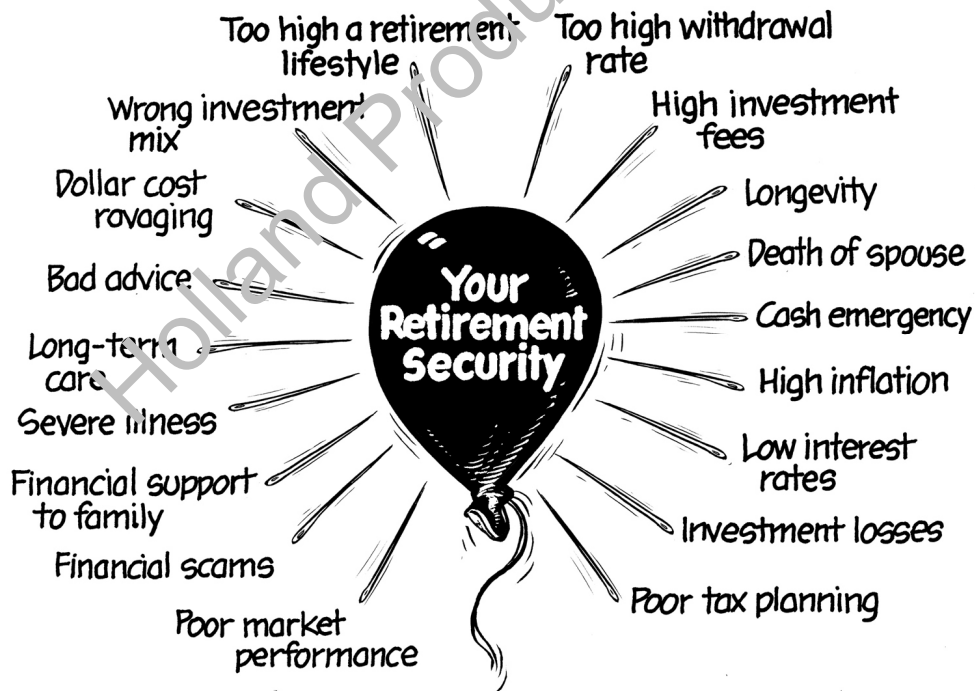


## **Secret #2: How to Eliminate the Threats to Your Retirement**

After a lifetime of hard work and personal sacrifice, most retirees look forward to relaxation and a variety of pleasant activities during their “golden years.” This lifestyle shift, however, is not the time to lower your guard because serious threats remain that can damage your retirement. I’m not talking about a home invasion or losing your wallet. I’m talking about real financial events that can drain your retirement resources. If they are not adequately addressed with solid retirement planning and the right investment and financial products, these “threat needles” could seriously *puncture* your retirement lifestyle.



We should also acknowledge that there are some financial threats over which we have little control. Unfortunately, it is these very same threats that get sensationalized, exaggerated coverage by the 24/7, ratings-driven media. Lethargic economic policies, mushrooming national debt, looming tax increases, and the expanding role of government can only be dealt with in one way: at the voting booth. Now let’s move on to the threats that, with some smart planning, we can manage or eliminate completely.

## Cash is King

**Threat #1 - Cash Emergencies:** There's a reason they say that "cash is king." When you need it, you need it! It doesn't matter why.

**So where's the threat?** The threat lies in the reality of "when you need it, you need it." If an emergency occurs and you need cash to deal with a problem, then you are going to find a way to get the cash right away. Without an adequate cash reserve, your next step will probably be to borrow funds or liquidate investments; that's the threat. If you are forced to borrow funds quickly, you might have to pay a higher interest rate or agree to other unfavorable terms. If you have investments that can be liquidated, the threat is having to sell those investments at a bad time. If your investments have suffered a loss due to a market drop, and that is the time when you need some emergency cash, bad news! Now you've got to sell investment holdings that are down in value, and you might only get 70 or 80 cents on the dollar. The unfortunate result is that you've got to liquidate more stocks or mutual funds to get the same cash.

