Preparing For An Income To Last A Lifetime:

Rebuilding Your Retirement Income

To have a secure retirement, with Social Security underfunded and pensions disappearing, it is imperative that you turn your personal savings into guaranteed income for life.

Financial Security Group

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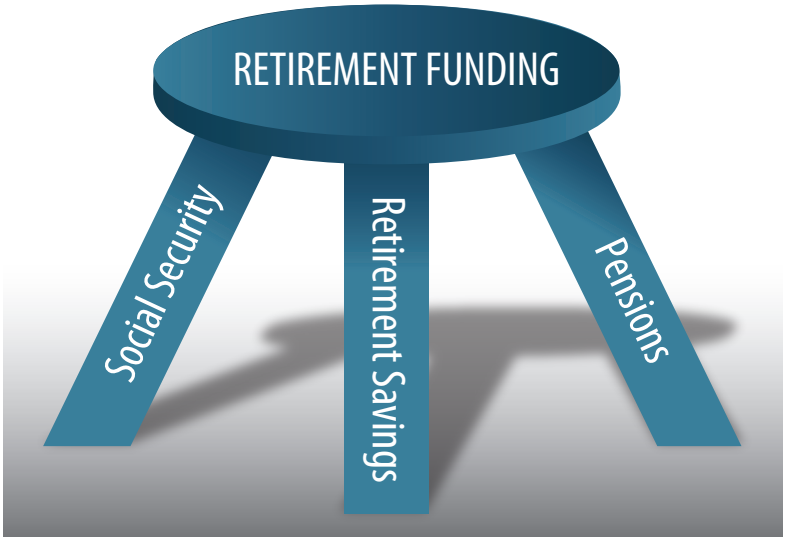


Not that long ago, the typical retirement plan consisted of three income sources often referred to as the three "legs" of the retirement income stool: Social Security income, pension income, and withdrawals from personal savings. Strength in each leg would produce a comfortable and secure retirement income.

However, in today's turbulent economy, with the Baby Boomers rushing headlong into retirement, two of the legs have become weak and wobbly. As a result, you will likely be dependent on your own retirement savings to generate income. Let's look at how this happened and how you can prepare.

Social Security – The Weak Leg

It seems every week there is a new headline detailing the rocky road ahead for Social Security. The 2014 Social Security Trustees Report projected the Trust Fund, which holds surplus money to pay beneficiaries, will be empty by 2033. As a result, they may not be able to pay 100% of projected benefits. You have probably been wondering how you and your retirement may be impacted by the changes ahead.

The Social Security system was created by FDR during the Great Depression to help reduce poverty among older Americans and to encourage older workers to retire so that jobs would become available to younger workers. Back then, people were not expected to collect Social Security for very long. In fact, the life expectancy for males was only age 58![1] Considering those levels of life expectancies, the program was not structured to provide the bulk of a retiree's income for several decades.

However, Ida May Fuller of Vermont, the recipient of the very first Social Security check, provided an interesting foreshadow of today's funding shortfall. She retired in 1940 at age 65, and then lived to the ripe old age of 100. She paid a total of $24.75 into the system while working, but received $22,888 in benefits!

While Ida May might have been an exception in her day, now people over age 85 is one of the fastest growing age groups (see Figure 1). Today, a male's life expectancy is age 76 at birth, and if he lives to age 65, his life expectancy is age 82![2] According to MarketWatch, for a married couple, both aged 65, there is a one in four chance that one spouse will live for another 30 years. Paying out benefits for that length of time inevitably puts a strain on the system.

