Learn how to manage your retirement

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Planning now can help make a difference tomorrow

Whether retirement is on the horizon or you're already retired, now is the time to work closely with your financial advisor to develop a plan for financing the years ahead.

Use this guide to help make the most of your consultations with your financial advisor.

Evaluate your current situation

For many people, retirement can last a long time. Current life expectancy for men in the United States is about 76 years; 81 for women.[1] But these averages understate an important fact: Life expectancy changes as you grow older. For example, if you live to age 65, the chances are good that you'll live into your late 80s.

There's a reasonable possibility that your retirement could last 25 to 30 years. That's why it's critical to work with your financial advisor to make sure you're prepared.

Keep an eye on cash flow

Once you're retired, it's essential to watch your cash flow and estimate your income and expenses each year. This practice can help your financial advisor spot potential financial trouble and make adjustments that can help keep your retirement plan on track.

Estimate your income and expenses

When you estimate your expenses, it can be helpful to separate them into nondiscretionary and discretionary categories.

- **Nondiscretionary.** These are basic expenses, such as food, mortgage payments, insurance premiums, taxes, gasoline, and utilities.
- **Discretionary.** These are optional expenses, such as travel, hobbies, gifts, and charitable contributions.

1 Jiaquan Xu, Sherry L. Murphy, Kenneth D. Kochanek, and Brigham A. Bastian, 2016. Deaths: Final Data for 2013. *National Vital Statistics Reports* 64(2):1–119.

To estimate your sources of income, include such things as Social Security benefits, pensions, veterans' benefits, royalties, rents from investment properties, dividends, and interest.

Depending on your age, you may also need to include the required minimum distributions (RMDs) that you must take from your traditional IRAs and qualified retirement plans such as a 401(k) (with the possible exception of Roth 401(k) plans). Federal law mandates that you generally must start making withdrawals from these accounts by April 1 in the year after you turn age 70½. Remember that withdrawals made from a tax-deferred plan before age 59½ may be subject to ordinary income tax, plus a 10% federal penalty tax.

Using your estimated expenses and sources of ongoing income, your financial advisor will be able to determine approximately how much you will need to withdraw from your investment portfolio each year.

Review your insurance coverage

Large, unexpected expenses can damage the best-laid retirement plans, but adequate insurance coverage can help protect you against many of these expenses. That's why you'll want to make sure your coverage is sufficient for all your policies.

Medicare

During your retirement, you also may incur insurance costs specific to retirees. For example, retirees age 65 and older qualify for Medicare health insurance but must pay a monthly fee for the coverage. And because Medicare doesn't cover all health care costs, many people purchase Medigap insurance to plug the gaps in Medicare.

Medigap insurance plans can vary from state to state. Be sure to consult your state insurance department for plans available in your state.

Medicare Part D

Originally, one of the most glaring gaps in the Medicare program was its lack of coverage for prescription drugs. This long-awaited benefit was introduced on January 1, 2006. Known as Medicare Part D, the program gives recipients a choice of drug plans, provided by private companies, that are designed to suit a variety of medical and financial needs. Visit the Medicare website (medicare.gov) for details about the plans and tools to help you determine which one suits your needs.

Long-term care

Medicare provides little help if you require long-term assistance with everyday activities. Consequently, many retirees purchase long-term care insurance to try to prevent their savings from being devastated should they require such care. Long-term care insurance can be complicated and expensive, so be sure to consult your financial advisor before you make such a purchase.

Life insurance

There is one type of insurance that you may no longer need after you retire—life insurance. Unless others depend on your pension or other income that would cease when you die, or you have major debts such as a mortgage or loans for children in college, you may want to consider canceling your life insurance policy.

If you own a cash-value life insurance policy, you have several choices: Cash it out and incur taxes; exchange the cash value of the policy, tax-free, into an annuity; or keep the policy for estate planning purposes. Your financial advisor can help you determine the best way to handle your life insurance.

