# An HNW Adviser’s Personal Income Plan

By Kerry Pechter *Thu, Dec 19, 2019*

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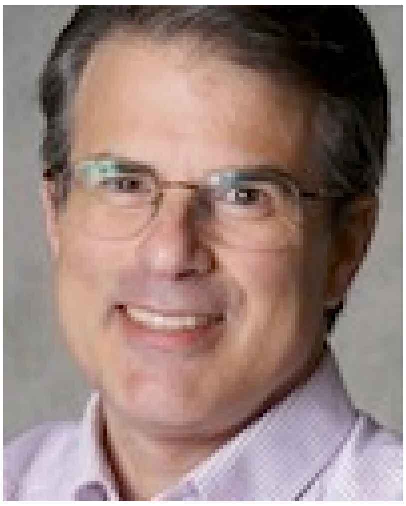

Meet Alex Powers, a 62-year-old institutional bond manager and former private banker and portfolio manager. Not quite retired, he shuttles seasonally with his wife between a house in suburban New Jersey and a cottage on Cape Cod. Their two Millennial-age children are educated and self-supporting.

Eight years ago, at 54, Powers started facing his retirement planning chores. His longevity risk was hard to gauge; his mother’s family was short-lived, but his father is 97 years old and an aunt had lived to 96. His wife’s folks are 88 and 87. So the couple needed to prepare for long lives and potentially large long-term care costs.

He turned to a relatively recent annuity concept: deferred income annuities, or DIAs. For those unfamiliar with DIAs, they are income annuities that are typically purchased early in retirement for a lump sum and start paying out a fixed monthly income at age 75 or later.

“I liked the deferred income annuity concept,” he said. “As an investor, you want to diversify your risks. Buying a certain amount of stable income seemed like a good idea for a portion of our assets. Annuities also seemed to represent a good deal relative to bonds.” He believes individuals should start to consider DIAs five to 10 years before retirement to get the most out of the mortality risk pooling effect (which distributes the assets of annuity owners who die to those who live on.)

In 2011, he purchased what he described as a small joint-life DIA, from The Hartford (later Global Atlantic), that will start paying an income when he and/or his spouse reach age 84. Given the 30-year deferral period, the late income start date, and his choice not to add a cash refund feature (which would pay their beneficiaries a death benefit if the they didn’t live long enough to recoup any or all of their original investment), he was able to buy the future income stream at a steep discount.

Two more DIA purchases followed. At age 58, Powers bought a New York Life contract that starts paying out a fixed income when the couple reaches age 76. That same year, he bought a Northwestern Mutual Life DIA contract that starts paying a variable income when they reach age 79. The income is variable because the contract earns the life insurer's dividend each year during the deferral period. This type of contract promises less guaranteed future income than a fixed DIA but a chance for much higher income.

Overall, Powers said he applied 6% to 7% of his savings to DIAs, creating a ladder of income that increases as each of his sources of guaranteed income kicks in. Social Security benefits for him and his wife will start at age 70, to be supplemented by additional layers of guaranteed income at age 76, age 79 and age 84. He also has a defined benefit pension that he can start taking anytime between the ages of 65 and 70½.

"I look at the DIAs as 'longevity insurance,' he told me recently. "My wife worries about nursing home expenses. To us, this is better than long-term care insurance. You get the money no matter what. And the further out you buy it, the less it costs. I'm not a big believer in the 4% rule."

"We'll eventually be getting a bit less than 40% of our income from guaranteed sources. We don't spend a ton of money relative to our means. The DIAs will cover most of our basic income needs as long as inflation stays under 3% to 3.5%. I figure that if inflation runs no more than 3%, the proportion I get from guaranteed income will eventually go up to 60%.

"Other than mortality risk pooling, asset diversification is the only free lunch in the investment world. The more ways you can diversify the better off you'll be. The way to do that is to have investments that are uncorrelated."

Besides income annuities, he holds a sprinkling of real estate investment trusts (REITs), along with long-duration bonds, junk bonds, closed-end funds, gold, and index funds. He describes his portfolio as 40% bonds, 30% stocks, 10% closed end funds (mainly fixed income) six percent REITs and five percent gold.

"My dad thinks I'm nuts to own gold, but I think of it as an inflation hedge, a deflation hedge and a political-upheaval hedge," Powers said. "I could probably go with more in stocks, but I believe this allocation improves my safe withdrawal rate."

What about the rest of the Powers' "household balance sheet"? With so much back-loaded guaranteed lifetime income, they probably won't need their personal real estate as a buffer against longevity risk. Plans for their two paid-off homes are still unspecified, he added: "If we need additional money for long-term care, then we can sell one of our homes. At this point we don't think the kids will be interested in them."

As for tax planning, "We use a professional tax return guy who I can bounce ideas off of," he said. "Just this year I started doing a limited conversion to a Roth IRA.

"The conversion was intentionally limited because I don't want to bump up my tax bracket much. I should do more research on Roth conversions as a hedge against future tax law changes." Regarding the DIAs, "we haven't worked out the tax effects as much as we could." As for bequests, "We have done some estate planning in case we both meet an accidental death. But nothing more significant."

Having been both an adviser of ultra high-net-worth investors and an institutional trader/portfolio manager, he learned a few lessons. Wealth managers are too quick to try to sell single securities and structured notes to wealthy clients, he said. He also discovered that a firm's best investment managers are more likely to be running the firm's own money or its proprietary funds than advising clients. Yet he doesn't think most people should try beat the market on their own. "Investing in index funds is a good thing," he said.

"People who are used to selling stocks and bonds for a living tend to discourage you from buying annuities. The people who sell annuities want you to put a lot of your portfolio in them. The proper solution—the truth—is somewhere in the middle," Powers said. "By far the most important thing that advisers do is to help people through the down periods so they don't get scared out of the market."