[1] Social Security Administration - http://www.ssa.gov/history/lifeexpect.html
[2] Social Security Administration - http://www.ssa.gov/oact/STATS/table4c6.html

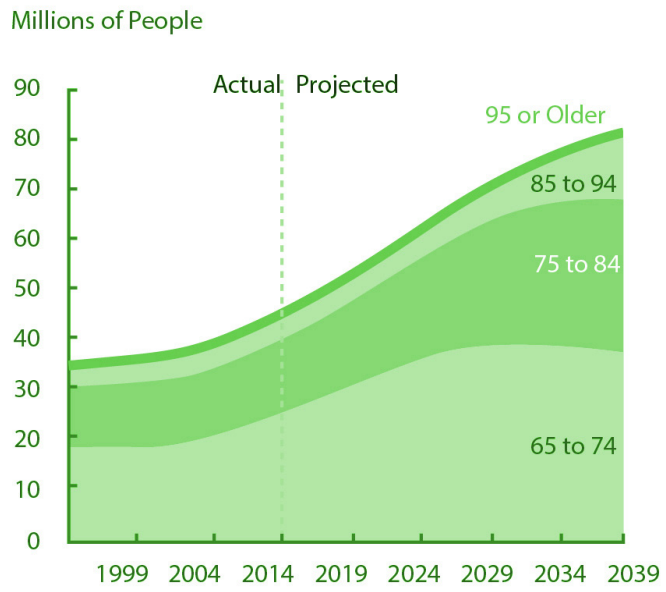
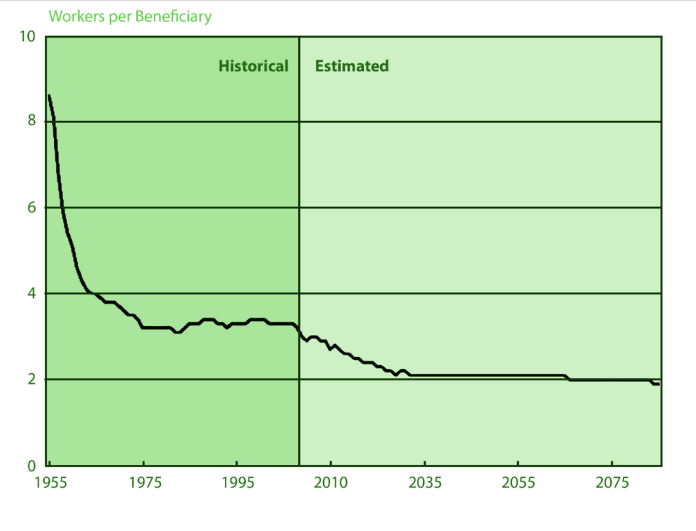


Figure 1: Number of People Age 65 or Older, by Age Group

Longevity is not the only cause of the Social Security system's poor fiscal health. The number of people contributing to the program compared to the number of people receiving benefits is falling. Baby Boomers are retiring in greater numbers every day and will continue to do so for over a decade. More people are leaving the work force than are entering it, putting more and more pressure on the system. Figure 2 illustrates the historical, current, and projected ratio of workers to Social Security beneficiaries.

Source: Congressional Budget Office



Source:
2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table IV.B2.
http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2011/fast_facts11.html

Figure 2: Ratio of Workers Per Social Security Beneficiary

Fewer workers, combined with increasing life expectancies, should cause every current and future retiree to be concerned about the stability of their Social Security check.

Possible reductions in future benefits will devastate one of the most important features of Social Security: inflation protection. The length of retirement for someone retiring today can easily stretch to 30 years or longer. Over that length of time, inflation can greatly erode purchasing power. Take a look at Figure 3, which shows how much $10,000 is worth over time, assuming a 3% annual rate of inflation.

Figure 3: Effects of Inflation on $10,000 over 10, 20, and 30 Year Intervals

Value of $10,000 in...		
10 Years	20 Years	30 Years
$7,441	$5,537	$4,120

Clearly, if you are relying on a source of income in retirement, having it protected from the ravages of inflation is extremely important in order to maintain your standard of living. Unfortunately, for most people, Social Security benefits are their only source of income that comes with this kind of security. If the Social Security Administration has to begin reducing its cost of living adjustments in order to survive the dismal financial future it is heading toward, it will be very bad news for retirees.

Social Security is buckling under its own weight. With its obligations getting larger and its sources of revenue shrinking, the Social Security program may have to start cutting benefits for retirees and increase the retirement ages in order to survive into the future. If you are planning on using Social Security to fund a significant portion of your retirement income, and especially to protect your income from the eroding effects of inflation, this is a troubling series of events.

