RETIREMENT by DESIGN
Retirement Income Source

BUILDING BLOCKS OF RETIREMENT

WWW.RETIREMENTXDESIGN.COM

Building Blocks of Retirement

By David J. Scranton, CLU, ChFC, CFP®, CFA®, MSFS

Traditionally, the key to a financially solid retirement plan has been to save early, ideally from the day you start working. It's always been good advice to live by, but today's retirement is more complex. It requires a different approach.

It wasn't always this complicated. There was a time in the not-so-distant past when you worked 30 years for the same employer. When it came time to retire, you had a pension and Social Security to depend on. Now, most of us are facing challenges that are making it harder to achieve a more comfortable retirement lifestyle. Living longer, carrying more debt, family dynamics and healthcare weigh heavily on many Americans. Market volatility and fallout from the pandemic have only exacerbated the situation.

Retirement can be the most rewarding and exciting phase of your life, but today more than ever, it's up to you to make that happen. To do it, you'll need the right strategy.

The information in this guide can help you better understand what that strategy should look like and how to go about creating it. More specifically, you will find solutions that may assist you in offsetting lower-than-expected income sources; creating streams of renewable income; and guarding against market volatility. But let's start with some basics.

How much will you need?

Estimating your retirement budget can give you insight into how much money you may need to fund your retirement.

There are three categories of expenses you'll need to consider:

1. Fixed Expenses: Mortgages, car payments, insurance premiums, and other fixed payment loans. These are predictable expenses and should not change much over time.
2. Variable Expenses: Healthcare, groceries, utilities, and other costs that are likely to fluctuate over time.
3. Discretionary Expenses: Travel, hobbies, or dining out are some of the things you would like to have funds available for. Typically, the amount allocated in this category will be whatever is left over after paying fixed and variable expenses.

We've provided a worksheet for you to build your own estimated retirement budget. It includes living expenses common for most people. Remember, this will simply be an estimate to help you plan for your retirement expenses.

HOUSING		**PERSONAL**	
Item	Monthly Expense	Item	Monthly Expense
Mortgage/Rent		Grooming/ Personal Care	
Maintenance/Repairs		Clothing	
Utilities		Hobbies	
Homeowner's Insurance		Dining Out	
Other		Vacation	
Total		Adult Care	
		Alimony	
TRANSPORTATION		Memberships	
Item	Monthly Expense	Other	
Car Payment		Total	
Insurance			
Maintenance		**LIVING EXPENSES**	
Gas		Item	Monthly Expense
Other		Groceries	
Total		Phone/Cable/ Internet	
		Other	
MEDICAL EXPENSES		Total	
Item	Monthly Expense		
Medical Services/ Co-pays			
Medications		**INSURANCE**	
Insurance		Item	Monthly Expense
Dental		Life Insurance	
Other		Supplemental Health	
Total		Long Term Care	
		Other	
		Total	
TAXES			
Item	Monthly Expense		
Real Estate Taxes			
Personal Taxes			
Other			
Total			
		MONTHLY TOTAL	

Don't forget your goals!

To help determine your retirement expenses accurately, you need to factor in your specific retirement goals. Do you plan to downsize and move? If so, where to? Do you plan to take a big trip or make a major purchase? It's important to identify your retirement goals as specifically as possible. Once you do, you can estimate their expense and factor that into your overall budget estimate. This will start to give you an idea of how much retirement income you'll need to generate – but it's only a start!

Other Considerations

Life doesn't always go according to plan, and retirement planning is the same way. In addition to your anticipated total monthly costs, there are other factors to consider, including:

Required Minimum Distributions

Starting at age 73, the IRS requires you to take annual distributions from your retirement accounts and pay taxes on the income. Having the right strategy to help satisfy your required minimum distributions (RMDs) without the risk of spending down your principal is crucial.

Inflation

Prices fluctuate, and things get more expensive as the years go by. As an example, let's say you have $100 in your pocket today. Assuming a modest 3% inflation rate, that same $100 will be worth approximately $64 in 2035. In summary, over time, inflation erodes the value of money.

Healthcare Costs

The biggest concern for retirees that almost always makes retirement more expensive than they ever could imagine is healthcare. Healthcare costs are subject to some of the greatest inflation rates in the country. Since 1948, the price of medical care has grown at an average annual rate of 5.3% compared to 3.5% for the consumer price index overall.[1] So, at close to 6%, healthcare and medical costs are essentially doubling every 12 years.