Review your living situation

Retirement is also a time to look at your living situation. Begin by asking yourself how well your current home works for you. Consider its size and upkeep. Take into account whether it will meet your and, if married, your spouse's future physical needs. It may be time to make a move—either to a smaller house or to a retirement community.

Downsizing to a smaller home allows you to free up cash. In addition, capital gains of up to $250,000 ($500,000 for a married couple) from the sale of your house are free of federal income tax. Your savings may be even greater if you relocate to an area with lower living costs and low (or no) state and local income taxes.

Maintain some liquidity

When you have unexpected expenses, a small liquid account—usually a money market account—can help you avoid having to sell portfolio assets at an inopportune time. You and your spouse can work together to determine the liquidity level that makes sense for you.

Consider annuities

Annuities are insurance products designed to pay income as long as you live. Certain annuities allow you to name a recipient of the income after your death. Many retirees purchase annuities to generate ongoing income that supplements Social Security and pensions.

Some annuities make fixed payments, while others make payments that increase over time. Some generate variable income based on the performance of the underlying mutual funds you select. Keep in mind that variable annuities are subject to market risk.

The trade-off for many annuities is that, upon your death, any remaining principal stays with the company issuing the annuity and is not available to your heirs. The upside is that, if you live long enough, you may exhaust the principal. Annuities can be complicated, so work carefully with your financial advisor to determine if an annuity is right for you.

Organize, share, simplify

Your plans for retirement involve more than just financial calculations. You also need to make sure that those you care about understand your plans and have access to important information.

Here are a few steps to consider to get organized:

- **Update your beneficiary designations.** These designations supersede instructions in your will.
- **Make sure important documents and records are easy for your family to locate.** These should include your will; trust documents; insurance policies; a detailed listing of your assets, including account numbers and dollar amounts; and a durable power of attorney.
- **Involve your family.** Because many of your financial decisions affect your spouse and other family members, you should prepare them to step into your shoes if necessary. Discuss your plans with them and make sure they are familiar—and comfortable—with your financial advisor.
- **Simplify your finances.** Your financial advisor may recommend consolidating your assets with a single company. This can make it easier for him or her to track your financial situation and calculate your RMDs each year. It can also reduce your paperwork at tax time. In addition, it can ease the transition should a family member have to take charge of your finances.

Adjust your portfolio

Before you begin drawing income from your investment portfolio, your financial advisor may adjust the investment mix so it is more appropriate for your new circumstances.

For your own peace of mind, you may want to talk with your financial advisor about some commonly held misconceptions regarding retirement portfolios.

Myth: Stocks are too risky for retirees

Not necessarily. If you were comfortable with a certain proportion of stocks in your portfolio before you retired, chances are good that you'll be comfortable with that same proportion for some time during your retirement. Although your financial advisor may recommend reducing the proportion of stocks as you move further into retirement, you may still want to maintain the growth potential that stocks can provide.

Myth: Bonds are the best investment for retirees because they produce income

The interest that bonds generate can be an important source of income, and bonds can provide the balance and diversity critical to all portfolios. But your financial advisor may also suggest keeping stocks in the mix. Although past performance doesn't guarantee future returns, retiree portfolios usually need the kind of inflation-beating growth that stocks have historically delivered over time.

All investing is subject to risk, including the possible loss of the money you invest. Bond investments are subject to interest rate, credit, and inflation risk.

Myth: For safety, stick with short-term reserves

Short-term reserves, including money market funds, bank certificates of deposit, and U.S. Treasury bills, do offer stability and relative safety. As a result, they can be a great place to store cash temporarily or to use for liquidity. But, historically, short-term reserves have barely kept ahead of inflation and typically have yielded far less than other types of investments. Most retirees should not keep a significant portion of their assets in these kinds of accounts.

Plan for inflation

Your financial advisor will consider the impact of inflation on your financial plan. Even at a moderate 2% annual inflation rate, you'll need income of about $223,000 in 20 years to buy what $150,000 buys today.

A balanced, diversified portfolio is important

Inflation is only one factor your financial advisor will consider in evaluating your investment mix. One type of investment alone—stocks, bonds, or cash—is not likely to maximize a portfolio's success. A mix of investments can provide the balance of growth, income, and stability that allows a portfolio to better withstand the fluctuations in financial markets.

