
It Ain't Always Rocket Science

By Editor Test *Wed, May 26, 2010*

"Thank God I'm not the average retiree trying to decide who or what to believe regarding what to do with my retirement savings."

The other day on the radio I heard a talk show host describing a product that provided retirees all of the upside potential of the stock market with NO downside risk.

And, if you acted now, there would be a "bonus" interest rate added to your account for the first year.

In addition, you could begin a monthly income that would grow with the market, but could never go down. And all of this "GUARANTEED"!!!! A simple, single product solution that addressed every retiree's concern.

Throughout the program there was much discussion about other investments and the world economy.

When I researched the host of this show, I discovered that he was not registered with a broker dealer, did not have a securities license nor any license that would allow him to advise on investments. In other words, he was not regulated by the investment industry.

Then, not long after this astounding presentation, I read a commentary stating that a properly designed retirement income portfolio must consider the pricing of puts and calls, risk premiums, forward pricing, lognormal assumptions and standard deviation. These discussions were led by Ph.D.s, MBAs and economists.

All I could think to myself was, "Thank God I'm not the average retiree trying to decide who or what to believe regarding what to do with my retirement savings."

Simply stated, a retirement income solution should not be a single product, nor should it be based on some mathematical analysis that requires an advanced degree in quantum physics.

In my opinion there are three steps to an overall retirement income strategy:

1. Define and create an adequate "floor" of income that you cannot outlive.
2. Segment your retirement into no longer than five-year increments.
3. Create the proper mix of fixed and market opportunity asset classes.

Let's begin with the *floor*. I define the floor as the source of payment for all those expenses that you can't avoid (basic survival needs). Typically, these expenses fall into the food, clothing and shelter categories. Your sources of income to meet these expenses could include pensions, Social Security, life annuities, and deferred annuities with guaranteed income riders.

Now, on to *segmentation*. Most of the additional expenses above your "floor" are important, but are not

necessarily critical and don't repeat themselves every year. (Certainly they are desirable for a comfortable and worthwhile retirement.) These would include travel, new cars, gifts, dining out, entertaining, etc. For most retirees these expenses comprise 25%-50% of their total income need.

Dividing your retirement years into five-year segments allows you to adjust your income periodically in case these expenses change or go away. Segmentation also allows for adjustments to events that are unplanned or out of your control, such as helping children or grandchildren, coping with changes in health, keeping up inflation or taking advantage of opportunities.

Finally, *proper mix*. Having a proper mix of fixed and growth asset classes in your overall portfolio is important to ensure an inflation-proof income. The exact mix is a function of an easy acronym: TNT (Time, Need and Tolerance). What is your retirement TIME horizon, how much income do you NEED and how high is your TOLERANCE for risk.

This mix will obviously be different for everyone, but a good rule of thumb is to put at least 25% of your portfolio in equity (growth) asset classes. The first ten years of your retirement income should be taken from fixed accounts, while the remaining growth-oriented portfolios can be re-invested and ride the market's turbulence.

There are a variety of products that are consistent with this 1, 2, 3 approach. Thoughtful consideration and research should be applied before you choose them. As you proceed, keep in mind:

1. Don't put all your retirement savings in one product.
2. Guarantees come with a "cost."
3. Ideally, the advisor who specializes in retirement income planning should have multiple licenses, and have expertise in insurance as well as investment products.

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