Longevity

With advances in medical care, people are living longer. Today, the Society of Actuaries says that the average man at 65 can expect to live another 21.5 years, and the average woman another 23 years.[2] If you have family members living longer than that, plan for the change that your retirement savings will need to stretch 30 years or more.

Long-Term Care

Long-term care involves a variety of services designed to help meet a person's health or personal care needs. It can be in the form of independent or assisted living. It is difficult to predict how much or what type of long-term care a person might need. Factors that influence care include age, gender, marital status, lifestyle, and health history.

Preparing for the Unexpected

Although not all unexpected events are negative, the big ones that affect your financial future tend to be. Disability, long-term illness, the death of a spouse, and the special needs of children or aging parents are the kind of personal life events that can affect your financial security and well-being. To combat unexpected financial hardship, you should have an emergency fund, which should be relatively liquid and cover three to six months of living expenses. Your plans should also include contingencies in the event of job loss, reduction of retiree benefits, or changes to Social Security and Medicare.

Working After Retirement

Being retired doesn't mean that you have to stop working. You may find satisfaction in having a job that genuinely suits your interest, regardless of salary. Continuing to work can also help you stay active and connected. A 2013 study conducted by Northwestern Mutual found many Americans simply planned to continue working into their 60s, 70s, and even 80s.[3]

Having the Right Mindset

Many people have been taught to believe that the most important factor in preparing for retirement is how much they've saved. While it's important to save as much as you possibly can for retirement, many people put too much emphasis on their lump sum and not enough on having the right strategy. That's because many have been taught that the only way to help avoid running out of retirement income is to have X amount of money saved. The reality is that if your money isn't allocated properly, and you haven't created a strategy that helps protect it from market volatility and other forces, you could run out no matter how much you've saved. On the flip side, if you do have the right strategy in place, you may need a lot less saved than you might think to enjoy a happy, successful retirement.

The first step in building the right strategy lies in having the right mindset. That means understanding that once you're in your 50s, you are transitioning from the growth and accumulation stage of retirement planning to the income stage. With that, you need to adopt an income mindset and recognize the importance of building a financial strategy geared directly toward income.

Income = common sense

Subconsciously, most people understand the sense of having a strategy geared directly toward retirement income, even if they don't realize it. Here's an example that illustrates this fact:

Joe is planning to retire from his Company. The Company set aside $1 million for Joe as a retirement benefit. He has two options on how to take it:

Option A
Receive company stock. Of course, Joe cannot sell it right away because it's restricted stock. However, he can collect a 2% dividend on it each year. That's $20,000 in income.

Option B
A defined benefit pension where Joe's company pays him $60,000 a year for the rest of his life. Joe doesn't get any stock, but he will get $60,000 a year for the rest of his life.

Knowing this, which option would you take?

It's hard to turn down $1 million, but until he can sell that stock, that money really isn't Joe's; it's restricted. Joe couldn't even list it as an asset if he were to go to the bank to get a loan. Sure, Joe will get $20,000 in income, but in some respect that's the best he will get with Option A.

With Option B, Joe will get $60,000 a year no matter what; the entire $60,000 is usable year after year.

If you're like most people, you chose Option B because – either consciously or subconsciously — you realize, that when it comes to enjoying a more secure retirement, it's all about the income.

