductions	$	6,850
Additions	*Included in Take Home Pay:*		
	Healthcare (Medicare Costs)	$	250
	Lifestyle Changes:		
	Travel	$	1,000
	Fishing	$	250
	Golf	$	500
	Yoga	$	350
Subtractions	Discontinued Current Expenses:		
	Additional Retirement Savings	$	(500)
	Commuting Costs	$	(125)
	Total Monthly Income Needed	**$**	**8,575**

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2. Add Up Guaranteed Income Sources

Now that you have an idea how much you'll *need*

t income from a mix of guaranteed and

non-guaranteed sources.

A **guaranteed** source of income is one that you can't outlive. You'll get a steady check each month

al markets. It's a source of income you

can count on no matter what. The most common guaranteed income sources are:

Social Security

If you've worked and paid FICA taxes for at least ten years throughout your career, you'll be eligible for

early as age 62. In most cases it makes sense

rategy that **maximizes** the lifetime value of

st strategy for you will depend on a number

s. Fortunately there are many great social

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security calculators available, and the Social Security Administration

igibility and

Pensions

elf fortunate.

Pensions are becoming a rare breed in America, as corporations seek to reduce their investment risks. Most large companies prefer contribution plans like 401(k)s, rather than a traditional pension. If you're expecting pension income, add it to your guaranteed monthly income.

oo, if you

have them.

Example:

nt. He's

t his

company for over 30 years, and has accumulated a monthly pension

eed

income is $5000.

Guaranteed Source of Income

You'll get a steady check each month throughout retirement, regardless of what happens in the financial markets.

3. Draw Up an Income Plan

Now you have a solid estimate of your monthly living expenses in retirement, along with how much guaranteed
as your **retirement income gap.**

Monthly Spending Need – Monthly Guaranteed Income = Retirement Income Gap

Your retirement income gap is the amount of money you'll need to produce each month using your retirement savings. Essentially you'll need to convert your nest egg into a consistent stream of income.

How will that happen you ask? There are two main choices. One is the fully *guaranteed* approach, the second is the fully *non-guaranteed* approach.

1 Annuitization: Fully Guaranteed

Annuitization is when you use a lump sum to purchase an annuity policy from an insurance company. In exchange, the insurance company promises to send you a check each month for the

rest of your (or you and your spouse's) life. While there are many
ed
income annuity.

This method is popular for many because it **protects** your savings
ck
and bond markets, the insurance company is obligated to keep sending you monthly checks. In other words, when you annuitize you're converting your savings into *guaranteed* income, and transferring investment risk from you to an insurance company.

Annuities do have their downsides though. After you buy an annuity policy, you no longer have total control over your savings. This means that you may not be able to take withdrawals from the policy if there's an unforeseen expense or emergency. Returning the policy and reversing the transaction is not always possible, and when it is it can be very expensive.

understand. The policy above describes a very "plain vanilla"
le,
variable annuities allow you to invest in mutual fund like sub-accounts. Indexed annuities allow you to share in some of the

Retirement Income Gap

The amount of money you'll need to produce each month using your retirement savings.

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market's growth over time. Each have their nuances and cost structures.

Typically, the best annuities for consumers are the least expensive and easiest to understand. good rule of thumb is that the more complex an annuity gets, the better it is for the *insurance company and sales agent*, and the worse it is for you. The more complex products typically have higher up front sales charges & annual the straightforward, "plain vanilla" policies.

On top of this, annuity salesmen collect *huge* commissions for recommending the more complex products – as much as 9% of your initial investment. For this reason they're often sold unscrupulously and for the wrong reasons. Annuities **can** be a great way to produce guaranteed retirement income. But other than

2 Systematic Portfolio Withdrawals: Fully Non-Guaranteed

Rather than fork over your nest egg to an insurance company, you can always invest it on your own. Then, as you need to pay your bills, you can take withdrawals from your portfolio over time and deposit them in your checking account.

Whereas annuitization produces fully *guaranteed* retirement income, systematic portfolio withdrawals are fully non-guaranteed. The value of your invest

on your portfolio's performance. It's also possible to run out of money if you experience poor returns, you live longer than expected, or you spend too much.

