ESSENTIAL STRATEGIES FOR A SUCCESSFUL RETIREMENT

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Charting a Course to Help Your Money Last

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents several factors that can have an impact on your retirement situation and the financial decisions you will need to make when you retire.

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Essential Strategies for a Successful Retirement

The quality of your retirement lifestyle may depend a great deal on the financial decisions you make when you retire. Some of these decisions can be very complex and may involve some issues you have failed to take into consideration. We're not here to address every retirement funding issue. We are here to help educate you on the retirement landscape, and the plethora of decisions you will need to make along the way to help your assets last throughout your retirement years.

Several factors can have an impact on your retirement situation. Let's go over a few of them.

FACTORS:

- The **length of your retirement** will affect how much money you can spend, and the lifestyle you will enjoy. With recent advances in technology and medicine, life expectancies are stretching considerably, and chances are good that you'll be spending a large portion of your life in retirement. It's not unreasonable to expect that a healthy 65-year-old retiring today and in the next couple of decades will spend 20 to 30 years in retirement.[1]
- How does **inflation** affect your purchasing power? Inflation is the rise in consumer prices over time — a factor you've been battling throughout your working years. In retirement, it may be a harder factor to deal with unless your retirement income keeps pace with or exceeds the effects of inflation.
- The **retirement lifestyle** you envision will also have an impact on your savings. The general rule of thumb is that you will probably need at least 70 percent to 80 percent of your pre-retirement income to live comfortably in retirement.

CHARTING YOUR COURSE FOR THIS STAGE IN LIFE INVOLVES MAKING DECISIONS IN FIVE KEY AREAS:

- First, **size up your current situation**, considering the lifestyle choices you will make and the sources of retirement income that are available to you.

[1] Member. (n.d.). Retrieved November 29, 2018, from http://www.soa.org/

- Second, choose a **distribution method** that will help your funds last as long as you do.
- Third, understand **retirement plan distribution rules** in order to help avoid paying unnecessary taxes and penalties.
- Fourth, develop an **investment strategy** to help you make the most of your money. The types of assets and vehicles you choose can affect your retirement income stream.
- And fifth, **prepare for the unexpected** to help protect your assets

SIZE UP YOUR CURRENT SITUATION:

Some retirees are still lucky enough to have a pension to depend on, but times are changing. Traditional pensions are gradually becoming a benefit of the past. They are being replaced by defined contribution plans, which generally require plan participants to be responsible for their own retirement savings and investments.

WE'LL FOCUS ON THE THREE PRIMARY SOURCES OF INCOME THAT MOST PEOPLE WILL DEPEND ON IN RETIREMENT:

- Personal savings and investments (including retirement plans)
- Social Security
- Continued employment earnings

Personal savings and investments will make up the bulk of retirement income for many of today's workers. People often save for retirement using tax-deferred retirement savings vehicles such as employer-sponsored retirement plans and individual retirement accounts (IRAs). Some people purchase annuities to provide supplementary retirement income.

Many individuals also invest in taxable financial vehicles such as individual stocks, bonds, cash alternatives, and mutual funds. When you retire, you will be making decisions about whether to keep your assets in these vehicles; whether to move them, consolidate them, or sell them; and whether to utilize other investments.

When we talk about retirement income, **Social Security** is a major topic of discussion. Social Security is the single largest source of income for 62 percent of retirees.[2] If you have earned at least 40 work credits (about 10 years of work), you are eligible to receive Social Security retirement benefits. The

[2] Social Security Administration. (2017). Retrieved November 29, 2018, from http://www.ssa.gov/

benefit you receive is based on an average of the highest 35 years of earnings, in which you paid Social Security payroll taxes, as well as on the age when you claim benefits.

If you claim Social Security at age 62, you will receive a permanently reduced amount. Under the current formula, the percentage of the full benefit will fall gradually from 75 percent (for those born in years 1943 to 1954), to 70 percent (for those born in 1960 and later). Full benefits are available at "full retirement age," which ranges from 66 to 67, depending on year of birth. Do you know your full retirement age? For someone born in 1950, full retirement is age 66. Someone born in 1960 or later has to wait until age 67. By waiting until age 70, you can receive a higher benefit amount — up to 132 percent of the full benefit.

Married couples have additional options, including spousal and survivor benefits that they need to navigate. If your birthday is before 1/2/1954 you have a couple of additional options that should be explored with a financial professional (like our firm).

