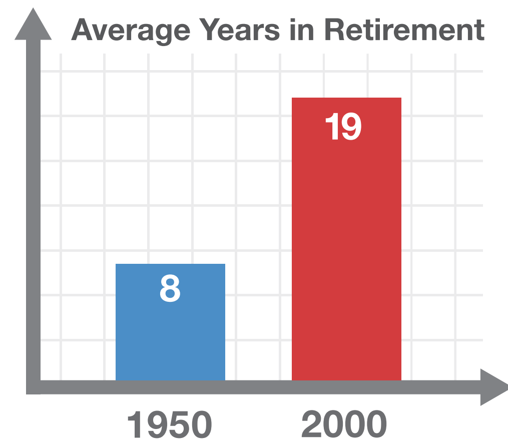
Balancing the Need for Growth and Income in Retirement

Help your clients build the right investment mix to see them safely through their whole lives

Look up the word "retirement" in a dictionary and you may come across something like this: "a withdrawal from one's position or occupation or from active working life."[1] As you likely know from experiences with clients, however, retirement today often involves taking up a second career, working part time or volunteering. Today's retirees, in fact, are defining retirement in countless new ways. This shift requires that advisors pivot their approaches to incorporate clients' changing expectations for their retirement years.

One reason retirement is taking on so many forms is that people have many more years to explore and enjoy. While men spent an average eight years in retirement in 1950, that figure had more than doubled, to 19 years, by 2000.[2] Rising life expectancies mean that many clients will experience a retirement that is much longer. For instance, while the average 65-year-old woman can expect to live until age 86.6 and the average 65-year-old man can expect to attain age 84.2,[3] roughly one of every four 65-year-olds today will live past age 90, and one out of every 10 will live past age 95.[4] What's more, today's retirees are relishing a longer period of good health. Women age 65, for instance, live an average of 14.8 years in full health and men age 65 live for almost 13 years in full health, according to a healthy life expectancy measure developed by the World Health Organization.[5]

It's no surprise then that retirees expect to remain active and pursue new goals. Instead of stopping work altogether, they are planning retirements in which "they might work, take career breaks, go back to school, volunteer and try different things in no established order," according to a survey conducted by the Stanford Center on Longevity.[6] Just as they are pursuing individualized retirement goals, clients today are seeking customized financial planning that reflects their own specific circumstances. As a result, financial advisors have an opportunity to take on an increasingly valuable role as longevity strategists, creating portfolios that can meet both growth and income needs during clients' long, active lives.



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-Stanford Center on Longevity survey [6]

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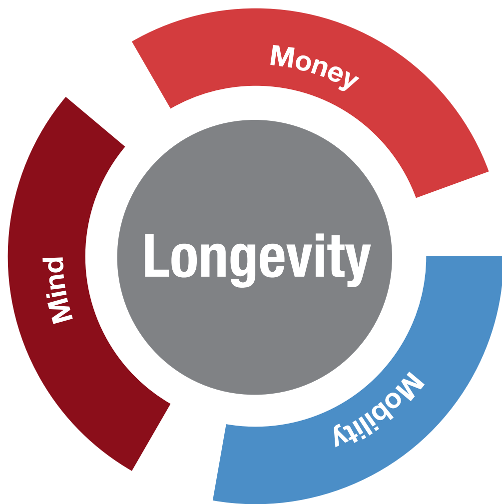

Longevity gives advisors new opportunities

> **As people live longer, we want them to be prepared to have the lifestyle they imagined.**
>
> *-Nag Odekar*
> *VP of Marketing for Great-West Financial*

More than 90% of people say that it isn't enough to simply put aside money for retirement, according to the survey by the Stanford Center on Longevity. Clients want a more personalized and specific plan that goes beyond traditional retirement planning.[7]

Many financial advisors, however, focus on a target number that clients need to accumulate without taking time to assess each individual's spending needs, says Nag Odekar, vice president of marketing for Great-West Financial. Rather than focusing solely on accumulation, advisors should be having conversations with clients about such things as professional development, lifestyle interests and managing health and possible chronic illness. Advisors who have these conversations will gain a much better estimate of a client's spending needs—and will then be able to develop a retirement plan that suits his or her situation. "Advisors should not just focus on an accumulation strategy, but they must also educate clients on building a spending strategy," says Odekar.