That said, with the fully non-guaranteed approach you retain total control over your account. You can withdraw funds as you wish and will be prepared for unforeseen medical expenses or emergencies. Even though your monthly income might not be guaranteed, you can still manage it yourself and distribute whatever's left over after you die to whomever you wish. With annuities, the insurance company typically keeps any remaining balance after you die. Some policies give you ensive. Choosing one will reduce the

The Retirement Income Spectrum

If you think about it, the fully guaranteed approach and the fully non-guaranteed approach are complete opposites. And the space in between creates a spectrum, and is a blend of the two. There's no reason you couldn't annuitize a portion of your nest egg, and invest the rest as you wish.

A popular method for many retirees is to annuitize just enough of their nest egg to cover their most basic expenses. This means you'd have guaranteed income to pay your grocery & healthcare bills and keep the lights on, no matter what. All other expenses, like travel & fun money, would be covered by withdrawals from your portfolio. Even though they wouldn't be guaranteed, you'd still have some investments to leave to the rest of your family as you wish.

Retirement Income Spectrum

Fully Guaranteed		Fully Non-Guaranteed
Annuitization	*Anything in Between*	*Portfolio Withdrawals*

Fully Guaranteed (*Annuitization*)

Insurance Company Bears Investment Risk
No Control Over Nest Egg
Consistent Income For Life
Cannot Adjust Cash Flows For Emergencies

Fully Non-Guaranteed (*Portfolio Withdrawals*)

You Bear Investment Risk
Totoal Control Over Nest Egg
Withdrawals From Portfolio Constitute Income
Can Make Adjustments For Unforeseen Expenses
Remaining Funds Distributed As You Wish

Your Income Plan

Now it's time to create **your** income plan, and decide how you want to convert your retirement savings into monthly income. In other words, you'll now get to decide where you want to fall along the retirement income spectrum.

This will depend on a few things:

- How important guaranteed income is to you
- Your capacity & willingness to take risk
-

- Whether you want to retain control over your nest egg
- How you want to distribute your assets after you die

Example:

Let's revisit our friends John and Jane. We already know they need to produce $8575 each month to sustain their lifestyle through retirement. They're expecting $5000 per month in guaranteed income, and therefore have a retirement income gap of $3575. Let's also assume that they've accumulated a nest egg of $2,000,000.

$3575 each month for the rest of their lives.

If they opted for a fully non-guaranteed income stream, John and Jane would invest their entire nest egg and withdraw funds as they need them:

- $3575 * 12 = $42,900 withdrawal needed per year

Alternatively, they might decide to annuitize just enough of their nest egg to cover their living expenses:

- $3575 monthly income required
-
- The annuity guarantees $3575 per month for the rest of both their lives
- They invest the remaining $1,050,000 for a rainy day & inheritance for their kids
- This way, John and Jane get the best of both worlds. They guarantee their living expenses for the rest of their lives, and invest the rest to pass on to their kids.

Taking Taxes Into Account

To account for your tax liabilities you'll need to estimate your adjusted gross income in retirement.

They could also purchase an annuity to cover **only their most basic** expenses:

- $8575 monthly spending needs, of which $6500 is on essential items (food, utilities, family, etc.)
- After their guaranteed income of $5000, they'll need to annuitize just enough to provide $1500 in additional monthly income
- At current rates, this annuity costs John & Jane $400,000
- They invest the remaining $1,600,000. This money will be used for discretionary expenses like travel, and the remainder will be left to their kids.

Accounting for Taxes

When building your retirement income plan, it's important to take taxes into account. If your nest egg is in a retirement account like an IRA or 401k, you'll owe taxes on all the distributions. This means your withdrawals must be large enough to cover your tax liabilities.

To account for your tax liabilities you'll need to estimate your adjusted gross income in retirement. With that information, you can determine

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whether you'll need to take additional withdrawals from your nest egg to pay taxes each year. For this calculation you can use the following equation:

*Guaranteed Income + Non-Guaranteed Income – Tax Liability = Monthly Living Expenses * 12*

This can be confusing, so let's see how it might affect John and Jane:
Let's add another wrinkle to the story, and assume that John and Jane's nest egg of $2,000,000 is in an IRA, meaning it will be fully taxable upon withdrawal. Let's also assume that John's pension payments are fully

ble as income.[1]

Here's what their adjusted gross income would look like:

Pension Income: $3,000 * 12	$36,000
	$20,400
IRA Withdrawals: $3,575 * 12	$42,900
Adjusted Gross Income	**$99,300**

[1]Social security is taxed based on provisional income. Since John and Jane's provisional income would be greater than $44,000, confusing, so see IRS guidance or your CPA for more information.

