THREE
OAKS
WEALTH
REGISTERED INVESTMENT ADVISER

The 5 Step Retirement Income Plan

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 retirement nest egg & 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 too early without sufficient savings could 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.

Navigating Retirement Planning

The hardest part about making the transition is that you can't know exactly how much money 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?
- What if you haven't saved enough?

These are all important questions 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 retirement income plan that gives you confidence in your financial position.

You shouldn't have to worry about whether you've saved enough to retire with independence and dignity. Follow these five steps and you'll be well on your way.

01 Estimate Monthly Expenses in Retirement

The first step to knowing whether your nest egg is large enough to fund your retirement is determining what you expect to spend each month in retirement.

To produce this estimate, grab a blank piece of paper and jot down everything 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 three days on the golf course every week can add up quickly.

02 Add Up Guaranteed Income Sources

Now that you have an idea how much you'll need throughout retirement, you can start figuring out where the cash flow will come from. Most all Americans draw retirement 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 you can't outlive, regardless of what happens in the financial markets. It's a source of income you can count on no matter what. The most common guaranteed income sources are:

Social Security

You can start collecting payments as early as age 62. In most cases it makes sense to postpone your benefits though, since doing so will increase your benefit amount for the rest of your life.

You'll want to find the strategy that maximizes the lifetime value of your benefits AND matches your cash flow needs and tax planning strategy.

Pensions

If you'll receive pension benefits in retirement, consider yourself fortunate. Pensions are becoming a rare breed in America, as corporations seek to reduce their investment risks.

Add any expected pension benefit to your guaranteed monthly income. Include other benefits like deferred compensation arrangements too, if you have them.

03 Draw up an Income Plan

Now you have a solid estimate of your monthly living expenses in retirement, along with how much guaranteed income you can expect. The difference between the two is known 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.

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 shapes and forms of annuities, the most basic structure is a fixed income annuity.

Systematic Portfolio Withdrawals | Fully Non-Guaranteed

Rather than fork over your nest egg over to an insurance company, you can always invest on your own or with the help of a professional.

You then take withdrawals from your portfolio over time and deposit them in your checking account.

Since you're taking the investment risk in this approach it's 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 accounts. You can withdraw funds as you wish and will be prepared for unforeseen medical expenses or emergencies.

Your Income Plan

Choosing between a fully guaranteed and fully non-guaranteed income will depend on a few things:

- **How important guaranteed income is to you**
- **Your capacity & willingness to take risk**
- **How much flexibility you want**
- **Whether you want to retain control over your savings**
- **How you want to distribute your assets after you die**

You don't need to fall on one end of the spectrum either. Many retirees prefer a mix, where some of their expenses are guaranteed through annuitization and others are paid for by withdrawals from their accounts.

04 Reality Check. Determine Your Margin of Safety

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?

The 4% Rule

The 4% rule states that a portfolio invested 60% in stocks and 40% in bonds can safely withdraw 4% of the initial value (plus inflation) each year over a 30 year retirement.

This rule was developed by a financial planner named Bill Bengen in 1990. At the time Mr. Bengen was curious about safe withdrawal rates for his own clients' retirement.

To figure this out, Mr. Bengen ran a series of "stress tests". He started by using stock & bond market data from 1927. Using a 30 year retirement period he calculated the maximum percentage a retiree could withdraw each year without running out of money.

The first period ran from 1927 to 1956, the second from 1928 to 1957, and so on. While many of the 30 year periods he evaluated allowed for withdrawals as high as 7%, 8%, and even 10%, the one rate that worked in every scenario 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, World War II, extreme inflation in the 1970s, the market crash of 1987), the 4% rule is still accepted as a reasonable rule of thumb today.

While it's not free from criticism, it's an acceptable starting point: if you plan to withdraw less than 4% of your retirement portfolio each year throughout retirement, there's a low likelihood you'll ever run out of money.