**What's the fix?** Build up a cash reserve. Many experts say you need a cash reserve equal to three to six months of living expenses. This is not a bad rule of thumb, but can we give it a little more thought? What can go wrong in your personal situation that can cause you to need a lot of cash? Add up all of your insurance deductibles. If everything breaks at the same time, how much would that cost you? What if your roof needs to be repaired? Is your car still under warranty? Add up all of these potential outlays and then assume that they were to happen simultaneously!

\$

Health Insurance Deductible  
Car Insurance Deductible  
Homeowner's Insurance Deductible  
Major Car Repair or Replacement  
New Roof or Air Conditioning Unit  
+ Two Months Living Expenses  
Total Emergency Cash Reserve

As a double check, you can compare the dollar amount from this formula to the six months living expense number. I'd go with whichever one is higher just to be safe. When in doubt, have more cash.

## Federal Taxation: Unlimited Wants and Limited Resources

**Threat #2 - Poor Tax Planning:** It never ends. It seems like every time politicians talk about “simplifying taxes” they either *raise* them or add another thousand pages to the Tax Code. You get taxed on just about everything from your paycheck to gas for your car, electricity in your home, TV, Internet, phone, clothing, beer, wine, cigarettes, cars, boats, and houses. So, in other words, almost everything is taxed except breathing and groceries (at least not yet). To add to this, every form of city, county, state, and federal government has its hand in your pocket!

**So where’s the threat?** With so much taxation already, we need to make sure that we don’t do anything that will accidentally cause even more taxation. We need to make sure that we plan our finances to minimize taxes (unless you believe you don’t pay enough in taxes . . . if that’s the case, just send an extra check in with your next income tax return).

**What’s the fix?** Here are some smart, and not-so-smart, tax moves:

### Retirement-Smart Tax Moves to Consider

- Converting All or Part of Your Traditional IRA to a Roth IRA
- *Maxing Out* a Lower Income Tax Bracket
- Incurring Capital Gains Before Rates Are Expected to Go Up
- Using Lower Turnover Mutual Funds in Regular Brokerage Accounts and Higher Turnover Mutual Funds in IRAs

### Not-So-Smart Tax Moves

- Getting a Home Mortgage Just for the Tax Deduction
- Taking Money from Your IRA to Pay Off Your Mortgage
- Taking Money Out of IRAs and Annuities Before Age 59½
- Not Considering That Investments Get Reset to Current Values at Death, Which Usually Reduces Capital Gains

## Who Wants to Play *Monkey in the Middle*?

**Threat # 3 - Long-term Care Expenses:** Advances in medicine have extended life expectancy, but not necessarily the quality of our lives. Many of us will require some form of home health care or nursing home care during our lifetimes, and it won't be cheap. You may have already seen the huge costs involved if a member of your family has received such care. Thirty to fifty thousand dollars a year for assisted living or nursing home care is common; sixty or more is not unusual.

**So where's the threat?** If you have between \$100,000 and \$2,000,000 in financial assets, you need to take deliberate steps *now* to address the financial risks of long-term care so it doesn't wreck your retirement later.

**What's the fix?** If you have few financial resources, there is no threat. Well, actually, there is a threat, but it may not make any sense to do anything about it. In general, I've advised those who have less than \$100,000 in financial assets to simply ignore the costs of long-term care. Why? In these situations, the costs of acquiring adequate long-term care insurance can be too high for their income and assets (why worry about the costs of what might or might not happen when it's possible there won't be enough money to pay the light bill?). Yes, I said ignore it, because if long-term care is required, those high costs would quickly deplete the available resources anyway and then the care is usually paid for by Medicaid, a government-funded safety net for the poor.

On the other hand, if you have substantial financial assets, say over \$2,000,000, you could probably pay for long-term care costs out of your income or investment earnings. However, I would still investigate long-term care insurance for my clients who fit in this category.