Continued employment is another popular source of income for retirees. In fact, many people assume that if they don't have enough money to retire when the time comes, they'll just keep working. Unfortunately, health issues or an unfavorable job market may force many people to alter their employment situations unexpectedly. According to one study, 79 percent of workers expect to work for pay in retirement, but the reality is that only 29 percent of today's retirees have actually worked for pay at some time during their retirement years.[3]

You should also consider that if you claim Social Security benefits before reaching full retirement age and continue to work, your benefits may be reduced if your earnings exceed annual limits. When this happens, $1 in benefits will be withheld for every $2 you earn above the annual limit (in 2018, the income threshold amount is $17,040). Starting in the year you reach full retirement age, $1 in benefits will be withheld for every $3 in wages above a higher annual limit ($45,360 in 2018).[4] Once you have reached full retirement age, there is no limit on employment earnings. Of course, employment income is fully taxable as it is earned.

CHOOSING A DISTRIBUTION METHOD

To make the most of your money, you will need to make decisions about where you should keep your funds, how to tap into these funds, how much you can afford to withdraw each year, as well as which assets to spend first. Market volatility, low interest rates, longer life spans, and rising health-care costs have made it harder to determine a suitable drawdown method.

Before making any retirement plan distribution decisions, it's important to evaluate the main distribution methods that may be available to you.

- You may decide to cash out with a **lump-sum distribution**. This would give you total control over your money. You could use it to pay off an existing mortgage, purchase a vacation home, start a business, reinvest in the markets, or any way you like.
- Some plans will let you take **systematic withdrawals**, which may be a fixed amount or a fixed percentage of your accumulation at regular intervals. Of course, with this method, it's possible to deplete your accumulation over time, depending on the amount of your payouts.

[3] Employee Benefit Research Institute. (2017). Retrieved November 29, 2018, from https://www.ebri.org/
[4] Social Security Administration. (2017). Retrieved November 29, 2018, from http://www.ssa.gov/

- Another option is a **lifetime annuity**, which is a series of guaranteed regular payments. Typically, this annuity will last for your lifetime or for the joint lives of you and your specified beneficiary. Be aware that these payments are not indexed for inflation. And if you decide to annuitize, the decision is irrevocable. Guarantees are based on the financial strength and claims-paying ability of the issuing company.

WHICH DISTRIBUTION METHOD IS APPROPRIATE FOR YOU?

Before you can answer this question, there are a few things you should consider.

- First, consider your age. Remember that there is generally a 10 percent federal income tax penalty on distributions received before you reach age 59½.
- Next, look at your liquidity needs. Do you need spendable cash to pay for college, a new home, or any other goals? If so, a lump sum with current taxation may be appropriate.
- Also consider market volatility and the preservation of your funds. If the market's ups and downs leave you anxious, you may want to take advantage of the guaranteed regular payments provided by a lifetime annuity.
- Then look at your income needs. If you don't need to use the bulk of the money right away, you may want to let it continue accumulating tax deferred in your original plan or move the funds to another tax-deferred vehicle.
- Finally, consider your current and future tax situation. Are you ready to pay taxes on the distribution now at your current income tax rate? Will you be in a lower tax bracket in retirement? Is your income high enough that you will pay taxes on your Social Security benefits?

RETIREMENT PLAN DISTRIBUTION RULES

As we mentioned earlier, IRAs and most employer-sponsored retirement plans are subject to specific distribution rules. If you understand them, you may be able to avoid paying unnecessary taxes and penalties on withdrawals from your plans.

One of the first rules to understand is that withdrawals from most tax-deferred retirement plans prior to age 59½ may be subject to a **10 percent federal income tax penalty**. Of course, you still must pay ordinary income taxes on distributions (qualified Roth IRA withdrawals are an exception). However, most tax-deferred retirement plans have certain exceptions to this early-withdrawal penalty:

- Distributions resulting from death or a permanent disability.
- Distributions following separation from service at age 55 or older, or if you separate from service before age 55 and arrange to receive a series of substantially equal periodic payments. *Note:*

The age 55 exception does not apply to IRAs, annuity contracts, or modified endowment contracts (MECs). The exception for death does not apply to MECs.

- Distributions that are used to pay qualified, unreimbursed medical expenses that exceed 7.5 percent of adjusted gross income in 2018 (reverts to 10 percent of adjusted gross income in 2019), or that are used to pay health insurance premiums by certain individuals who have separated from employment.

