# Distribution Matters!

## Retirement planning has two 'phases:'

There are two distinct, and equally important phases to comprehensive retirement planning:

- **The Accumulation Phase** – describes our working years - the period when we're setting aside and investing income in preparation for retirement. The result is an ***account balance*** the retiree will have built up by the day of their retirement.

- **The distribution Phase** – starts on retirement day and continues through the remainder of life. It is the period over which retirees will convert their accumulated retirement account into income, which will in turn, determine the lifestyle they'll enjoy in retirement.

Among most investors, and frankly, most investment advisors, most of the thought and energy goes into the accumulation phase, '*How can we achieve the greatest account balance at retirement?*'

After all, it seems to make sense that the larger the account balance at retirement, the more retirement income it will support – right?

Unfortunately, that's not how it works. Other factors will play a key role in how much income can be drawn from an account balance in retirement.

- What if I take too much and run out of money before I die?
- How much do I want to be sure to leave my kids/grandkids?
- What if I take too little and we're not able to enjoy the retirement lifestyle we've always dreamed of?
- What if I (or my spouse) gets sick?
- What if taxes go up?
- What if Social Security goes away?

- What if my medical costs go up?

These are important 'distribution' phase questions, yet we tend not to consider them when plotting an accumulation strategy. We only realize their importance when we reach the distribution phase of life - and by that time, there are fewer - and less attractive options for us to deal with these very important considerations.

What's worse, most of the financial professionals we rely on to guide us – fail to explain our options up front and set us on the right path. Part of that is systemic – part intentional – and part is driven by their own interests. Regardless, the results can be devastating and irreversible.

## Consider that you're offered two choices at retirement.

You can either have an account worth $1,000,000 – or you can have an account worth $800,000.

But there's a catch.

- If you use the million-dollar account for income, it will provide you with an annual drawdown of about **$30,000** a year for (hopefully) the rest of your life.

- The $800,000 account on the other hand will produce about **$60,000** of annual income – reliably - for the rest of your life.

## Which account would you choose?

Most of us would choose the $800,000 account because the income advantage is of more value to us than the account balance differential.

We realize that *reliable*, *spendable*, retirement *income* is what will determine our retirement lifestyle – and is the reward for years of hard work, sacrifice, and saving.

**What is the $1,000,000 account?** It's the IRA, 401k, 403b, 457, SEP, or other tax-qualified account that most Americans will use for retirement accumulation.

It dangles goodies like pre-tax contributions, tax-deferred growth, and in some cases – employer matching contributions, before our eyes, and that magic elixir is compelling enough to attract most of our retirement savings.

But when viewed through a distribution lens – those so-called qualified plans – with all their bells and whistles – don't look so good.

That's why investment advisors strongly recommend we draw no more than 4% of our account balance for annual income. That 4% on the $1,000,000 account means about $40,000 a year. But since not a penny of that $40,000 has been taxed yet – we'll be left with only about $30,000 a year after taxes – assuming they stay close to today's rates.

Some advisors are even more conservative – limiting annual draw downs to as little as 2.8%, or an even more anemic $28,000 a year – which ends up at an even less inspiring $21,000 after taxes.

**Would $21-$30,000 a year support the lifestyle of a millionaire?**

Hardly!

So why would that high-paid Wall Street Advisor – the one who was smart enough to get you to the $1,000,000 mark in the first place – limit your draw down in retirement to such a paltry figure?

## This is where things begin to get interesting

There are four reasons your Wall Street Advisor would recommend not exceeding 4% of your account balance as an annual income drawdown:

1. **Market Risk** - To get even modest growth on your account, a Wall Street advisor will have to subject your money to at least some level of market risk. The advisor recommends the 4% drawdown rate so that even if your account takes a substantial hit from a market downturn (as most did in 2008 for example), you can still draw that $40,000 a year figure without (hopefully) running out of money.

2. **<u>Tax-Rate Risk</u>** – Likewise, 100% of the account balance is subject to taxation at unknowable, future tax rates. While no one knows for sure, most people believe taxes will only be higher in the future. By limiting the income draw to 4%, the advisor can 'hedge' against that possibility and maintain a more consistent net income draw it if comes to pass.