If you've got hundreds of thousands but not millions of dollars, you're the *monkey in the middle* (just like in the grade school game). You've got enough money that you don't want to spend all of it to qualify for Medicaid, but not enough to ignore the potential costs of long-term care. That means you'll need some form of long-term care insurance. Ask an independent agent to help you find the best insurance for your individual financial situation. "Independent" means the agent doesn't represent just one insurance company and can help you compare products and solutions.

## Sins of the Father and the Daughter

**Threat # 4 - Family Financial Support:** I offer my apologies in advance on this threat because I know it is a subject that will hit too close to home for some, literally. I'm not going to tell you to disown your family or that you shouldn't spoil the grandkids whenever you get the chance. I am very concerned, however, that you could jeopardize your own financial health while trying to help a family member with severe financial problems.

**So where's the threat?** They say a drowning person is dangerous and that you shouldn't put yourself at risk when offering aid. This is so true, both *in and out of the water*. This threat to your finances is, ironically, that your *love* for the person will cause you to make emotionally-driven bad choices that will hurt your own financial well-being and may even cause you to suffer the same *financial drowning* yourself.

First Example: I've watched a retired couple ruin their own finances by supporting a son who has a drug addiction. After *years* of second chances and promises of "I'll never do it again," the parents' good intentions have left them with very few financial resources. Their once healthy retirement savings have been replaced with second mortgages and skeletal investment accounts. Instead of letting their son hit bottom, go bankrupt and maybe change his ways, the parents now face financial doom themselves. A forty-year-old son can rebuild his finances, but a seventy-year-old father has few options to replenish his retirement.

Second Example: The threat of family financial support isn't just about parents supporting their kids. I once saw a daughter expend a huge portion of her and her husband's finances to provide long-term care for her parents. Most of us would consider this an honorable act, but the generosity forced the husband to work ten years longer than he planned.

**What's the fix?** Offer them your emotional support. Help them with the basics: food, clothing, and shelter. Help them apply for governmental programs. Explore bankruptcy if necessary. However, do not give them more than 5% of your savings. If it takes more than that to fix their problems, you probably don't have enough resources to help without putting yourself at risk. How can you help them if you are *caught in the rip current* yourself? Set the 5% financial gift limit and don't budge an inch.

## Ladies Will Be Doing Finances for Themselves

### **Threat # 5 - Insufficient Survivor Income at the Death of a Spouse:**

With the average wife living about four years longer than the average husband, there is a significant chance that many women will end up handling their own finances. Of course, there are plenty of times when the situation is reversed, and the man finds himself on his own.

**So where's the threat?** When either spouse dies, retirement income is often reduced. The survivor must make do on one social security check, and perhaps, less pension income. The threat is that the survivor's solo income will be reduced to the point that her or his retirement assets must be drawn upon at an unsustainable rate. That means, at some point, the survivor could run out of money.

**What's the fix?** I am pleased to report that many couples *do* recognize that their finances will change when one of them dies. Often this leads to the wise decision to get help and develop a plan to understand exactly what could happen and how to deal with it. Of course, this kind of work is probably best done by an experienced adviser. I highly recommend that a couple build their financial plan so it will work while they are both alive, as well as in a survivorship scenario. While assisting retirees with their financial plans, I usually focus on making sure that enough reliable income will be provided to the spouse who would be more adversely affected by the death of her/his partner. In practical terms, this usually means that some financial changes may need to be made immediately. Here are some examples:

- The amount of life insurance may need to be increased.
- Long-term care costs will need to be addressed.
- Accounts may need to be "earmarked" for the survivor's needs.
- Investments may need to be more conservative or aggressive.
- The amount of joint income being taken may need to be reduced.
- More income may be needed from a guaranteed, fixed source.

The best time to do survivorship income planning, of course, is while both spouses are alive. This approach avoids the obvious difficulty of having to make financial decisions during a period of grief. Both spouses can feel confidence in the wisdom of an advanced plan for the survivor.

