6 Major Elements to Ensure a *Successful* Retirement Plan

LVIG LEHIGH VALLEY INVESTMENT GROUP

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Creating a Retirement Plan Policy Statement

6 Major Elements to Ensure a Successful Retirement Plan

There are 2 major parts to creating a retirement plan.

The first part, most of us know pretty well. It's the accumulation part. Over the years that you work, you learn a thing or two about how to build wealth: you save, you invest, you protect money from taxation and you leverage accounts like IRAs and 401Ks. But, part two is a little trickier.

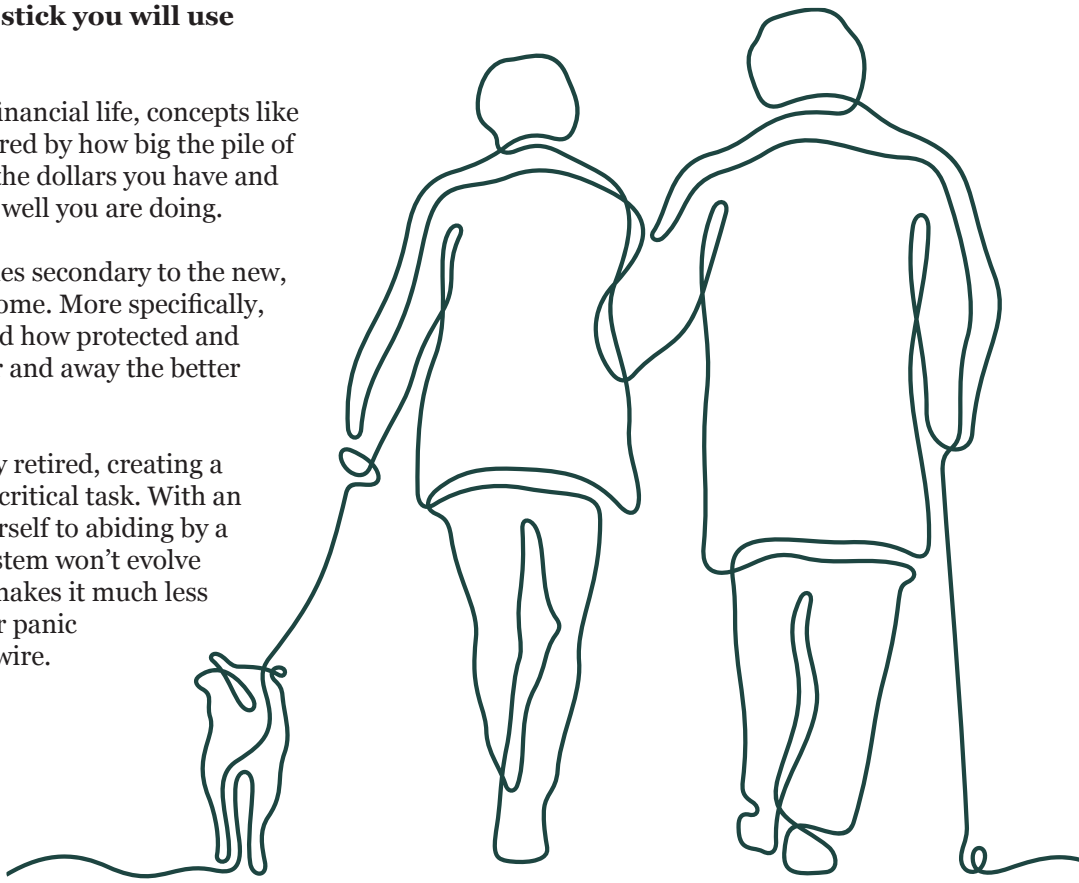
When you transition to the decumulation part of your retirement – the time when you will start pulling funds OUT of your investments -- the knowledge and skills you developed in phase one of retirement might not apply. In fact, they might actually be counterproductive. That's because, in retirement, a separate set of variables comes into play. While core ideas like asset allocation and the quality of your investments are still very important, new factors such as how you will draw down your assets and where those dollars will come from will rise to the highest level of importance.

More to the point, the measuring stick you will use to measure success will change.

During the accumulation part of your financial life, concepts like "progress" and "success" will be measured by how big the pile of assets you have is growing. Add up all the dollars you have and that goes a long way to telling you how well you are doing.