This dynamic demands that financial advisors take on a new role as longevity advisors. Advisors who embrace this role have the deepest, broadest life-planning conversations with their clients and offer the widest range of product solutions, according to Joseph Coughlin, director of the Massachusetts Institute of Technology AgeLab.[8] What's more, such an approach can help advisors build rich, meaningful relationships with their clients. "As people live longer, we want them to be prepared to have the lifestyle they imagined," says Odekar.

Old saving and spending rules no longer apply

With retirement becoming increasingly individualized, old “rules of thumb” may no longer work adequately. For instance, conventional wisdom has traditionally suggested that people should save enough to replace 70% to 80% of their current living expenses during retirement. Some retirees, however, may spend more during the initial phase of their retirements, while others spend less.

Another rule of thumb that may no longer apply today is the 4% withdrawal strategy, says Odekar. For one thing, investment returns are likely to be lower over the next 20 years than they were over the past 30 years, according to a 2016 report by McKinsey Global Institute.[9] In addition, longer retirements may require a lower withdrawal rate if clients are to avoid outliving their assets.

The decreasing utility of these old rules further supports the need for advisors to take an individualized, strategic approach to clients’ financial plans and retirement portfolios. With the increasing number of low-cost “robo-advisor” services, advisors who provide personalized, sophisticated services will add value and remain competitive.

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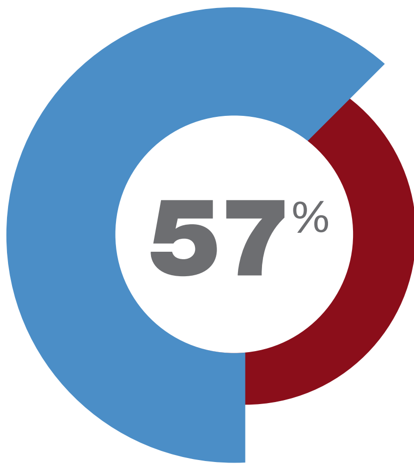
Structuring clients' retirement portfolios for both growth and income



More than half of Americans (57%) say that their biggest worry about retiring is outliving their nest egg.

-American Institute of CPAs survey

More than half of Americans say that their biggest worry about retiring is outliving their nest egg, according to a survey by the American Institute of CPAs.[10] After all, if the market goes through a prolonged downturn during retirement, your clients may no longer have time to benefit from the ensuing recovery. To ensure that their future is secure, you must design portfolios that are balanced for safety, growth and income.

One way to build security into a retirement plan is to help clients create the equivalent of a regular "paycheck" in retirement using protected sources of income. Fully 84% of people say that having a protected lifetime monthly income in retirement is important to them, and nearly half say that protected income is the most important goal for their retirement, according to one survey.[11]

How much income should be protected? One strategy is to match fixed expenses with fixed sources of income. "For your clients to feel secure, they need to know that their basic necessities are fully covered," says Mike McCarthy, senior vice president and head of national sales for Great-West Financial. A simple budget calculation is a good place to start: Tally the clients' essential retirement spending costs, including food, housing, utilities and insurance. Then add up their sources of protected income—typically Social Security and any pension the client may be entitled to—and compare it to their expenses. "If there is a gap, consider filling it with an annuity as a portion of their portfolio," says McCarthy.

Annuities essentially shift investment risk from investors to the insurance company that issued the annuity. The purchaser of the annuity pays an initial premium or lump sum, or makes payments over a period of time, and in return receives a stream of income similar to a pension or Social Security. In retirement satisfaction surveys, retirees who have annuitized income from a pension and/or an annuity have higher satisfaction scores throughout retirement than those who do not, according to Towers Watson.[12] What's more, clients whose basic needs are covered may be more likely to stomach the inevitable ups and downs of the growth portion of their portfolio, and potentially less likely to panic if the market takes a serious dive.

Growth, protected income and flexibility with variable annuities

While a protected lifetime income stream can bring peace of mind, it doesn't necessarily ensure that your clients will maintain their future buying power. Variable annuities, however, give clients the chance to profit from market upswings and keep their money growing longer for retirement.

Since some clients balk at the idea of giving up control of their money, variable annuities can also offer a compelling alternative to fixed annuities. Clients can continue to invest their money in the stock market through variable investments and adjust the underlying investment mix as they desire. At the same time, optional riders allow clients to purchase a guaranteed minimum withdrawal benefit that doesn't change even if the market performs poorly.