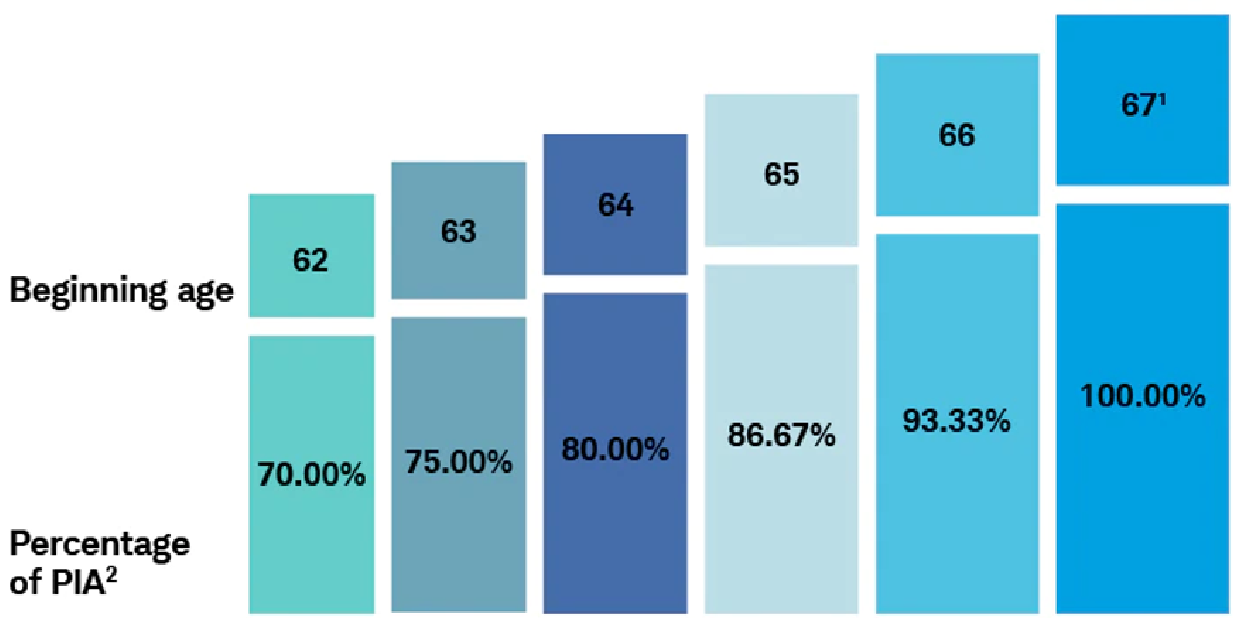
Potential Income Sources

There are many potential sources of income to choose from, which all carry distinct benefits and risks. Some are tied to the stock market and may provide the potential for significant growth, though they may also come with significant risk. In contrast, other sources provide fixed, dependable income for a guaranteed period of time. These sources carry less risk, but their growth potential is more limited and must be strategically managed.

Social Security

For now, Social Security remains a more secure source of income you can count on if you have worked for most or all of your adult life. A considerable number of people claim their Social Security benefits at age 62. However, if you can wait, you will receive a larger benefit. Of course, deciding when to draw Social Security benefits will likely be based on your health, how long you plan on working, and your assets.

Effect of taking retirement benefits early (DOB: Jan. 2, 1960)



Source: SSA.gov

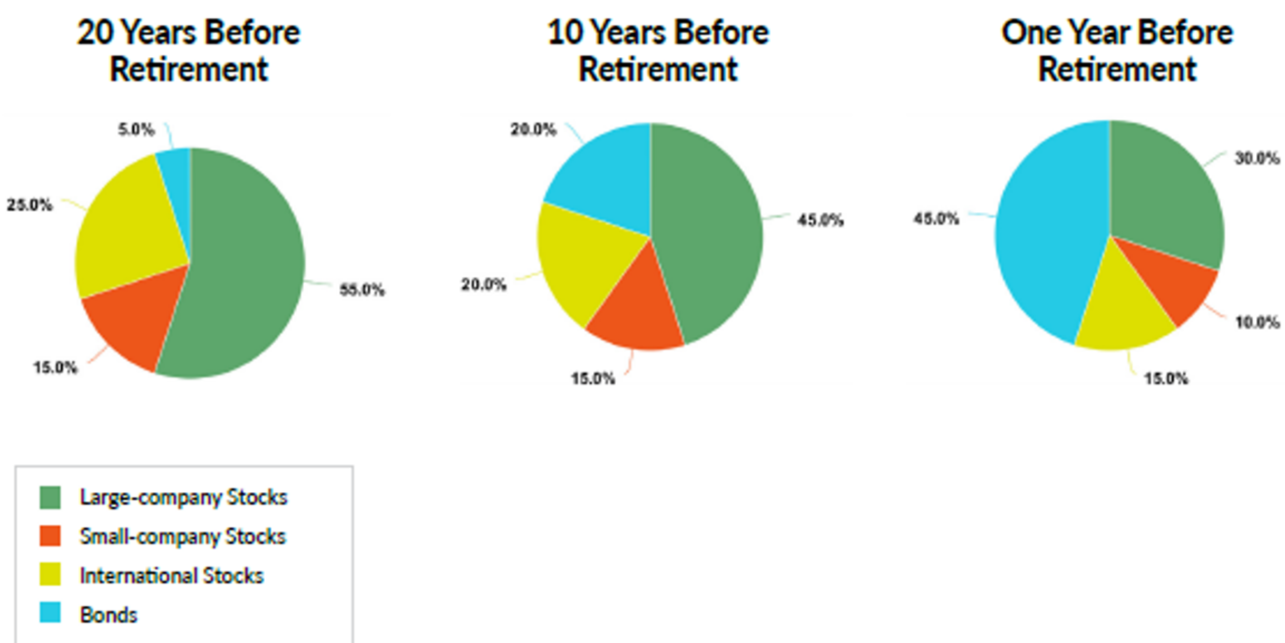
[1]Represents Full Retirement Age (FRA) based on DOB January 2, 1960