Your financial advisor will aim to create a balanced and diversified investment mix and control risk as much as possible, rather than concentrate solely on producing the highest portfolio returns. But keep in mind that diversification does not ensure a profit or protect against a loss.

Plan your asset withdrawals

One of the most important recommendations your financial advisor will make is how much you can regularly withdraw from your accounts without exhausting them. There are two commonly used methods and a third one that is a hybrid of those two.

Under all three methods, you sell assets to produce retirement income. Your assets include not only the interest, dividends, and capital gains you've reinvested, but your principal as well.

You may be advised to sell assets once or twice a year and place the funds in a money market account that has checkwriting privileges. For convenience, you could also deposit ongoing income payments, such as Social Security and pension, in this account.

Choosing your withdrawal method

Each of the three methods for turning your assets into income has advantages and disadvantages.

As you consider the methods, keep in mind that the income produced by Method 1 isn't tied to market conditions. However, the income produced by Methods 2 and 3 are directly tied to the performance of financial markets. This means the annual income produced by Method 1 will be predictable and the income produced by Methods 2 and 3 will fluctuate (though with less volatility under Method 3).

Method 1: Dollar-adjusted withdrawals

Using this method, you establish a fixed withdrawal amount the first year, generally based on a percentage of your initial portfolio value. Each subsequent year the dollar amount of your withdrawal

increases by the previous year's inflation rate. The percentage recommended for your initial withdrawal is based on what you'll need to cover the difference between your income and expenses.

With this method, withdrawals are relatively predictable and generally keep pace with inflation. However, if the market should undergo a prolonged downturn during the first few years of retirement, your assets could be substantially depleted. That's because as your portfolio value shrinks, you'll be spending a larger percentage of your portfolio than you had originally intended. In this situation, it may be wise to work with a financial advisor to recalculate your withdrawals using the new balance so that you do not continue to overspend.

Here's a three-year example of the dollar-adjusted method for a retiree, Jack, who has a $500,000 portfolio and decides on an initial withdrawal amount of $15,000 (3% of the portfolio):

- **First year.** Jack withdraws $15,000.
- **Second year.** Jack withdraws $15,600: the previous year's amount ($15,000) plus $600 to account for 4% inflation.
- **Third year.** Jack withdraws $16,380: the prior year's inflation-adjusted withdrawal ($15,600) bumped up by a 5% inflation rate ($780).

Method 2: Percentage withdrawals

Using this method, you withdraw the same percentage annually from your portfolio. Annual withdrawals aren't increased for inflation. A 4% to 5% annual withdrawal rate is considered reasonable; however, the percentage your financial advisor recommends will be based on the amount you'll need to cover the difference between your income and expenses.

In general, this method is easier to use than dollar-adjusted withdrawals. With percentage withdrawals, while your portfolio may shrink, you should never run out of money. However, because your withdrawal amounts will fluctuate, you'll have to spend less in periods when your portfolio value drops. During those years when the markets are doing well, you must decide whether to spend or—our suggested approach—reinvest at least some of the excess.

Here's how a retiree, Jeanne, would use the percentage-withdrawal method over a three-year period. Jeanne starts out with a $500,000 portfolio and chooses a 5% annual withdrawal rate:

- **First year.** Jeanne withdraws $25,000: 5% of her portfolio balance.
- **Second year.** The portfolio has grown to $530,000: Jeanne withdraws $26,500.

- **Third year.** The portfolio has declined to $450,000: Jeanne withdraws $22,500 (15% less than in the second year).

Jeanne has to discipline herself to spend less during periods when her portfolio balance drops. For example, if after the third year shown in the example, the portfolio declines again, say by 10%, her income would drop to $19,238—about 23% lower than the first year's withdrawal.

Method 2 is easier to use and can mean your assets will last longer, but your income stream will fluctuate—significantly at times. This means during periods when your income drops, you'll have to discipline yourself to spend less. On the other hand, during years when the market performs well, you'll have the enviable task of deciding whether to withdraw the amount that exceeds your spending needs or leave it in the portfolio to potentially grow for future needs.