Despite these benefits, however, variable annuities are often unknown or misunderstood. They can appear complex, but the more knowledge someone has about them, the more likely he or she is to have a positive attitude about them and eventually own one, according to a LIMRA Secure Retirement Institute study.[13]

What's more, as the Department of Labor's fiduciary rule takes effect, it's all the more important for advisors to share every planning option with clients. "If you're going to be a fiduciary, you absolutely should have a conversation with clients about the possibility of including annuities in their portfolios," says Odekar.

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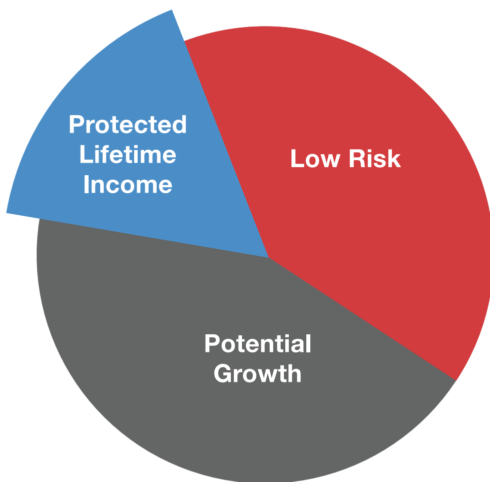
A tax-deferred investment and income option



Unlike an IRA or a 401(k), many variable annuities have no cap on the amount your clients can contribute. Yet similar to a traditional retirement plan, variable annuities are tax-deferred investments that allow your clients to avoid paying taxes on any income and gains from the annuity until they withdraw the money. As a result, their investments can have the opportunity to grow and compound every year tax-free, potentially increasing the eventual pay-out. There's also no tax hit for rebalancing your clients' portfolios or shifting money into different funds.[14] Clients typically rebalance their funds whenever they want, or choose to have their annuity portfolios rebalanced automatically. Clients may also roll an IRA into an annuity contract, turning a pool of assets into a protected stream of income.

For these reasons, once a client has maxed out his or her savings in a traditional retirement plan, annuities offer a useful way to shelter more money. In fact, while advisors most often add variable annuities to their clients' portfolios for income planning, they also use these products to provide tax-deferred growth and principal protection, according to a recent WealthManagement.com and FUSE Research Network survey.[15]

For clients who own annuities, advisors can consider reducing bond exposure and keeping more money in stocks, says McCarthy. Bonds typically help reduce volatility and preserve capital in a portfolio, but annuities may fulfill that role with the built-in safeguard of a protected withdrawal benefit. Holding fewer bonds and more stocks may improve the growth potential in your clients' portfolios while avoiding additional risk.

Clients who seek income now may choose an immediate annuity with an income protection benefit, which allows them to receive a payout every month beginning shortly after the premium is paid. Depending on the options your client chooses, payouts last for a set number of years or for life.

Meanwhile, clients who don't need access to income for five years or more may opt for a deferred variable annuity. In this case, payouts begin at a future date, allowing time for assets to accumulate on a tax-deferred basis. When distributions begin, they are made using a predetermined rate. The longer a client waits to take income distributions, the higher the percentage rate he or she will earn, within certain limits.

Advisors can recommend that clients purchase riders to further customize their annuity contracts in ways that suit their circumstances. For instance, an inheritance rider can provide heirs with either a lump-sum amount upon the client's death or a protected income stream for a certain period of time. Some annuities offer inflation adjustment features that can help ensure that clients' income keeps up with cost increases. In addition, married clients can opt for joint ownership with survivor benefits so that when one client dies, the surviving spouse continues receiving payouts.

Meeting today's planning challenges

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The combination of longer life expectancies, low expected investment returns and the decreasing availability of employer-sponsored defined benefit pensions makes planning for a comfortable retirement a great challenge. At the same time, retirees are charting many different types of retirement, creating the demand for customized financial planning. These shifts present advisors with an opportunity to play an increasingly valuable role: They can help clients shift from building wealth to developing an individualized spending plan that works for every phase of their lives and supports the lifestyle they plan to enjoy. "Longevity is about independence and dignity," says Odekar. "The best advisors should not scare their clients, but should instead help them prepare for and enjoy retirement." ■

14 Rebalancing does not ensure a profit and does not protect against loss in declining markets.

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