While the future of Social Security may be in peril, there are Social Security claiming strategies you can take advantage of today that will help you get the most money possible. One of the simplest ones is to delay taking your benefits as long as possible. There can be up to a 32% increase in the size of your initial benefit simply by waiting until age 70 instead of age 62 to begin taking Social Security. There are other more complicated strategies that you can take advantage of as well. You should discuss these with a retirement income specialist.

Social Security benefits are subject to tax, so you should take that into account when doing your retirement income planning. However, Social Security income taxation is calculated according to a special formula. The higher your total income in retirement, the higher the percentage of your benefits are subject to tax. The chart below shows you those thresholds in detail.

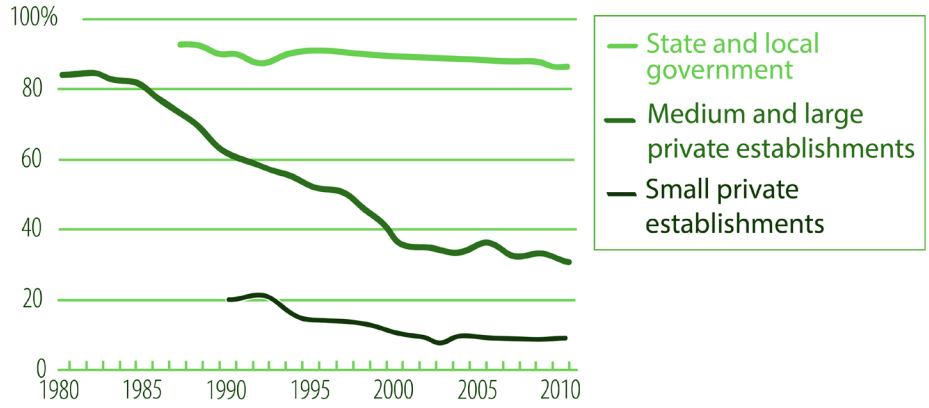
	Combined Income Thresholds	
	Filing as Individual	Filing Jointly
0% of Benefits Taxed	Less than $25,000	Less than $32,000
50% of Benefits Taxed	Between $25,000 and $34,000	Between $32,000 and $44,000
85% of Benefits Taxed	More than $34,000	More than $44,000

Unfortunately, these income levels are not indexed for inflation, so they never increase. This means that even though, in 10 years, $34,000 will be worth a lot less due to inflation, the threshold for 85% of your benefits being subjected to taxation will not have increased. It has been this way since 1993. A retirement income specialist can help you plan so as to pay as little tax as possible on your Social Security benefits.

PENSIONS – The Vanishing Leg

A major reason why Social Security has become such an integral part of many retirement income plans is because the company pension is quickly becoming a thing of the past. Below, in Figure 4, you can see this clearly.

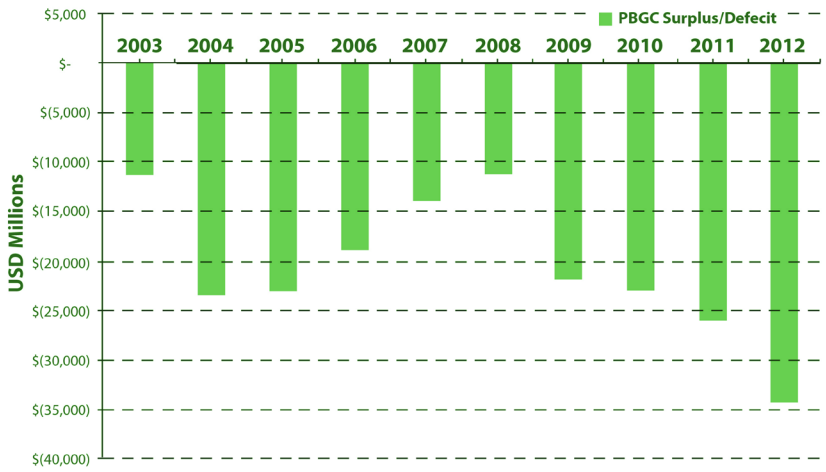
Figure 4: Availability of Pension Plans to Workers in Public and Private Sectors 1980 - 2010



This trend is being driven by the same factors that are chipping away at the Social Security program: huge numbers of Baby Boomers retiring every day and increasing life expectancies. Companies are finding it more difficult to sustain those kinds of liabilities on their balance sheets while still remaining profitable. They are freezing and, in many cases, completely eliminating their pension plans.