3. **<u>Major Health Event</u>** – The advisor knows that once you reach retirement, the likelihood of a major health event goes up. Maybe you'll need access to a lump sum for some sort of experimental, or life-saving treatment. Maybe you'll need extra money for long-term-care, assisted living, or home health care. Whatever may lie in the future, the advisor uses the 4% rule so if you need to go get at a lump sum – or you need to draw more income due to those expenses - it's there.

4. **<u>The Broker doesn't want to take a pay cut</u>** – If, at the 4% drawdown rate, the remaining account balance grows at about the same 4% rate, the account balance will remain at its $1,000,000 starting point year after year. That way, the Advisor – who is typically compensated a percentage of the account balance – will never have to take a pay cut. If the advisor earns 1% in annual fees on your account balance – he or she will earn $10,000/year on your account year-in and year-out - for as long as you live.

***If* market risk *does* come calling** – and lays claim to part or your retirement account; or ***if* the tax-man *does* show up** and claim a higher share of your retirement plan; or ***if* you *do* suffer a health event** that requires access to more of your money – the Advisor will appear to have been looking out for your best interest.

If those things don't happen however, you could spend 20-30 years in retirement, only to die with roughly the same $1,000,000 you started with – whether that was your intention or not. And that means, <u>you will have lived a retirement lifestyle far below what might have been possible had those risks been eliminated</u> – allowing you to draw far more income on an annual basis. **<u>That's why distribution planning *has* to be a greater part of accumulation planning</u>**.

Putting an accumulation plan in place that eliminates or minimizes the distribution risks up front, may lead to a smaller account balance at retirement (although not necessarily so), but it can also mean a must better retirement income and lifestyle.

## Distribution Matters

**Step one** is to inventory the potential risks that are unique to retirees:

- **Market Risk** – Understand that the greatest threat to your money is market risk. To minimize or eliminate market risk, it may be necessary to move into investment vehicles that don't impose risk on your principal.
- **Tax-Rate Risk** – Moving as much of your retirement nest-egg into non-taxable accounts and vehicles is another strategy to take this particular risk off the table, and ensure a higher income draw that doesn't require a 'hedging' strategy.
- **Longevity Risk** – this is the risk of out-living your money – and is one of the most frightening risks retirees face. There are very few forms of guaranteed, lifetime income anymore. Most private pensions are a thing of the past, leaving Social Security as the only lifetime source of income. But there are ways to convert part of your own retirement funds into inexhaustible lifetime income streams, and the 'reliability of income' they promise can relieve a lot of pressure – and provide greater income to many.
- **Medical/Long-Term Care Risk** – There are also ways to take the 'what if one of us get's sick' question off the table. While traditional long-term care coverage has become more expensive and less accessible, there are some other forms of coverage that are highly accessible, very affordable, and come with other benefits that traditional insurance never contemplated.

**Step two** is to look at all the options the investing markets have to offer, giving special attention to those that promise to limit – or even eliminate altogether – some, or all of these risks.

Imagine for a moment that there were options out there that better balanced our accumulation aspirations, with our distribution concerns.  Imagine we could build a substantial retirement nest-egg that was:

- Immune from market risk,
- Accessible tax-free,
- That provided access to a separate bucket of money in the event of a health crisis or long-term care event, and that
- Had a much higher likelihood – or even a guarantee - that we could never outlive our money no matter how long we lived.

**At Velomon, that's our specialty**.  We seek balance.  We place the proper emphasis on distribution – and in most cases we do so with very little – if any compromise to the accumulation potential.

The result is a lifetime of investing peace of mind.  Just think what it would be like to be dispense with anxiety over turbulent markets, see-sawing tax policy, and the uncertainty of longevity concerns.

Your job is to commit to funding your retirement dreams – ours is to make them come true in the most fulfilling manner possible.  Reach out to your Velomon Financial Wellness Coach – and let's start a conversation.

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