Retirement Income
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How to Walk Through Fire

By Kerry Pechter *Tue, Aug 4, 2009*

Crossing the retirement "red zone" might be compared to a fire-walk. But here are three advisors who are guiding clients (and their portfolios) from age 55 to age 65 with barely even a hot-foot.

Since last fall's market crash, you hear a lot about advisors who are struggling to repair their clients' portfolios, their clients' confidence in them, or their clients' optimism about retiring on schedule. But not every advisor or client is singing the Wall Street blues.

Three advisors who, perhaps coincidentally, all live and work in the Western half of the U.S., say that most of their older clients feel cool and calm despite the firestorm around them. That's because they've already established a retirement floor income that's invulnerable to market volatility.

In Denver, for instance, Phil Lubinski's clients who are within five years of retirement aren't canceling any travel plans. That's because Lubinski, who uses a version of the classic "bucket method" of investment management, has pre-funded their initial retirement years.

"I read all these articles about people who say, 'I can't afford to retire when I wanted to,'" Lubinski said recently. "I estimate that people need at least $175,000 of income over the first five years of retirement. Five years before retirement, I'll carve off $146,000 and let it grow for five years at three percent. Then the next five years is covered.

"Some people will say, 'Do I really want to give up five years of market returns on almost $150,000?' I say, 'What's more important: the rate of return or the certainty of being able to retire on schedule? If you keep the money invested, you run the risk of not being able to retire.' I advised one client to put $400,000 in a stable value fund before retirement. He said, 'Are you nuts?'"

"It just seems obvious to me," Lubinski added. "So few people or advisors have a strategy that looks ahead farther than 12 months. They're not thinking long-term."

When creating a retirement income plan, Lubinski sets up six "buckets" and divides the client's investable assets among them. Generally, the first bucket is filled with cash equivalents and funds the first five years of retirement. The next bucket, typically in bonds, funds the next five. Each succeeding bucket starts with a smaller base and a higher risk profile. The sixth bucket funds living expenses from ages 90 to 95, if needed, or a bequest.

If the assets in each bucket grow at their historical rates, they will be converted to low-risk assets at "maturity." If they don't grow, the client adapts by spending less or perhaps borrowing from the last bucket. "It's always possible that that year's income won't be as high as we thought it would be. On the other hand, if you hit your [appreciation] target early or if you can hit by going in at a lower risk level, that's what we'll do," Lubinski said.

The misunderstood asset

Dean Barber, who runs an advisory firm in Lenexa, Kansas, specializes in clients who are about to retire or have already retired, including about 600 families with $700 million under management. "We deal with the 'Millionaire Next Door'," he said—folks who tend to err on the side of risk-aversion and frugality.

Perhaps because of his clients' age and risk profile, Barber focuses on playing defense. "Our philosophy is to protect first and grow second," he told RIJ. "In late 2007 and early 2008, we got extremely defensive. So our conservative portfolios were down only one percent, and our most aggressive was down 22%. We deployed a little more capital back into stocks in February of this year, and now we're about 20% long in equities in our most conservative portfolio."

Exploiting Social Security is the center of Barber's retirement income philosophy. Unlike many retirees who might take Social Security benefits at 62 and protect other wealth, Barber's clients take Social Security at age 70 and set aside no-risk assets as bridge income until then.

"Let's say you want to replace Social Security for a few years. You take a piece of money and spend it down. You spend the IRA money. You use a money market account or a short-term bond fund, and you create a high probably of success. Sequence of returns risk disappears," Barber told RIJ recently.

"Social Security is a misunderstood asset class," he said. "You'd need almost $250,000 more in savings to equal what Social Security can do for you, with its increases over time. The amount of dollars left on the table by not incorporating Social Security as the main driver is shocking. But our industry gets paid to manage assets, so why would they tell you spend your money first?"

That reduces the pressure to assume market risk, so Barber can focus on addressing other risks in retirement. "There are so many more risks than market risks," he said. "You have to ask yourself the question, what could possibly go wrong? There are taxes—that's just around the corner. There's inflation. There's the premature death of a family member. Bad investments are just one potential problem."

'Situational awareness'

Larry Frank, a Rocklin, California, advisor, has a somewhat younger clientele who are just encountering income issues. As first reported in an earlier issue of RIJ, he combines a traditional 3% to 5% SWiP method for generating retirement income with a two-bucket system that segregates client assets into ready money and reserves.

As his clients have aged, Frank has gone through a personal evolution. "The first time I went through this kind of market, between 2000 to 2003, I was on the learning curve," he said. "I believed the mantra that if you invest for the long term, you'll come out fine. At the time, my clients were still accumulators."

Frank dealt with the 2008-2009 market crisis mainly by responding early. Two years ago, spotting troubling economic signals, he stopped buying the market dips and backed away from equities, particularly for clients close to retirement.

“Starting in the middle of 2007, I began pulling back, to a moderate allocation of 60% to 80% stocks,” he said. “Because my over-55 group is more at risk of losing employment or having a health issue, I pulled them back to a balanced 50/50 allocation moderate allocation, and in April 2008 I pulled them back another notch, to 75% short-term bonds and 25% stocks. But the accumulators we didn’t change unless they insisted. They went down with the market and now they’re coming back with the market.”

“Other advisors claim that this is market timing,” he said. “But I’m not trying to predict anything. It’s all based on mathematical triggers.” For instance, if a decline in market values raises a client’s effective withdrawal rate high enough to substantially increase the client’s age-adjusted risk of running out of money, he’ll tweak the payout rate and, in some cases, halt the flow of money from the long-term bucket to the short-term bucket.

At the same time, he’ll study economic indicators and Federal Reserve policy to determine whether the fluctuations are likely to be market noise or a fundamental market shift. “You have to do it with the grey matter,” said Frank, who described his system in the *Journal of Financial Planning* last April. “In the military”—Frank flew helicopters and C-141 transports—“we called it developing ‘situational awareness.’”