Method 3: Percentage withdrawals with ceiling and floor

This method starts with a percentage withdrawal but adds an upper (ceiling) and lower (floor) limit. The annual withdrawals will vary, but the floor and ceiling keep that fluctuation within a set range. When the markets do well, less than the percentage withdrawal is tapped. When the portfolio value decreases, more than the percentage withdrawal is taken.

Here's how a retiree, Pat, would use the percentage withdrawal with ceiling and floor method over a three-year period. Pat starts out with a $1 million portfolio and chooses a 4% annual withdrawal rate with a 5% ceiling and 2.5% floor:

- **First year.** Pat withdraws $40,000: 4% of her portfolio balance.
- **Second year.** The portfolio has grown to $1,060,000: Pat has three figures to calculate. The percentage withdrawal ($1,060,000 x 4% = $42,400), the

Comparing withdrawal methods

Dollar-adjusted withdrawals	Percentage withdrawals	Percentage withdrawals with ceiling and floor
Withdrawals are predictable and keep pace with inflation.	Withdrawals will fluctuate.	Withdrawals will fluctuate but within a set range.
Greater risk of exhausting principal.	Smaller risk of exhausting principal.	Lower risk of exhausting principal relative to the dollar-adjusted method.

ceiling withdrawal (the previous year's withdraw plus 5%, or $42,000), and the floor withdrawal (the previous year's withdrawal minus 2.5%, or $39,000). Under this method, the middle number is always the one used, in this case, $42,000.

- **Third year.** The portfolio has declined to $1,038,582. The percentage withdrawal would be $41,543; the ceiling withdrawal would be $44,100; and the floor withdrawal would be $40,950. Pat withdraws the middle figure, $41,543 (1% less than in the second year).

Which assets do you tap first?

As you require income, your financial advisor will guide you in choosing which accounts to tap.

When you start taking federally mandated RMDs from your traditional IRAs and employer-sponsored retirement accounts (with the possible exception of Roth 401(k) plans), you'll want to use these funds for your spending needs before you tap other accounts. But until then, your financial advisor will base recommendations on two important considerations:

- Keeping your investment mix on target, perhaps by using the withdrawal as an opportunity to bring the mix back into balance.
- Keeping your assets growing to the maximum extent possible.

These goals may appear to conflict at times. However, as a rule of thumb, bringing your investment mix into balance is generally considered to be more important. Nevertheless, each retiree's situation is unique, so there are exceptions to this general rule.

Sell to keep your investment mix on target

Your financial advisor may recommend that you start withdrawing funds from the portion of your portfolio that has become concentrated in one type of investment. For example, if the stock market has grown rapidly and your target mix of 60% stocks and 40% bonds has become a lopsided 65% stocks and 35% bonds, your advisor may advise you to sell stocks to adjust your investment mix, reduce the portfolio's risk level, and produce income.

Sell to maximize asset growth

The next best thing to not paying taxes is paying as little as possible for as long as possible. Consequently, your financial advisor may recommend withdrawing your assets in this order:

- Taxable assets.
- Tax-deferred assets in traditional IRAs and employer-sponsored plans.
- Tax-free assets in Roth IRAs.

Here's the reasoning: In taxable accounts, you're paying taxes each year on the dividends, interest, and realized capital gains that your assets produce.

You also may pay tax on the withdrawals themselves if your assets have appreciated in value. In tax-deferred accounts, you pay taxes only when assets are withdrawn, even on gains. And for Roth IRAs, provided certain conditions are met, including holding the account for at least five years and being at least age 59½, you pay no taxes at all—and you can even pass the assets on tax-free to your heirs.

If you're participating in a Roth 401(k), you can avoid taking RMDs by rolling the balance over to a Roth IRA. Otherwise, you'll be required to start making withdrawals from the Roth 401(k) in the year after you reach age 70½.

