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Business

Heard off the street: The trick to retirement saving is making it last

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By Len Boselovic, Pittsburgh Post-Gazette

As more Americans take on the job of investing and managing their retirement money, there will come a day when they face an equally challenging assignment: making it last.

Even if they theoretically saved enough to afford the retirement they've envisioned, a lack of discipline, inappropriate asset allocation, market volatility, inflation and other factors may torpedo their plans. Making smart choices is especially critical to those who can't rely on a pension check from their employer.

Advisers say that as a general rule, you won't outlive your money if you limit retirement account withdrawals to 4 percent a year. But there are plenty of exceptions to the rule. You may live longer than you anticipate, not invest enough in stocks to keep pace with inflation or take a beating if the stock market turns south early in your retirement.

Consider the case of new retiree with a \$200,000 earning an average of 6 percent a year. Taking out 4 percent would produce pretax income of \$8,000, or \$667 a month.

Since the fund appreciates at a rate greater than 4 percent, it would increase each year, allowing the investor to withdraw more than \$8,000 in subsequent years just by sticking to the 4 percent withdrawal rate. After 10 years of withdrawals, the account will have grown to \$238,000, says Diane Pearson, director of financial planning for Legend Financial Advisors in McCandless.

Sounds pretty easy until you consider the thin odds of consistently earning 6 percent a year. Although it would be inappropriate for a recent retiree to invest all of his or her money in the Standard & Poor's 500 index, here's what would have happened if he had done that at the end of 1999 and started withdrawing 4 percent a year.

Because the S&P lost ground the next three years, there would be \$143,000 in the account today, Ms. Pearson says. Someone who left work a year later and followed the same strategy would only have \$173,000.

"You have to anticipate ... that you are going to be dealing with volatility and losses that large," Mr. Pearson cautions.

The lack of predictability has more investors nearing retirement age considering immediate annuities, which guarantee a consistent monthly payout based on your life expectancy, how much you invest, whether you want your spouse to receive payments after you die, and other factors. Some offer inflation protection.

The fact that fewer people work for employers who provide traditional pension plans also has increased interest in annuities.

"Everybody's trying to reach these Boomers who don't have pensions," says Paul Brahim, managing director of BPU Investment Group, Downtown.

But annuities aren't the solution for everybody. An annuity is essentially a bet with an insurance company on how long you (and your spouse if you choose that payout option) will live.

"If you live beyond your life expectancy, you win," says Robert Nusbaum of Middle America Planning in Mt. Lebanon. "The ideal candidate would be someone with low risk tolerance, potentially long life expectancy and little desire to leave an inheritance."

One of the trade-offs for the predictable payment is relinquishing the opportunity to earn more through other investments. That may be fine for retirees who don't like risk, "but thinking people can probably do a little better than that," Mr. Brahim says.

If you plan to use money from a 401(k) or IRA to purchase an annuity, make sure the purchase qualifies as a tax-free rollover of your retirement money, says Joseph Nicola, a tax manager with Sisterson & Co., a Downtown accounting firm. Otherwise you'll pay taxes on the amount you withdraw from your retirement account, reducing the amount you can put to work in the annuity.

"A lump sum distribution can foul you up significantly," Mr. Nicola says.

Mutual fund operators are devising ways to generate a regular paycheck in retirement by using mutual funds. Fidelity says its Income Replacement Funds, introduced last week, will provide regular monthly payments based on how long an investor wants the money to last, whether it's until 2016 or 2036. Vanguard's Managed Payout funds are designed to pay out 3 percent, 5 percent or 7 percent each year.

Mr. Brahim says the funds will appeal to many who don't want to take an active role in managing their money and who want a monthly paycheck from someone other than Social Security.

"Investors really do want a set-it-and-forget-it type of system for retirement income," he says.

But making that choice intelligently requires some thought and involves trade-offs. Brad Levin of Legacy Wealth Partners in Encino, Calif., says pre-retirees who underestimate how long they will live could outlive their Vanguard or Fidelity accounts. Mr. Brahim says the new funds, like annuities, aren't a smart choice if you want family members or your favorite charity to receive something upon your death, or if you want the flexibility of taking out more than your monthly allotment. Expenses and taxes are two other important considerations.

In short, there's a lot of homework to do before you set it and forget it. In fact, if you do your homework well, you'll realize you can get into plenty of trouble if you forget it. So, as always, be careful out there.

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