The Five Primary RISKS in Retirement <u>Income</u> Planning

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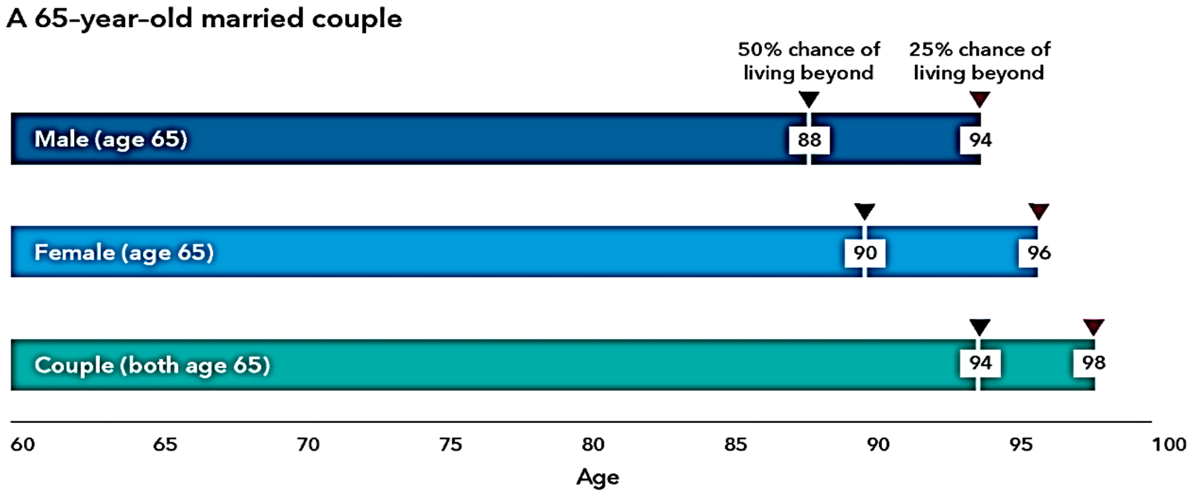
When planning for retirement and you fall into my so-called "Retirement Red Zone" (the 5 years before and 5 years after your retirement start date), there are five areas retirees need to think about and protect their assets against.

1. Longevity Risk

The BIGGEST threat retirees face is outliving their savings & income. The chart below illustrates that a 30-year retirement is very realistic to plan for, despite if we feel otherwise. For example, a 65-year-old married couple has a 50% likelihood that one surviving spouse will live to age 94, and a 25% likelihood that one surviving spouse will live to age 98!



SOURCE: *Capital Group and Society of Actuaries and American Academy of Actuaries, Actuaries Longevity Illustrator, as of September 18, 2023.* *https://www.capitalgroup.com/advisor/insights/articles/ir-retirement-longevity.html*

Given the above realities, it is critical that your income in retirement will last as long as you do. A qualified licensed Investment Advisor can help you develop an investment plan & income plan to help protect against the longevity risk.

2. Sequence Of Returns Risk

One primary goal of a Retirement Plan is to have income that is reliable and that you cannot outlive. Historically we may think of income sources such as Social Security and pensions, along with personal savings and investments making up the difference.

However, fewer people today have pensions. And according to the most recent [1]2023 Social Security Trustee Report, Social Security "*will be able to pay 100 percent of total scheduled benefits until 2033, one year earlier than reported last year. At that time, the fund's reserves will become depleted and continuing program income will be sufficient to* ***pay 77 percent*** *of scheduled benefits*." Generating income to supplement Social Security and/or a pension will likely need to come from personal savings and investments, such as bank savings, brokerage accounts, 401(k)'s and IRA's. But what if you retire and start taking systematic

[1] *A Summary of the 2023 Annual Social Security and Medicare Trust Fund Reports -* https://www.ssa.gov/oact/trsum/

investment withdrawals for livable income before the stock market takes a hit or enters a Bear Market period? Withdrawals at the wrong time can ravage your retirement portfolio and cause it to run out of money. That is *Sequence of Return Risk*. To illustrate how critically important this is to your income plan, let's look at an example using actual market return data:

In this hypothetical scenario, John starts retirement in the year 2000 with $500,000 invested in the S&P 500. He takes a 5% withdrawal, which increases by 3.5% every year to keep up with inflation. Since he began taking withdrawals prior to a down market period, his retirement account is reduced to zero when he celebrates his 78th birthday. On the other hand, Susan starts with the same $500,000, the same 5% withdrawal increasing by 3.5% every year for inflation, but she retires three years later than John, in 2003. All other factors being equal, Susan has money throughout her retirement while John runs out of money early on at age 78.