[2]PIA = The primary insurance amount is the basis for benefits that are paid to an individual

Stocks and Bonds

Two of the most common investments used in financial planning are stocks and individual bonds. Traditionally, stocks provide higher yields and come with higher risk. In contrast, bonds earn interest through maturity and are often less lucrative but more stable. As such, the Securities and Exchange Commission (SEC) notes that many people increase their ratio of bonds to stocks as they approach retirement.

Most stocks are extremely liquid. Additionally, most bonds issued from well-established sources are also liquid. Stocks are considered a variable security, as their values rise and fall with the market. Individual bonds are typically a fixed-income security, meaning the interest rate doesn't change. You'll also know the exact value of the bond that the debtor will pay you at maturity. However, if you sell the bond before maturity, its value may be different, depending on the current interest rate environment.



Exchange Traded Funds vs. Mutual Funds

Mutual funds remain the dominant player in the investment world, thanks to their prominence in retirement plans. However, Exchange Traded Funds (ETFs) have been growing quickly in the last decade, as investors are drawn to their low fees and ease of trading. Some funds engage in what's called active management, in which the fund's manager picks what stocks to buy and sell. This approach is more typical for mutual funds. The other approach is called passive investing. Here the fund manager doesn't select the investments, but rather mimics an index like the S&P 500. This approach is more typical of ETFs, though ETFs may sometimes be actively managed.

	ETFs	Mutual Funds
If you prefer lower investment minimums	An ETF could be more suitable for you	A mutual fund may not be a suitable investment
If you want more hands-on control over the price of your trade	An ETF could be more suitable for you	A mutual fund may not be a suitable investment
If you're looking for an index fund	An ETF could be more suitable for you	A mutual fund could be a suitable investment
If you want to repeat specific transactions automatically	An ETF wouldn't be a suitable investment	A mutual fund could be a suitable investment

Annuities

An annuity is a type of contract with an insurance company that can provide income in exchange for an initial lump sum or fixed series of payments. They come in a variety of options, including fixed, variable, and indexed. They also come with different terms, conditions, and payouts. Before placing money in any annuity, make sure you review all terms of the contract so you can fully understand the features, benefits, limitations, and fees associated with it.

Portfolio Allocation

There is no one-size-fits-all strategy for retirement income planning. Each option has its benefits and risks, and some can be complex. On some level, most people understand they're supposed to de-risk as they age. The option(s) that you choose will be correlated to your risk tolerance. Those with a higher risk tolerance, for instance, might want to continue investing in the stock market but with a strategy geared toward stock dividends rather than capital gains.

At the same time, for most people, reallocating at least a portion of your investment dollars to the more conservative world of individual bonds and other bond-like instruments also seems like a sensible approach... and it is! But it's also more complex than investing for growth, and in most cases should be done with the help and guidance of a financial advisor who specializes in retirement income.

The point is, you don't have to choose just one type of retirement income, nor should you in most cases.

Summary

Retirement is something to be enjoyed, but a successful retirement doesn't happen by accident. It takes work, planning, and most of all, the right strategy. That means a strategy that:

- Aligns with your specific retirement goals and meets your income needs
- Helps protects your principal from the dangers of market volatility and spenddown
- Helps prepares you for the many challenges unique to retirement
- Generates more reliable income that you can't outlive!

Source:

1. https://fredblog.stlouisfed.org/2017/07/healthy-inflation/
2. https://www.benefitspro.com/2019/06/03/society-of-actuaries-releases-preliminary-update-to-longevity-tables/?slreturn=20221112174431
3. Retirement and Longevity," Northwestern Mutual, 2013 [https://www.northwesternmutual.com/about-us /studies/ planning-and-progress-2013-study]
4. http://www.sec.gov/investor/pubs/assetallocation.htm

RETIREMENTbyDESIGN

Retirement Income Source

18 Crow Canyon Court, Suite 280, San Ramon, CA 94583
Office: 888.303.3203 | Direct: 925.429.5150 | Email: aflores@retirementxdesign.com
www.retirementxdesign.com