Fine-tune your withdrawals

Your financial advisor may recommend fine-tuning your withdrawals further, either to gain as much tax efficiency as possible or to help you meet specific financial goals. Some examples of withdrawal tactics include:

- Selling taxable assets that have lost money.
- Selling taxable assets that you've held longer than a year.
- Selling tax-deferred assets when conditions are right.

Your financial advisor also will check your investment mix after you sell assets and rebalance your portfolio if necessary. However, if your primary goal is to maximize the amount you leave to your heirs, your financial advisor may recommend a different approach. In this case, he or she might suggest that you continue to hold taxable assets that have risen significantly in value.

Should you tap the equity in your home?

More and more retired homeowners are considering reverse mortgage loans, which let you tap the value of your house without selling it. Here's how they work: A lender grants you a loan against the equity in your home, which is repaid when your house is sold—usually after your death.

A reverse mortgage loan offers several advantages: You don't have to repay the loan while you live in your house, you can't be evicted, and you owe no income tax on the loan. Reverse mortgage lenders, however, charge steep up-front fees—as much as 10% of the loan value or more. And the loan must be repaid before your heirs can receive any of your property.

Monitor your plan

Once you have a solid plan for financing your retirement, it’s important to meet with your financial advisor regularly to make sure your plan remains on track.

Adjusting to bear markets

Your portfolio can probably withstand a market downturn, even over a period of a year or two. But it’s natural to be concerned about the decreasing value of your portfolio during more prolonged downturns. Your financial advisor will help you adjust to hostile markets by recommending changes in your withdrawals or by suggesting measures to increase your income.

Consider all your options

As you periodically reevaluate your retirement financing plan, you’ll want to consider several other issues.

“Surplus” years

In good economic times, both dollar-adjusted and percentage withdrawals may produce more income than you need. You’ll then have to decide whether to spend the surplus or leave it in the portfolio to potentially grow for future needs.

Stepped-up withdrawals

You may, of course, withdraw more than the guideline amounts using either method, but doing so can increase your risk of depleting your assets.

Spending more than the recommended guideline is easy to do as you begin enjoying your freedom from the structure of daily work. The result, however, is less money working for you, which can lead to a cash squeeze later in retirement.

Whether annuities fit in

Whichever withdrawal method you choose, your financial advisor may suggest purchasing an annuity designed to give you a lifetime income. Because an annuity can help smooth out your income, it can be especially useful in years when your portfolio’s return is negatively affected by market turbulence. Keep in mind that annuity guarantees are based on the claims-paying ability of the underlying insurance companies that issue the annuities.

Higher-return investments

Your financial advisor may suggest boosting income through investments that could potentially earn higher returns than those you currently hold.

The returns of some portfolios—particularly very conservative ones—might benefit from modestly increased investments in different kinds of bonds and stocks. But, of course, higher returns also usually mean higher risks. So if you decide to stretch for higher returns, work closely with your financial advisor to decide which investments would work best for meeting your goals—and try to stick to low-cost investments.

Other ways to boost income or reduce expenses

There are a variety of ways to augment your income or reduce your expenses. As mentioned previously, you can move to a smaller home or a less expensive region. You can also sell nonfinancial assets or even return to work.

One thing you shouldn't count on as a source of income: inheritance. Many retirees expect an inheritance, and many do indeed receive it. But keep in mind that it's not unusual for money you expect to inherit to be depleted because of illness, bankruptcy, poor market performance, or other unexpected events.

Continue to invest tax-efficiently

Even in retirement, it's important to continue investing your assets tax-efficiently. If you work part-time and have earned income, you can contribute to a Roth IRA and benefit from its tax-free earnings. There's no maximum age limit for contributions to a Roth IRA.

If you're no longer eligible to make contributions to tax-deferred or tax-free accounts, consider investing your taxable assets in tax-efficient funds, such as index, tax-managed, exchange-traded, or tax-exempt bond funds.[2] This will help limit the federal income tax you must pay on capital gains and dividend income. It's possible that tax-managed funds will not meet their objective of being tax-efficient.