But, in retirement, that element becomes secondary to the new, more important measuring stick of income. More specifically, how much income you can generate and how protected and predictable that income is, becomes far and away the better measure of your success.

If you are close to retirement or already retired, creating a retirement policy statement (RPS) is a critical task. With an RPS, you're effectively committing yourself to abiding by a given system. That's not to say your system won't evolve as the years go by, but having an RPS makes it much less likely that you'll make rash decisions or panic when something in the world goes haywire.



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Here are some major elements that you should include in your plan:

Specify retirement details.
Lay out the basic details of your retirement program so that someone else reading it for the first time would have a pretty good idea of what you plan to do. In this case, simple is good. Write it out; make it straightforward. You will have to make some basic assumptions like how long your retirement will last, what your investments might earn and what inflation might be.

Document retirement assets.
Summarize all your accounts and their values periodically. Calculate a total dollar amount for all of your retirement accounts. If the accounts are IRAs, annuities or 401Ks, make sure you have a copy of the beneficiary designations on each account. And, keep a log of how to access each account on line in case someone else needs to act for you in the future.

Detail how you'll address inflation.
Write down what inflation level you're assuming will prevail over your retirement years. We typically think that 2%-3% is in line with historic norms. But, despite the fact that recent inflation numbers (CPI) have been reported lower than that, there is a measure of inflation that is more relevant to retirees. The CPI-E more accurately measures the key areas of spending for senior citizens. When health care, housing and travel are factored in, inflation may be closer to 4% for older Americans.

Outline your retirement portfolio strategy.
Again, keep this simple; it doesn't have to be fancy. A basic example could be: "Maintain a portfolio that consists 60% of high-quality, dividend-paying stocks and 40% high-quality bonds, along with a cash component consisting of two years worth of living expenses. Spend from cash and periodically refill using rebalancing proceeds. Withdraw 4% annually from investable assets."earn and what inflation might be.

Specify a spending plan.
Document the key components of your retirement spending plan. What are your spending needs? How much will be covered by direct income sources like Social Security, pensions, and income annuities. Then add in the cash flow that will come from your portfolio assets.

If you're a few years from retirement and aren't sure what your spending needs will be, try this useful (but tedious) exercise. For a 3-month period, write down every single dollar you spend – everything! – from credit cards to checks to actual cash transactions. Then organize all those expenses into 3 categories.

"Non-discretionary" expenses are the items that you will spend no matter what. Think electric bill, real estate taxes, insurance premiums. These are the expenses that will be with you for life. "Work related expenses" are those items that you expense now but won't have to in retirement.

As an example, you will no longer have 401K or IRA contributions to make when you retire. If you live in PA for example, there won't be any state income tax on your retirement income like a pension, annuity payments or IRA withdrawals.

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Document your income flows.
This is the heart of the plan: Where will you go for cash from your portfolio on an ongoing basis? There's no one right way to do it; you have options. The key is a decumulation strategy that you can implement, that makes investment and tax sense, and that provides you with flexibility to change course if circumstances dictate.

The most common approach that retirees THINK they have to use is living on income distributions alone. Just look at whatever income is produced by your investments – dividends, interest, net rentals, etc – and plan on that being your supplement to Social Security and pension. Unfortunately, in today's world of very low yields, this approach might not be viable. And, because the only assets providing higher income flows presently tend to be much higher risk than more typical investment grade bonds, this income-centric approach may upset your risk/return profile.

A more technical, but effective option, may be to use an asset rebalancing approach. This involves setting and maintaining a specified allocation to several investment classes and then systematically selling relatively highly appreciated portions of the portfolio to fund living expenses while allowing under-performing assets to "recover" their value over time.

A third option is a blend the two strategies above. The investor uses income distributions to provide a baseline of living expenses (think "non-discretionary" expenses from above) while maintaining the core portfolio based on a satisfactory risk/reward profile (i.e., stays invested in a way that allows them to sleep well at not!). Then, the retiree periodically rebalances and "harvests" gains to cover the additional living expenses we previously denoted as "discretionary." In essence, when there are excess funds available, go have some fun!!

There's an old adage that says,
"failing to plan is planning to fail."

Your retirement is TOO important for that. So, don't fail to plan! If you need some help getting started or fine tuning your plan, let us know. We can help.