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This amount of annual income would put John and Jane in the 25% federal tax bracket, and their total tax liability would be $16,412:

Tax Rate	Brackets (Married Filing Jointly)	Tax Owed
10%	Up to $18,450	$1845
15%	$18,450 - $74,900	$8467
25%	$74,901 - $151,200	$6100
	Total	**$16,412**

So, after taxes, John and Jane will need to withdraw extra funds (in bold) from the IRA in order to account for their tax liability. We want to know how much they'll need to withdraw each year in order to produce

to be $64,783 per year, or $5,399 per month:

Pension Income: $3,000 * 12	$36,000
	$20,400
IRA Withdrawals[2]: $5,399 * 12	$64,783
Adjusted Gross Income	**$121,183**

The resulting tax liability would be:

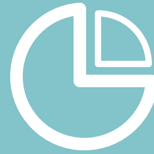
Tax Rate	Brackets (Married Filing Jointly)	Tax Owed
10%	Up to $18,450	$1845
15%	$18,450 - $74,900	$8467
25%	$74,901 - $151,200	$11,571
	Total	**$21,883**

And their after tax cash flow:

Pension Income: $3,000 * 12	$36,000
	$20,400
IRA Withdrawals[2]: $5,399 * 12	$64,783
Tax Owed	($21,883)
Annual After Tax Income	**$102,900**
Monthly After Tax Income	**$8,575**

As you can see, John and Jane will need to withdraw $64,783 from their IRA each year to account for taxes instead of $42,900.

[2]Since John and Jane's entire nest egg is in an IRA, it doesn't matter whether they purchase an annuity or take withdrawals from investments over time. In both scenarios the withdrawals would be considered taxable income.



4. Reality Check: Determine Your Margin of Safety

The moment of truth. Have you saved enough to retire on time? What's the likelihood that you won't run out of money? How can you know for sure? When it comes to retirement planning, there a few very convenient rules of thumb. This one you've probably heard of before:

The 4% Rule

So how much of your nest egg can you safely withdraw every year, without ever running out of money?

You've probably heard of the 4% rule before. It says that if you have a retirement portfolio invested in 60% stocks and 40% bonds, you'll never run out of money if you withdraw 4% of the portfolio each year.

This rule was developed by Bill Bengen in 1990. At the time Mr
curious about safe withdrawal rates throughout retirement. He wanted to know the maximum amount his clients could withdraw from their retirement portfolios each year, without ever running out of money.

tests". He started by using stock & bond market data from 1927, and using a 30 year retirement period he calculated the maximum percentage

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a retiree could withdraw each year without running out of money. In technical terms, he calculated the maximum safe withdrawal rate for 30 year the retirement period between 1927 and 1956.

Mr. Bengen thought that using the one rate that worked in every single scenario would provide a very safe rule of thumb. As you can guess, 4% was the result: anyone retiring between 1927 and 1960 could withdraw 4% each year from a 60/40 portfolio and never run out of money. In many periods the safe withdrawal rates were as high as 10% per year. But the one rate that worked in every single scenario, even under the worst market conditions, was 4%.

Since then it's become the widely adopted rule of thumb for retirement planning. Because the period Mr. Bengen tested includes a wide range of market catastrophes and economic cycles (the great depression, f 1987), the 4% rule is still accepted as a safe rule of thumb today. There have been a few recent criticisms of the 4% rule, but in general it's still a wonderful benchmark for retirement planning.

For your retirement plan it's wise to start with the same threshold. If you plan to withdraw less than 4% of your retirement portfolio each year throughout retirement, there's a very low likelihood you'll ever run out

The 4% Rule

If you have a retirement portfolio invested in 60% stocks and 40% bonds, you'll never run out of money if you withdraw 4% of the portfolio each year.

of money. If you need to withdraw more than 4% from your portfolio each year to meet living expenses, there's a higher likelihood you could run out of money at some point in your retirement. If your required withdrawal rate is above 4%, you may need to reconsider your plan.

Will John & Jane Make It?

After we accounted for taxes, our good friends John & Jane will need to withdraw $64,783 from their $2,000,000 portfolio each year. This works out to 3.24% per year – well under our 4% threshold. Based on historical data, even in the worst market conditions there's a very high likelihood they'll never run out of money.