Even if you are one of the lucky employees of private companies who do offer traditional pensions, you still cannot rest easy. What if the company goes out of business or otherwise defaults on their promises? In 2003, Bethlehem Steel defaulted on $3.7 billion worth of pension payments. The size of Delphi's pension default in 2009 was $6.1 billion, and in 2005, United Airlines defaulted on an astounding $7.4 billion worth of pension payments.[3] It is true that the Pension Benefit Guarantee Corporation (PBGC) exists for exactly that reason: to insure the pension benefit promises made by their employer. However, have you looked at the PBGC's books lately? Even they are finding themselves in difficult financial straits. They have consistently run a sizable deficit for every single year in the recent past.

Figure 5: PBGC Annual Budget Deficits 2003 - 2012



Source: PBGC, http://www.zerohedge.com/news/2012-12-26/will-rising-union-activism-expose-zombified-us-pensions

[3] US News - http://money.usnews.com/money/blogs/planning-to-retire/2010/08/23/the-10-biggest-failed-pension-plans

As for government employees, many government agencies need to begin cutting pensions to subsidize their own deficits, just like we are seeing in Detroit. People cannot rely on promises made by public institutions; time and time again, they attempt to cut retirement benefits to make up for their own financial shortfalls.

Pensions are disappearing. Huge employers like General Motors, American Airlines, AT&T, Verizon, and General Electric have all eliminated their pension plans. Where they still exist, they can be unreliable. Relying exclusively on pensions is risky, because you never know when a chunk of your lifetime income may be taken away from you. You need to take at least some of your retirement income planning into your own hands with the help of a retirement income advisor. Otherwise, you will be gambling with the income that needs to support you and your family for the rest of your life.

