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MY WORD

Protect Retirement

ADVISORS SHOULD PAY ATTENTION TO ROI—NOT RETURN ON INVESTMENT, BUT RELIABILITY OF INCOME.

BY DAVID MACCHIA

DURING THE ACCUMULATION PHASE, PLANNERS TEND TO focus on maximizing retirement asset accumulation. The income-generation phase is typically thought of as starting at retirement and continuing until death. But new research from organizations like the Retirement Income Industry Association (RIIA) shows that we require new strategies to help boomer clients generate sufficient retirement income.

The old way of thinking requires retirees to withdraw a certain percentage of assets annually throughout retirement. But if the market takes a serious hit in the first year of retirement, say, the portfolio might not recover even if the market were to be up for each of the next 10 years. The client could take out less per year, but even then, a big hit in the first year of retirement might merely put off portfolio ruin by a few years.

A more realistic view of the retirement planning continuum identifies a critically important "transition management" phase that actually begins eight to 10 years before retirement and continues for another 10 years after retirement. If the goal is to generate income over a retirement lasting decades, the transition-management phase may be the most critical period for both the client and advisor.

The first eight to 10 years of transition management can be considered the late-accumulation phase. This is significant because a typical accumulation career generates half the total retirement dollars during the eight-year period preceding retirement. The stakes are enormously high. If investment returns on retirement assets are subpar in the late-accumulation phase, the entire nest egg is in jeopardy.

> A critically important "transition management" period begins 10 years before retirement and lasts 10 years after.

The second half of the transition-management phase can be thought of as early retirement. This first decade of retirement holds the potential risk of portfolio ruin, or the risk of outliving the portfolio's ability to generate income. How much of a risk? Investment losses, volatility and normal market downturns can create a 70% to 80% chance of total portfolio ruin. No advisor wants to put clients in this position, but it is happening today. Not enough attention is being paid to proper downside protection.

NEW SAFE-MONEY STRATEGIES

As boomers enter the transition-management phase, they begin to understand that retirement security is at stake. They undergo a psychological shift as they move from being somewhat risk-averse to unmistakably loss-averse. Shrinking guaranteed pensions, escalating health care costs, family debt and inflation contribute to their growing uneasiness about their retirement future. As a result, advisers should pay attention to conservative strategies that focus on ROI–not the typical return on investment, but rather reliability of income.

To achieve reliability of income, advisers can build a platform of guarantees into the long-term retirement income strategy. This can be accomplished with laddered strategies that use a strategic combination of fixed investments to provide income and stability in the early years of retirement and equity positions held for longer periods to generate income later in retirement. This is an excellent way to help mitigate the risk of portfolio ruin.

The security provided by guaranteed income riders on variable annuity contracts may let retirees choose a more aggressive equity orientation during the income-distribution phase, thereby increasing the probability of keeping pace with inflation and achieving life-long income.

Planners must help clients assess the real capacity of their portfolios to generate long-term retirement income. Can the income stream generated endure 30 or 40 years? If not, how do we layer guarantees along with growth strategies to help achieve a secure retirement? An adviser with the right training and insights is central to clients' financial security. FP

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