5. Account for inflation

ing. As you know, the things we buy every day tend to get more expensive over time. Sour cream & onion Sun Chips (my favorite snack of all time) cost more today than they did 5 years ago, and they'll continue to get more expensive over time.

ertain things you'll need (namely healthcare) will increase at a faster pace. Plus, while some of your guaranteed income sources might adjust rs won't. This means that your purchasing power will decline over time as you age. In fact, over a 30 year retirement your purchasing power will decline **over 40%**

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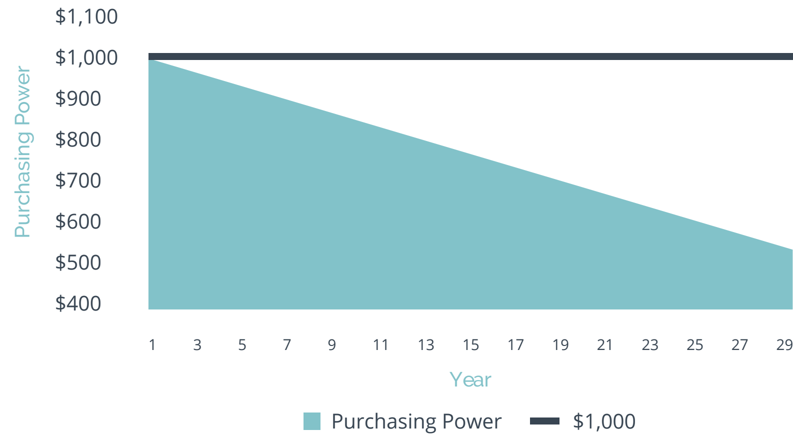
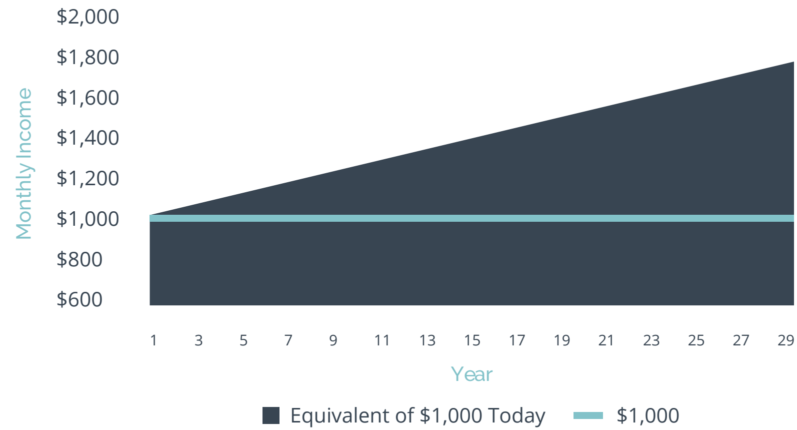

Purchasing Power Over Time
$1,100
$1,000
$900
$800
$700
$600
$500
$400
Purchasing Power
1
3
5
7
9
11
13
15
17
19
21
23
25
27
29
Year
Purchasing Power
$1,000


Inflation Effects Over Time
$2,000
$1,800
$1,600
$1,400
$1,200
$1,000
$800
$600
Monthly Income
1
3
5
7
9
11
13
15
17
19
21
23
25
27
29
Year
Equivalent of $1,000 Today
$1,000