## You Can't Get Milk Tomorrow from the Cow You Eat Today.

**Threat # 6 - Excessive Withdrawal Rate:** Here's an obvious statement: if you take too much from your investments and savings, you will run out of money. I've had the unpleasant task of telling some retirees that they were taking too much income from their portfolios. I delivered the bad news not because I like telling people "no" or that they "can't afford it," but to keep them from running out of money in the middle of their retirement. Some financial folks may say you can draw 4 to 6% a year and not run out of money in retirement. I say that's pure bolson and here's why:

- The typical retiree has a lot of fixed expenses. If you are drawing 6% from a \$300,000 investment portfolio, you are taking \$18,000 to pay your expenses. If your portfolio's value were to drop to \$250,000, then that same 6% is just \$15,000. I simply don't believe that the majority of retirees can slash their expenses so easily (and I don't think they should have to either). Most will still need the \$18,000.
- A fixed 6% withdrawal rate also doesn't necessarily provide any inflation protection, unless your investment account is growing rapidly. To the contrary, you can actually experience a reduction in income when using a constant 6% withdrawal rate.
- While inflation will vary each year, we should budget for at least a 3% increase to have a realistic long-term plan for income.
- Moreover, drawing 6% from your investment portfolio can cause severe erosion to your portfolio's value during extended downturns in the market. Take the recent ten-year period of 2000 through 2009 as an example. Let's start with the same \$300,000 portfolio and run it through the actual returns for this period. We'll use the S&P 500 index for the hypothetical earnings, assuming dividends are reinvested. Additionally, we will assume a 2% annual asset management fee which decreases the index returns by 2%. (Take a look at the "Ending Value" on the following *Fairy Tale* chart). Who would have the bravado to stick with such a risky scheme when their portfolio falls by over 50% in the first three years? Nobody I know. How about you?

## **The Fairy Tale of a 6% Withdrawal Rate**

Year	Earnings Including Dividends	Beginning Value	Withdrawal with a 3% Inflation Rate	Net Invested After Withdrawal	Investment Earnings	Ending Value
<b>2000</b>	-11.1%	300,000	18,000	282,000	(31,302)	250,698
<b>2001</b>	-13.9%	250,698	18,540	232,158	(32,247)	199,911
<b>2002</b>	-24.1%	199,911	19,096	180,815	(43,578)	137,237
<b>2003</b>	26.7%	137,237	19,669	117,568	31,373	148,941
<b>2004</b>	8.9%	148,941	20,259	128,682	11,429	140,111
<b>2005</b>	2.9%	140,111	20,867	119,244	3,471	122,715
<b>2006</b>	13.8%	122,715	21,493	101,222	13,963	115,185
<b>2007</b>	3.5%	115,185	22,138	93,047	3,252	96,299
<b>2008</b>	-39.0%	96,299	22,802	73,497	(28,663)	44,834
<b>2009</b>	24.5%	44,834	23,486	21,348	5,223	26,571

\* Performance of the S&P 500 index includes reinvestment of dividends and a 2% annual asset management fee which decreases the index performance by 2% per year. Additional expenses, such as custodial fees and brokerage commissions, have not been considered, and if applied, would lower the return. The Standard & Poor's 500 (S&P 500) is an unmanaged index commonly used to measure performance of U.S. stocks. S&P 500 consists primarily of large-capitalization stocks and may not be representative of a typical investor portfolio during retirement. You cannot invest directly into the S&P 500. The eighteen thousand dollar withdrawal is conservatively taken at the beginning of each year before applying the index annual return.

**So where's the threat?** This one's easy. If 6% is too much to withdraw annually, then you definitely cannot take more than 6%. If you take too much, you will run out. It is that simple. As the \$26,571 ending value in 2009 screams, the damage can be irreparable. Sometimes waiting only makes things worse.