IRAs allow additional exceptions to avoid the early-withdrawal penalty:

- Distributions that are used to pay tuition and certain other qualified higher-education expenses.
- Distributions used to purchase a first home ($10,000 lifetime limit).
- Distributions that are part of a series of substantially equal periodic payments.

Remember that certain criteria must be met, and other exceptions may apply. It might be wise to consult with a financial professional before you receive an early distribution for these reasons.

If you decide to wait before taking withdrawals from your employer-sponsored retirement plan or traditional IRA, you should understand the **required minimum distribution rules** imposed by the IRS. These requirements are designed to ensure that you do not defer the taxes indefinitely.

Generally, you must begin taking required minimum distributions, or RMDs, by age 70½. The first distribution must be taken no later than April 1 of the year following the year you turn 70½. Except for this first distribution, annual minimum distributions must be taken no later than December 31 each year. Here's an example: If you turned 70½ in March, you would have to begin taking minimum distributions from your account no later than April 1 of the following year. But if you did so, you would have to take two distributions in the same year, which could bump you into a higher tax bracket. With the exception of the first distribution, which can be delayed, minimum distributions for any year have to be made no later than December 31.

Failure to take the required minimum distribution could result in a 50 percent excess accumulation penalty on the amount that should have been withdrawn. This federal income tax penalty is imposed regardless of the distribution method you choose.

As I just mentioned, if you have assets in traditional IRAs and employer-sponsored retirement plans, you must start taking annual required minimum distributions from them once you reach age 70½. The latest date — required beginning date — to take the first distribution is April 1 of the year <u>after</u> you reach age 70½. However, if you're still employed, you may be able to delay minimum distributions from your <u>current employer's plan</u> until after you retire. But you still have to take minimum distributions from other tax-deferred accumulations (Roth IRAs and annuities are an exception). Although some people wait until the last possible deadline to start, this could be a mistake because the April 1 deadline after age 70½ is a one-time option, and it would require account owners to take two minimum distributions in the same tax year. If these distributions are large, this could move them into a higher tax bracket. It may be better to separate this distribution into different tax years.

The annual RMD will depend on your age, the value of your account(s), and your life expectancy. The calculation is fairly straightforward. You can use the IRS Uniform Lifetime Table (or the Joint and Last Survivor Table, in certain circumstances), which shows different ages and distribution years. Simply divide the value of your retirement account balance at the end of the previous year by the number of years you are expected to live, based on the numbers in the table. If you have several IRAs, calculate the RMD for each account for the total minimum distribution. If you wish, you can take the total amount from one account to meet your minimum required distribution. However, if you also have money in an employer-sponsored plan, such as a 401(k), you need to take money from each type of plan. And if you have more than one employer plan, you have to take separate withdrawals from each.

Contributions to a **Roth IRA** may be withdrawn tax-free at any time. Roth IRA earnings generally can be withdrawn income tax-free as long as the five-year holding requirement has been met and the distribution is made after age 59½. If the withdrawal is made before the five-year holding period and/or before age 59½, income taxes and an additional 10% federal income tax penalty may apply. And, of course, other exceptions could apply.

If you have an IRA or elect to roll over your tax-deferred employer plan funds to an IRA, it's possible to further extend the benefits of tax deferral for your heirs. This is sometimes referred to as a **multigenerational or "stretch" IRA** strategy. Using this strategy, your beneficiaries would stretch out withdrawals by taking required minimum distributions based on their own life expectancies (under current tax law). If your beneficiary is young, this can result in relatively small annual distributions, enabling the IRA balance to remain tax deferred for a longer period of time.

INVESTMENT STRATEGY

As mentioned earlier, when you retire, the rules of investing change. Though you still want your assets to grow, it may be even more important to find stable investments that provide a steady income. Remember, even though your portfolio may be growing, typically you will be withdrawing funds and living off those distributions. Generally, this means you will have more of your money in low-risk investments so that market volatility doesn't decimate your portfolio and threaten your lifestyle. Developing an investment strategy for retirement involves selecting a **mix of assets** that will provide a stable income, selecting appropriate investments in each class, and choosing accounts and vehicles that will hold your assets and provide a reliable source of income **that has the potential to last throughout your retirement years**.

You probably understand the concept of **asset allocation**, a systematic approach to diversification that determines an efficient mix of assets for an investor based on his or her individual needs. Asset allocation involves strategically dividing a portfolio into different asset classes — typically, stocks, bonds, and cash alternatives — to seek the highest potential return for your risk profile. It utilizes sophisticated statistical analysis to determine how different asset classes perform in relation to one another, and its goal is to achieve an appropriate balance of security and growth potential.