good chunk of your assets invested in

their prices over time to keep pace. Plus, any portfolio growt

Bonds on the other hand are **greatly**

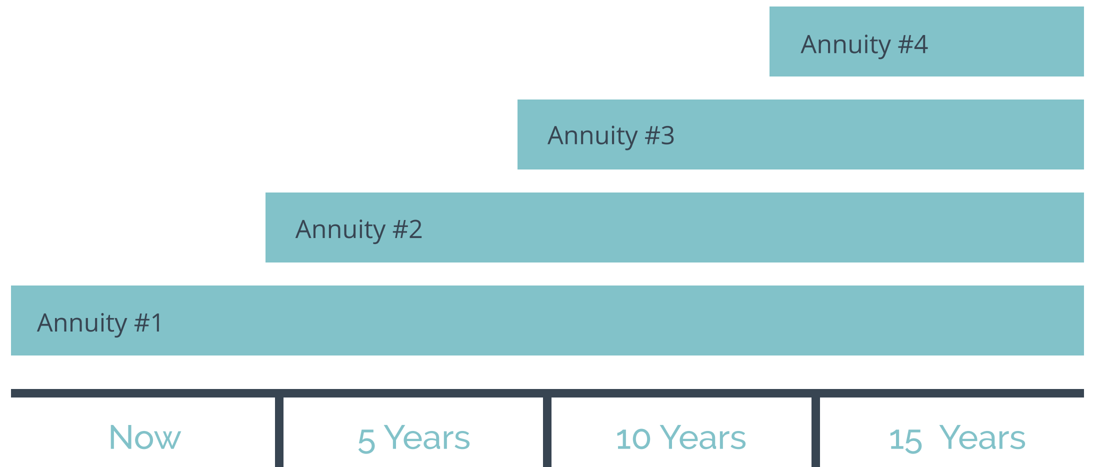
will take a big chunk out of your returns

unt based on current interest rates.

Some annuities have the option to increase income over time to

doesn't, you can always ***layer*** them over time:

- Rather than purchase one annuity that starts paying you income immediately, you could buy a series of
- tely
- The second annuity might pay you $100 per month, starting 5 years from now. Your balance in the policy will grow for 5 years until it begins distributions.
- Subsequent policies could also be purchased for later. This way you'd "give yourself a raise" every few years to help maintain your purchasing power.



The Laddered Annuity Strategy:

ill preserve your purchasing power over a 30 year retirement period:

- Start with the initial income you want to guarantee in year 1 w
- Purchase a deferred income annuity that pays **10% of your year one income, starting in year 5**
- Purchase another deferred income annuity paying **12% of your year one income, starting in year 10**
- Purchase a third deferred income annuity paying **14% of your year one income, starting in year 15**
- Purchase a fourth deferred income annuity paying **16% of your year one income, starting in year 20**
- **18% of your year one income, starting in year 25**