John $500,000 starting value

Age	Year	Withdrawal	Rate of Return[1]	Account Value
65	2000	$25,000	-10.14%	$424,300.00
66	2001	$25,875	-13.04%	$343,096.28
67	2002	$26,781	-23.37%	$236,134.05
68	2003	$27,718	26.38%	$270,708.27
69	2004	$28,688	8.99%	$266,356.87
70	2005	$29,692	3.00%	$244,655.42
71	2006	$30,731	13.62%	$247,246.10
72	2007	$31,807	3.53%	$224,166.91
73	2008	$32,920	-38.49%	$104,964.84
74	2009	$34,072	23.45%	$95,506.66
75	2010	$35,265	12.78%	$72,447.44
76	2011	$36,499	0.00%	$35,948.20
77	2012	$37,777	13.41%	$2,992.14
78	**2013**	**$3,878**	**29.60%**	**-$0.00**
79	**2014**	**$0**	**11.39%**	**-$0.00**
80	**2015**	**$0**	**-0.73%**	**-$0.00**
		Total WD	**Average Rate of Return**	
		$406,704	**3.77%**	

Susan $500,000 starting value

Age	Year	Withdrawal	Rate of Return[1]	Account Value
65	2003	$25,000	26.38%	$606,900.00
66	2004	$25,875	8.99%	$635,585.31
67	2005	$26,781	3.00%	$627,872.24
68	2006	$27,718	13.62%	$685,670.50
69	2007	$28,688	3.53%	$681,186.59
70	2008	$29,692	-38.49%	$389,305.71
71	2009	$30,731	23.45%	$449,866.52
72	2010	$31,807	12.78%	$475,552.48
73	2011	$32,920	0.00%	$442,632.25
74	2012	$34,072	13.41%	$467,916.81
75	2013	$35,265	29.60%	$571,155.21
76	2014	$36,499	11.39%	$599,710.55
77	2015	$37,777	-0.73%	$557,555.94
78	2016	$39,099	9.54%	$571,647.88
79	2017	$40,467	19.42%	$642,194.54
80	**2018**	**$41,884**	**-6.24%**	**$560,237.88**
		Total WD	**Average Rate of Return**	
		$524,276	**8.10%**	

SOURCE: *MacroTrends, S&P 500 Historical Annual Returns. Accessed February 20, 2024.*

3. Inflation Risk

Inflation Risk (also called Purchasing Power Risk) is a way to describe the risk that inflation can pose to an investment portfolio over time. Specifically, it refers to the possibility that rising prices of goods and services associated with inflation could outpace the returns delivered by your investments. In basic terms, it costs more to live and buy necessities and your income is not keeping pace to maintain your lifestyle, or cover your essential expenses.

Many of us have been experiencing the effects of high inflation the last couple of years. Imagine you are retired and living on a fixed income of Social Security and investment withdrawals, but the cost of living keeps increasing. Even with Social Security cost of living increases, you may struggle and feel the need to increase your income from your investments. Will taking larger withdrawals prematurely deplete your nest egg? Can your savings and investments provide that additional income when you need it?

Designing an investment plan to help address Inflation Risk is possible. While it may not be possible to avoid the effects of inflation completely, there are some things you may be able to do to reduce its sting without making drastic changes to your portfolio.

4. Long-Term Care Expenses

Long-term care costs by far are the most devastating to a retiree's savings and investment portfolio. With home health care, assisted living, and skilled nursing costs increasing on average 1.71% to 3.64% or more per year, what they cost today could easily double or triple by the time you need care.

According to a [2]Genworth 2021 Cost of Care Survey, home health care in 2021 was an average of $61,776 per year, assisted living was an average of $54,000 per year, and a private nursing home room was $108,405 per year. By 2051, home health care should be around $149,947, assisted living should be around $131,072, and a private nursing home room should be around $263,127 at 3% annual inflation.

Should the need for care arise in the future, the increased demand for income will need to be addressed. Couples must carefully consider the financial ramifications on the healthy spouse should one spouse need care. How will that affect his/her future income and financial security? Certified Financial Planners are skilled in planning for and anticipating unexpected life events including long-term care funding.

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[2] *Genworth 2021 Cost of Care Study: https://www.genworth.com/aging-and-you/finances/cost-of-care.html/*

5. Excessive Withdrawal Risk

Imagine you have saved $1 million in portfolio and you want to retire. You don't have a pension, so you will need to begin monthly withdrawals from your nest egg to supplement your Social Security income. You may wonder, what is a safe retirement withdrawal rate? In other words, how much income can I take each year without worrying about running out of money?

The widely followed 4% rule suggests retirees can safely take out 4% of a conservatively allocated portfolio the first year, adjusting upward for inflation annually, with minimal risk of depletion over a 30-year timeline. Withdrawing more than 4% increases risk of premature depletion of your portfolio significantly.

In the example above, the retiree that saved $1million and is ready to retire may choose to follow the 4% rule and plan for $40,000 of withdrawal income the first year. Careful consideration must be paid to the portfolio asset allocation among asset classes (cash, bonds, stocks, etc.). However, if he/she felt that $40,000 per year is not enough, there are other strategies that allow for higher withdrawal rates along with lifetime guarantees to protect against running out of income.

Retiring With Confidence & Final Thoughts

If you seek to retire with an increased level of confidence, this is where creating an income and investment plan that can help protect against longevity risk, sequence of returns risk, inflation risk, long-term care expenses and excessive withdrawal risk comes into play.

Working with a qualified licensed Investment Advisor and Certified Financial Planner™ is a good place to start a conversation. If you don't have an Advisor or seek additional advice, consider this an invitation to contact my office to request an initial consultation with no obligation. I have over 24 years' experience helping retirement-age clients with preparing and optimizing their income plan.

Are you **over age 59 ½** with a few more years before retiring? Now is the ideal time to discuss developing a customized retirement income plan. If you are a participant in a qualified retirement plan at work such as a 401(k) plan, attaining this age unlocks new opportunities to consider.

REQUEST INITIAL CONSULTATION

The information provided here is not investment, tax or financial advice. You should consult with a licensed professional for advice concerning your specific situation.

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