Independent Investor

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Asked and Answered: Key Questions About Retirement Income Planning

Managing money in retirement involves decisions about withdrawal rates, asset allocation and a host of other factors that will impact your lifestyle and how long your assets will last. Following are some straightforward answers to commonly asked questions about planning for income needs in retirement.

When should I begin thinking about tapping my retirement assets and how should I go about doing so?

The answer to this question depends on when you expect to retire. Assuming you expect to retire between the ages of 62 and 67, you may want to begin the planning process in your mid- to late 50s. A series of meetings with a financial advisor may help you make important decisions such as how your portfolio should be invested, when you can afford to retire and how much you will be able to withdraw annually for living expenses. If you anticipate retiring earlier than age 62 or working later than age 67, you may need to alter your plans accordingly.

How much annual income am I likely to need?

While studies indicate that many people are likely to need between 60% and 80% of their final working year's income to maintain their lifestyle after retiring, low-income and wealthy retirees may need closer to 90%. Because of the declining availability of traditional pensions and increasing financial stresses on Social Security, future retirees may have to rely more on income generated by personal investments than today's retirees.

How much can I afford to withdraw from my assets for annual living expenses?

As you age, your financial affairs won't remain static: Changes in inflation, investment returns, your desired lifestyle and your life expectancy are important contributing factors. You may want to err on the side of caution and choose an annual withdrawal rate somewhat below 5%; of course, this depends on how much you have in your overall portfolio and how much you will need on a regular basis. The best way to target a withdrawal rate is to meet one-on-one with a qualified financial advisor and review your personal situation.

When planning portfolio withdrawals, is there a preferred strategy for which accounts to tap first?

You may want to consider tapping taxable accounts first to maintain the tax benefits of your tax-deferred retirement accounts. If your expected dividends and interest payments from taxable accounts are not enough to meet your cash flow needs, you may want to consider liquidating certain assets. Selling losing positions in taxable accounts may allow you to offset current or future gains for tax purposes. Also, to maintain your target asset allocation, consider whether you should liquidate a portion of an asset class that may have become overweighted (i.e., exceeded your intended allocation).[1] Another potential strategy may be to consider withdrawing assets from tax-deferred accounts to which nondeductible contributions have been made, such as after-tax contributions to a 401(k) plan.

If you maintain a traditional IRA, or a 401(k), 403(b) or 457 plan, in most cases, you must begin required minimum distributions (RMDs) after age 70½. The amount of the annual distribution is determined by your life expectancy and, potentially, the life expectancy of a beneficiary. RMDs don't apply to Roth IRAs.

Are there other ways of getting income from investments besides liquidating assets?

One such strategy that uses fixed-income investments is bond laddering.[2] A bond ladder is a portfolio of bonds with maturity dates that are evenly staggered so that a constant proportion of the bonds can potentially be redeemed at par value each year. As a portfolio management strategy, bond laddering potentially may help you maintain a relatively consistent stream of income while limiting your exposure to risk.

When crafting a retirement portfolio, you need to make sure it generates enough growth to prevent running out of money during your later years. To facilitate this goal, you may want to maintain an investment mix that has the potential to earn returns that exceed the rate of inflation. Dividing your portfolio among stocks, bonds and cash investments may provide adequate exposure to some growth potential while also helping to protect against market setbacks.[3]

[1]Asset allocation does not assure a profit or protect against a loss.

[2]Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

[3]Investing in stocks involves risks, including loss of principal.

There is no assurance that the techniques and strategies discussed are suitable for all investors or will yield positive outcomes. The purchase of certain securities may be required to effect some of the strategies.

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.