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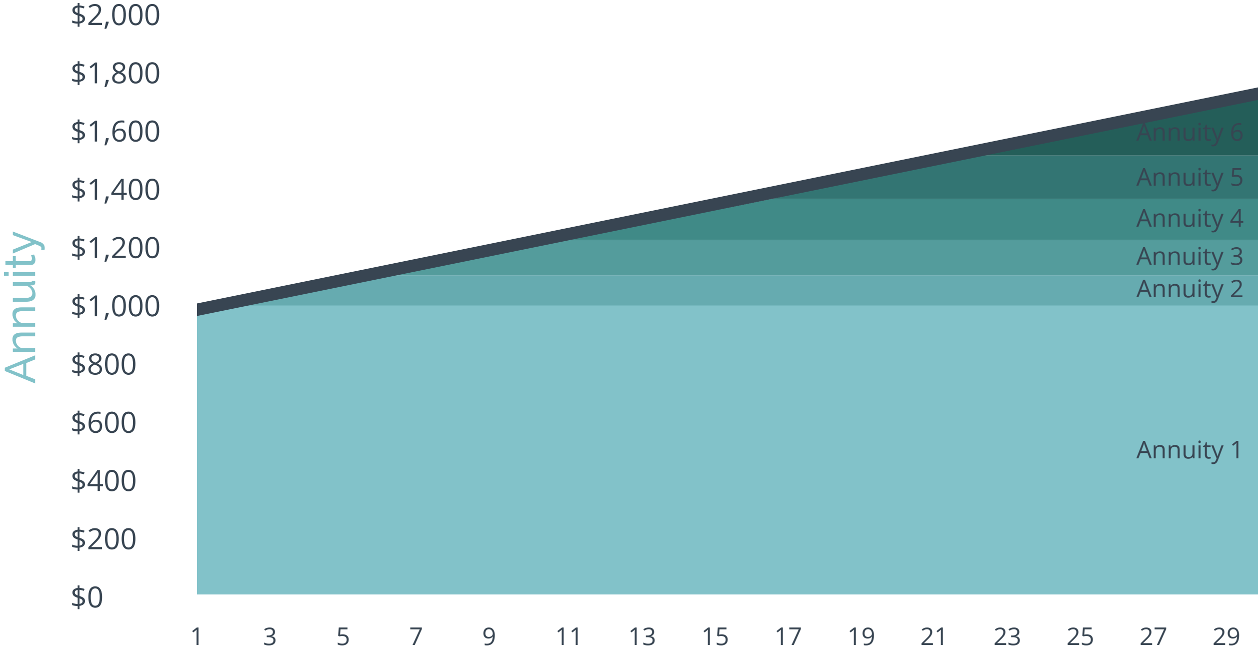
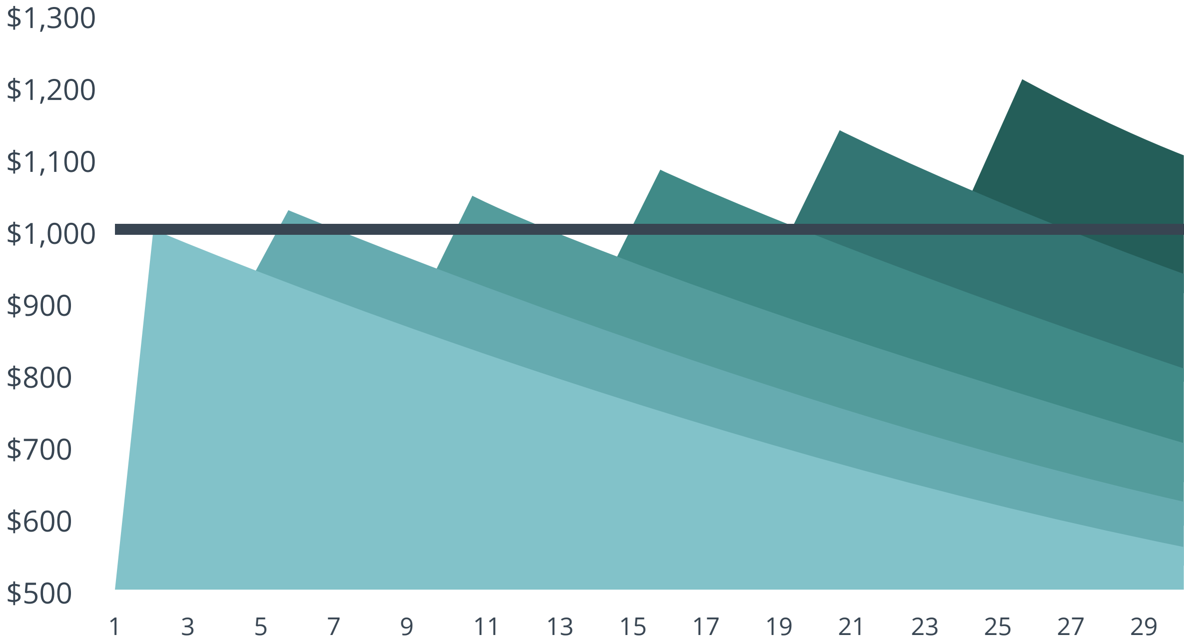
etirement:



As your purchasing power declines, the deferred income annuities will kick in to give you “raises” throughout retirement:



Bonus Step: Review Your Medical Insurance Coverage

For many retirees, healthcare is the expense that scares them most. Healthcare costs are rising faster than
rs down the road.

Planning ahead can help minimize these costs. As you probably know, Medicare won't be available until you turn 65. If you'll be retiring before then you'll need to make sure you have coverage. This can come from a few places:

-
- COBRA
- Private Insurance

Your Current Employer

es through retirement these days.
But if you have access to one, use it. The coverage will likely be very similar to what you had during your
ctors or change your prescriptions.

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COBRA

. It's meant to help people maintain coverage while they're in between jobs, by remaining on their employer's health plan after they leave the company. It can be expensive though, and usually only lasts up to 18 months. While you're employed, your company probably covers a portion of your premium costs. After you stop working, they'll pass the total cost on to you. All in all, COBRA works best if you're planning to retire shortly before turning 65.

Private Insurance

overage on your own. This may seem scary, passed. Insurance companies are no longer allowed to charge you more or deny coverage for preexisting conditions. Each state also now has health care exchanges, making it easier to sign up. The polici transparent too, which will help you forecast total costs.

In Sum

Whatever your retirement plan looks like, whether you decide to annuitize your savings or withdraw from them over time, make sure you have a well thought out plan with a decent margin of safety. If your ation and healthcare costs, you're already

For more tips and tools to help you maintain a comfortable retirement, be sure to check out my blog!

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