What you need to remember is that when you retire (and even as you are approaching retirement), customizing an appropriate asset allocation for your portfolio to provide income in retirement (or to protect against major loses) may be very different than it was when you were working and accumulating assets. Of course, it will still take into account three things: your investment objectives, your time frame, and your risk tolerance. Asset allocation and diversification do not guarantee a profit or protect against investment loss. They are methods used to help manage investment risk.

PREPARE FOR THE UNEXPECTED

To help protect not only what you have accumulated but your future retirement lifestyle, it's wise to take measures to prepare for the unexpected. This involves more than just protecting your portfolio from market volatility and loss. The three areas we will address are:

- Preparing for potential **long-term care** needs
- Making sure you have comprehensive **health-care** coverage.
- Developing an **estate conservation** strategy.

Did you know that 70 percent of 65-year-olds will need long-term care services at some point during their lifetimes?[5] **Long-term care** is the type of day-in, day-out assistance required when you are unable to care for yourself for an extended period of time. Unfortunately, Medicare and traditional medical insurance plans offer little or no relief for individuals who need this type of care. For many retirees, the cost of long-term care is daunting. A one-year stay in a nursing home costs an average of about $97,455. That's about $8,100 a month or $267 a day.[6]

In-home care and assisted-living care are also extremely expensive. Few retirees can afford to pay those costs out of pocket. Perhaps that's why many people consider purchasing long-term-care insurance.

WHAT ARE YOUR OPTIONS?

There are three primary payment alternatives for those who need long-term care.

- First, you can self-insure. Many people choose this option simply by default. Of course, you will be relying on your own financial resources to cover the potential costs. Considering the current and projected future costs of long-term care, this path could deplete a lifetime of savings in just a few short years.
- The second option is Medicaid. If you spend down your assets to below the poverty line, you may be able to meet the strict rules to qualify for Medicaid, which is basically federal and state-supported welfare.
- The third option is long-term care insurance. This strategy enables you to transfer a portion of the financial risk of long-term care costs to an insurance company in exchange for paying the premiums. This option can help you preserve your independence and freedom of choice should you ever require long-term care. After all, a nursing home may be your least-desirable alternative. Long-term care insurance may actually keep you out of a nursing home by providing benefits for alternative care, such as custodial care at home, in an assisted-living facility, or in a community setting.

Comprehensive **health coverage** is another concern for many retirees. Health-care costs have historically increased at a faster rate than general inflation, and the trend may well continue.[7]

In fact, if Medicare benefits remain at current levels, it's estimated that a 65-year-old couple who retire today and live an average life expectancy may need about $273,000 just to pay basic health expenses in retirement (assuming they don't have employer-paid retiree health benefits).[8] Under the circumstances, it's little wonder that paying for medical expenses has become one of the biggest worries that many retirees face.

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[5] ZIPSE, R. L. (2018). 2018 FIELD GUIDE: Estate & retirement planning, business planning & employee benefits. ERLANGER: NATL UNDERWRITERS.
[6] Cost of Care. (2018, June). Retrieved November 29, 2018, from https://www.genworth.com/aging-and-you/finances/cost-of-care.html
[7] 2018 Home: U.S. Bureau of Labor Statistics. (n.d.). Retrieved November 29, 2018, from https://www.bls.gov/opub/mlr/2018/home.htm
[8] Employee Benefit Research Institute. (2017). Retrieved November 29, 2018, from https://www.ebri.org/

ESTATE CONSERVATION

Estate conservation is also an area of concern if you want to help protect what you have accumulated and leave a legacy for your family. Taxes are one concern, although many estates will not be subject to federal estate taxes unless their taxable assets exceed millions of dollars.

The Tax Cuts and Jobs Act, which passed in December 2017, nearly doubled the federal estate tax exemption amount to $11.18 million in 2018; this amount is indexed annually for inflation. After 2025, when the tax reform provision expires, the exemption amount is scheduled to revert to its 2017 inflation-adjusted level. Even so, estates may be subject to *state* estate or inheritance taxes, income taxes, and excess accumulation taxes, as well as probate costs. Fortunately, there are a number of estate conservation strategies that could help you preserve more assets for your heirs.

SUMMARY

There is a lot to consider in retirement. If you have the time, energy and resources to stay on top of those things that will impact your finances throughout retirement then you are well on your way. If not, then consider hiring a financial professional who can work with you to put together customized solutions that meet your financial goals.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We are here to help.

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