RETIREMENT SAVINGS – Your Pillar of Strength

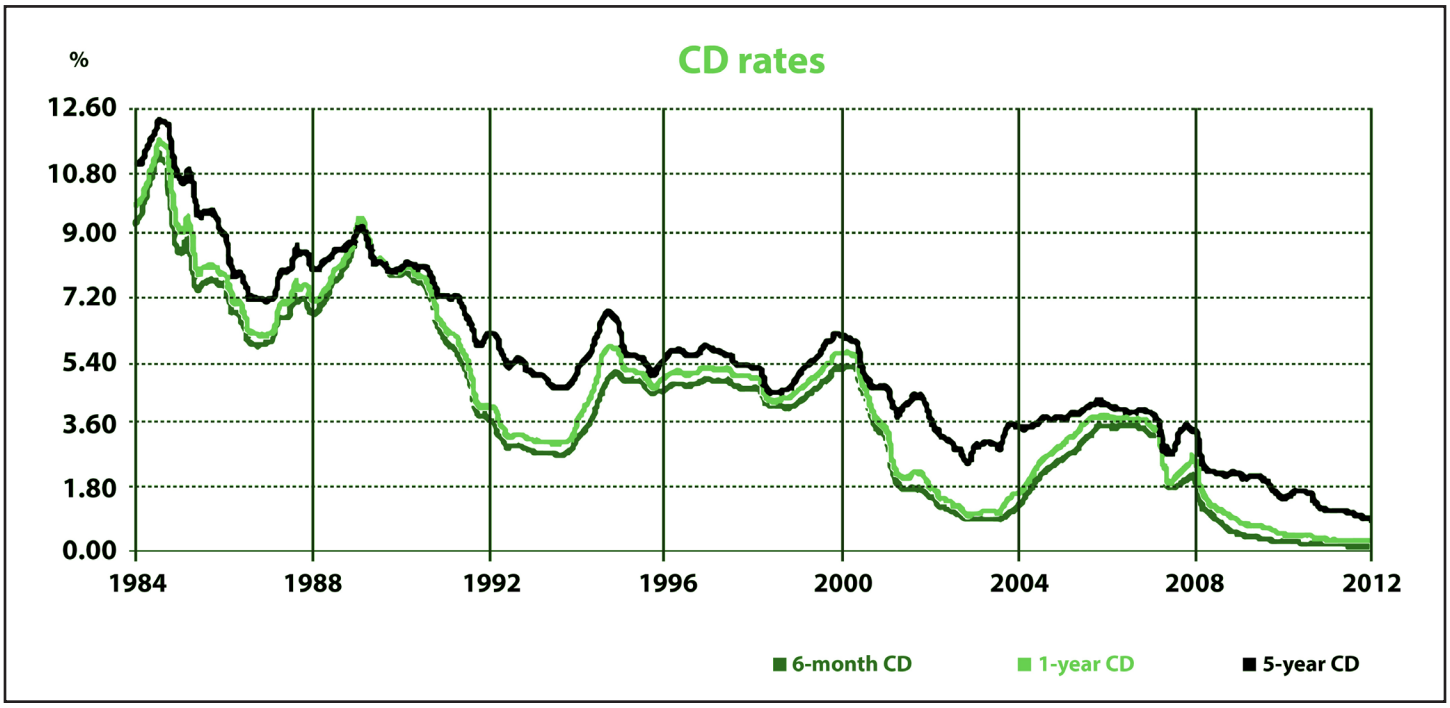
As John Adams said, “Facts are stubborn things…” The facts make clear that the first two “traditional” legs of retirement income planning have declined in reliability, and in the case of pensions, accessibility, over time. Where those legs fail, the third leg, personal savings, must succeed and become your pillar of strength.

There are two key points to consider when figuring out what to do with your retirement savings. The first is to stop looking at the account balance in your IRA or 401(k) and instead focus on how to convert that into a steady reliable income stream that will last the rest of your life. The second is to avoid risky investments that may actually increase the risk of running out of money, rather than making your savings go further.

Your challenge is to create your own pension from your retirement savings so you will get a monthly check for life. Traditional investing and withdrawal strategies will not do that. Instead, they can expose you to a number of potentially harmful financial risks, such as withdrawing too much money too soon from your retirement assets, fluctuations in the stock market, and rising inflation; all of which increase your chance of running out of money in retirement.

Even some of the traditionally “safe” investments, such as bank CDs, will not be of much help. CD rates are quite low these days. According to BankRate, even for a five year CD, the interest rate pays only around 2%.

Figure 6: Average National CD Rates



Data source: BankRate, http://www.bankrate.com/finance/cd-rates-history-0112.aspx

There are, however, solutions available today that can turn a part of your personal savings into a guaranteed lifetime stream of income. A retirement income advisor will be able to educate you further about these types of solutions. Your advisor can identify strategies and products where you receive guaranteed income for life that do not involve investing in the stock market or CDs. That way you eliminate the risk of living too long and running out of money. If you would like to put some of your money in the stock market, your advisor can show you products where you can enjoy the gains without suffering any of the losses. Your retirement income advisor can help you find solutions to today's retirement challenges to make your wealth last a lifetime.

One approach to thinking about a stable retirement income plan is deciding whether or not you have enough "mailbox money" to cover your ongoing expenses. Mailbox money is the checks you can count on finding in your mailbox every month. In the past, retirees would find their Social Security and pension checks in their mailbox. However, with pensions disappearing and Social Security underfunded, people are finding that they can no longer count on those checks anymore. If you are one of the many people in this position, you need to discuss solutions to this problem with a retirement income advisor. Your advisor can help you create additional sources of mailbox money so you will not come up short. Besides, even if you have a pension and Social Security, wouldn't it be great to get a third monthly check?

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