2 Although the income from a municipal bond fund is exempt from federal tax, you may owe taxes on any capital gains realized through the fund's trading or through your own redemption of shares. For some investors, a portion of the fund's income may be subject to state and local taxes, as well as to the federal Alternative Minimum Tax.

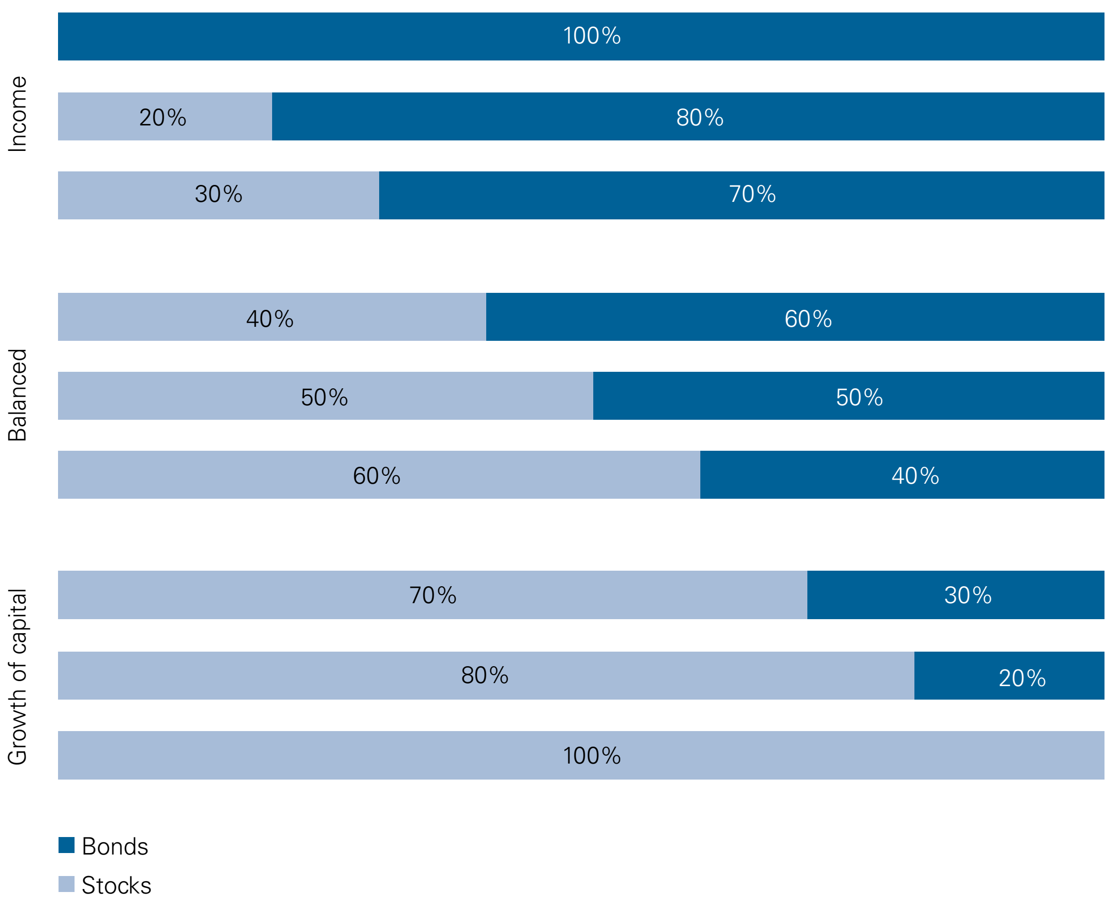
Rebalancing your portfolio

Work with your financial advisor at least annually to review your investment mix.

He or she may recommend rebalancing your portfolio if a particular type of investment has strayed more than 5 percentage points from your target allocation.

You may also be advised to rebalance if your risk tolerance changes. You may be comfortable with an investment mix emphasizing stocks early in your retirement, but a mix emphasizing bonds might be a better fit later. The chart below shows the type of investment mixes that your financial advisor may consider.

Possible investment mixes for retirement



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