

Advisors: Give this 'Tilt' a Whirl

By Kerry Pechter Wed, Aug 3, 2016

Last month, we reported on John Walton's "tilt" method of fine-tuning systematic withdrawals in retirement. New research by the Texas hydrologist-turned-retirement income specialist combines tilting and income annuities.



A combination of annuities, modulated withdrawals from an investment portfolio and monthly Social Security benefits is emerging as a way—especially for clients who can't afford to self-insure against longevity risk—to generate safe, sustainable income in retirement.

Flexibility is one of the benefits of this method. By adjusting a) the type, timing and size of annuity purchases, b) the level of spending each year, and c) the Social Security benefit start date, advisors can re-size the legs of this three-legged strategy to suit the needs of virtually any retiree or retired couple.

New research confirms the value of this technique. In the third in a series of articles at AdvisorPerspectives.com, University of Texas at El Paso engineer John Walton (at right), simulates the outcomes of income-generating strategies that employ what he calls a “constant rate” or “mortgage” systematic withdrawal strategy, his “tilt” method of increasing or reducing annual spending in response to market performance, and the purchase of a single premium income annuity at retirement.



“None of the recommended methods ever go broke, and the remaining capital never cascades irreversibly toward zero,” Walton writes. “There is no sequence-of-returns risk and very little longevity risk. The tradeoff is income stability. Income varies each year, and if returns are poor, income will suffer unless stabilized with annuities.”

Constant rate vs. mortgage method

To provide a bit of background from Walton's earlier articles on this topic: His constant rate strategies are based on the classic 4% rule. Annual spending is fine-tuned by applying a tilt each year with the tilt ranging from -1 (i.e., liquidating 4% of the *original* account balance each year irrespective of market returns), through +0 (i.e., liquidating 4% of the *current* account balance), up to +1 (i.e., liquidating less than 4% of current account balance when the market underperforms and greater than 4% when the market overperforms).

Alternately, Walton recommends a "mortgage" strategy. It takes advantage of declining longevity to increase the withdrawal rate as the retiree ages. At retirement, the withdrawal rate is pegged to the payout from a hypothetical (unpurchased) period-certain annuity. The premium is equal to the account value and the contract expires at an estimated age of death (e.g., age 85 or 90). Each year, as the period shrinks and the hypothetical annuity payout grows, the retiree can spend an incrementally higher percentage of the remaining portfolio.

In his most recent article, Walton combines these methods with the actual purchase of a single premium inflation-adjusted income annuity (SPIA) that pays out 4.5% starting at age 65, purchased at retirement.

His hypothetical case involves a 65-year-old woman with a starting portfolio of \$1 million who expects to receive an inflation-adjusted \$25,000 from Social Security each year for life and buys a SPIA with \$750,000, \$500,000, \$250,000 or none of her savings.

The best combination of income and safety resulted when the retiree used 25% to 50% of her initial capital to buy the inflation-adjusted SPIA at age 65, Walton found. The more money dedicated to the annuity, the higher the client's income floor and the lower the amount left to heirs. Strategies with annuities work best in low-return environments, and can be superfluous in high-return environments.

For the investment portfolio, Walton noted that the income annuities provide a margin of safety that allows clients to allocate 80% of their non-annuitized saving to equities. In the event of market volatility, the advisor conserves the portfolio by adjusting annual liquidation according to the tilt—i.e., spending less in downturns and more in upturns.

"When combined with guaranteed income, the positive tilts provide a very robust combination of high stable income and capital security over a broad range of market conditions," Walton wrote. "They combine the statistical advantages of annuities—safe

return of capital and mortality credits—with the statistical advantages of positive tilts—providing income that adaptively matches market returns while preserving capital.”

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