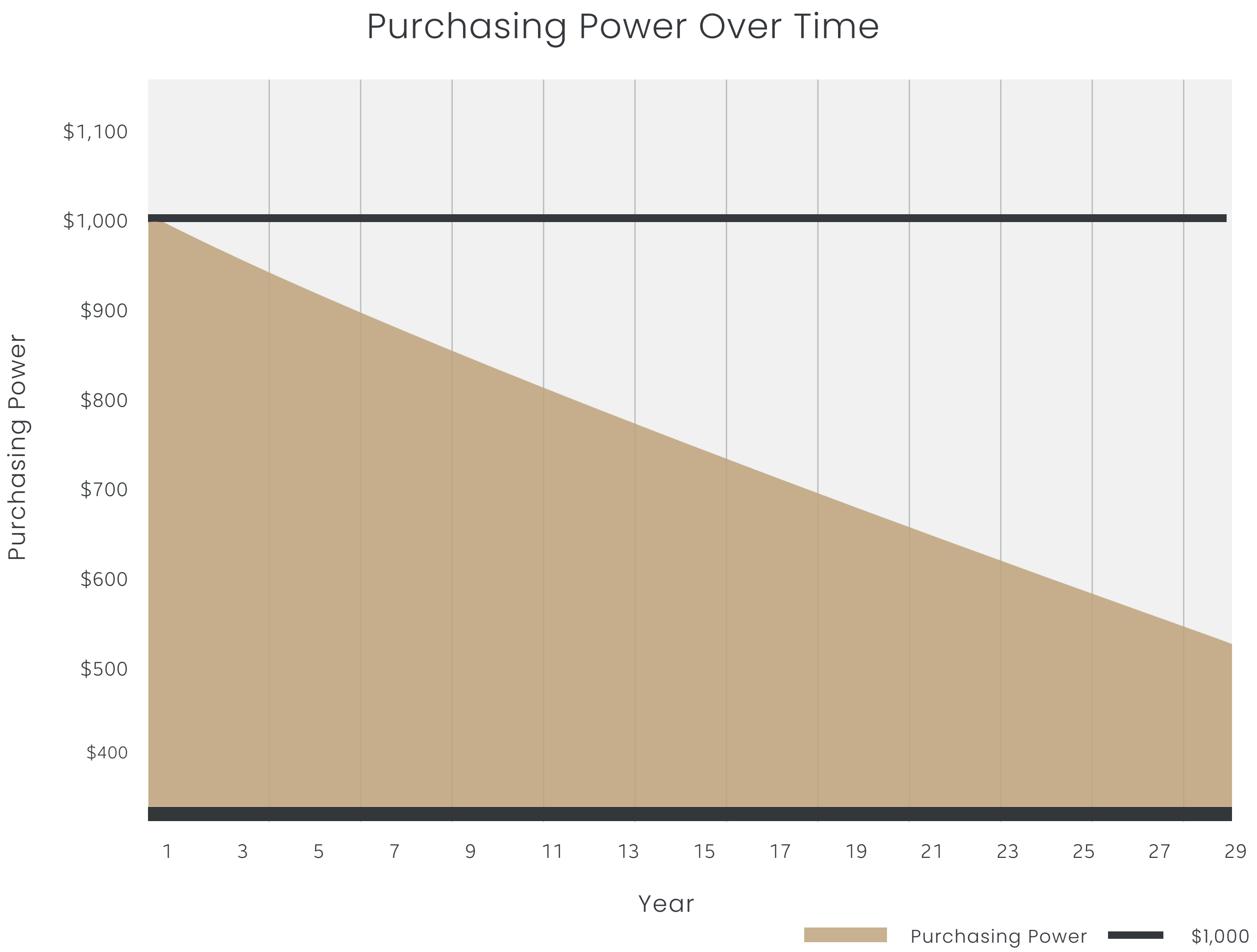
If you need to withdraw more than 4% from your portfolio each year to meet living expenses, there's a higher likelihood you could run out of money at some point in your retirement.

05 Account for Inflation

Inflation is the silent killer when it comes to retirement planning.

Since World War II, inflation has averaged about 2% per year. Certain things you'll need (namely healthcare) will increase at a faster pace. Plus, while some of your guaranteed income sources might adjust for inflation over time (Social Security and some pensions) others 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% given 2% annual inflation.



The best way to combat inflation is to maintain an allocation to growth assets like stocks in your portfolio.

Stocks historically have fared far better in the face of inflation than bonds. Accounting for how inflation might impact your plan is essential before stepping into retirement.

THREE OAKS
WEALTH
REGISTERED INVESTMENT ADVISER