**What's the fix?** First, get a plan with realistic income projections that include inflation. Second, don't invest too much directly in the stock market. Third, make sure that a significant portion of your retirement income comes from fixed sources that don't depend on what the stock market does each year.

## Bouncing the Check to the Undertaker

**Threat #7 - Unsustainable Lifestyle Spending:** Slow down. That's exactly what some people need to hear about their finances and lifestyle spending. These are usually the same people who hate the word, "budget." Hey, I understand; I can spend money as well as anyone. While you are working, you can get away with the occasional bouts of excessive spending because you have the time and the cash flow to replenish the deficit. However, when you stop working, your options shrink. You must make sure that your spending doesn't exceed your income.

**So where's the threat?** If your outflows exceed inflows, the difference has to come from either debt (such as credit cards, which is just delaying the problem) or from a reduction of your retirement assets (i.e., your investment principal). However, the more you reduce your investment principal, the greater the likelihood you'll run out of money. That is a serious threat to your retirement. A common source of stress among retirees (and arguments between spouses) is that they don't know how long their assets will last and how much they can draw each month.

**What's the fix?** Build a financial plan. Problem solved! A well-constructed financial plan is going to give you a year-by-year projection of how much consistent income your assets can provide. That income, after taxes of course, is what you get to spend! This is why I love planning for baby boomers and retirees. You can be more confident about what you can spend without running out! You can plan on that new kitchen, a new motorcycle, new cars, two rounds of golf a week, travel, vacations, addressing long-term care, fighting long-term inflation, and yes, even *bouncing that check to the undertaker* (well, not really, but you can decrease the likelihood of leaving a windfall to anyone when you die).

While I don't presume to be a relationship counselor, I have worked with hundreds of retirees, many of whom were couples. From this experience (and with apologies to Dr. Phil), I will say that spousal harmony seems to increase proportionally with financial certainty. More prudent spouses seem to relax once they know that they're not going to run out of money and more carefree spouses are happier because they get to spend and have fun, which is what they want anyway. Planning can be good for your finances and can be very good for your marriage. Don't fight. Get a plan.

## The Deadliest Way to Catch Your Retirement

### **Threat #8 - Trying to Use Dollar-Cost-Averaging in Retirement:**

Dollar-cost-averaging is a commonly used investment strategy where someone consistently invests a set dollar amount on a regular basis. Millions of working Americans do it with payroll-deducted contributions to 401(k) accounts. By investing, say a fixed \$100 each month, investors buy more stock or mutual fund shares when the stock market is lower than when it is higher. If this strategy is used over a long period of time, there is an opportunity to get a lower average investment purchase price, which means less is paid for more shares. That means more profit when the stock market goes up. In other words, when the price of investments goes up, we buy fewer shares; when the price goes down, we buy more. It is like automatically buying more of something when it goes on “sale.” Dollar-cost-averaging is considered by many to be a prudent investment strategy when saving for retirement.

**So where’s the threat?** Things can go seriously wrong if you try to use dollar-cost-averaging when you are retired. When you start taking money out for retirement income, dollar-cost-averaging becomes risky because you may have to liquidate more of your investments when stock prices are lower to get the same monthly income. Look back a few pages at the **Fairy Tale of a 6% Withdrawal Rate** and recall what can happen to retirement savings if dollar-cost-averaging is used in retirement. The impact on savings can be devastating if the stock market suffers a sustained downturn. What was helpful dollar-cost-averaging during the accumulation years, becomes a dangerous tactic in the retirement years that can ravage a portfolio... so I call it *Dollar-Cost-Ravaging*.

**What’s the fix?** Don’t withdraw your monthly income from funds invested directly in the stock market or investments that can go down in value. I routinely recommend that retirees draw their income from investments and financial products where there is little or no risk of having to sell at a loss. I prefer stocks with high dividends, bonds for interest, and fixed annuities for a steady, reliable flow of income. Your personal circumstances and current conditions will determine what is best for you.