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FEATURE ARTICLE
by Geordie J. Crossan, CFP® of NBS Financial Services, Inc. p.14

MONEY «
Ben S. Bernanke
Making His Mark
p. 8

* THE LAFFER CURVE
p. 32

TRAVEL «
LUXURY Cruise Lines + Destinations
p. 38

Charitable Giving Through Real Estate
p. 61

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Designing a Succesful Retirement Income Strategy

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As the nation's 76 million baby boomers are heading into retirement, one thing is clear: No group has ever had higher expectations for their later years. For the most part baby boomers anticipate a future marked by good health, active lifestyles and varied leisure pursuits-with the financial means to enjoy it all.

Of course, whether and to what extent reality conforms to this broader boomer vision of retirement remains to be seen. Certainly, the traditional pillars of a secure old age-Social Security, Medicare, retiree health benefits and a company pension-are facing major challenges. The fact is, the financial foundation that supported previous generations has been slowly, but surely, eroding.

Retirement may be life's most significant transition. Aside from the obvious personal implications, retirees will encounter numerous financial issues, such as:

- How will they move from receiving a regular paycheck to developing an ongoing income stream?
- Should they downsize their home or relocate?
- How will they meet rising healthcare expenditures?
- Do they have a plan to fund long term care expenses for themselves or elderly relatives?
- Could they outlive their savings and investments?

In each case we can assist retirees to overcome these challenges and potentially meet their financial goals by developing a comprehensive retirement plan-one that seeks to ensure that they have adequate lifetime income.

We must begin with the due diligence process. This stage is critical, as it is important for the advisor to understand the retirees exact needs and financial circumstances in order to develop a customized plan to meet his or her goals. To keep the process manageable and on track, we advise using the following five-step process.

Step 1: Create a Budget

Every good retirement income plan begins with a budget. Traditionally, advisors have estimated that individuals may need 70-80% of pre-retirement income when they leave the workforce. However, 68% of recently retired individuals indicated that their income needs initially following retirement exceeded 100% of their pre-retirement income.

During this step, it is important to educate retirees about how their income needs will change over time. For example, you'll need to account for rising health care and long term care costs and increased travel/entertainment expenses. As such, any assumptions made must be revisited on a regular basis and adjusted over time.

Step 2: Define a retirees Income Needs and Objectives

Before allocating specific numbers in a budget, we need to understand the retirees income needs and objectives. It's helpful to break out the expenses into two categories-basic income needs and lifestyle income needs. Basic income needs include food/shelter, auto, insurance, utilities and healthcare expenses. Lifestyle income needs include travel, entertainment, hobbies, membership dues, gifts/donations and loans.

Step 3: Take Inventory

The next step is to develop a comprehensive list of the retirees assets that can be tapped for income. Be sure to include both current and future assets. This should include annuity type incomes, such as Social Security and pensions, discretionary income sources, such as taxable and tax deferred savings, real estate and life insurance.

Step 4: Match Resources with Income Needs and Objectives

In this step, we match up the retirees financial resources with his or her retirement income objectives. We would focus first on the retirees basic income needs. Compare those with the retirees annuity-type resources, such as pensions and Social Security. Next, we consider the lifestyle income needs and where the income will come from to achieve these goals. We will want to determine the optimal "spend down" order for the retirees available resources. By matching the projected income and expense "buckets" you can quickly determine if there will be any shortfalls.

Step 5: Quantifying and Managing Risk

A sound retirement plan hinges on regularly monitoring annual withdrawal rates to avoid premature depletion of assets. There is no set rule as to what constitutes a sustainable withdrawal rate. Although, many reports suggest withdrawal rates of 3 to 5% dependent upon asset allocation and time frame. If shortfall appears likely, retirees may need to employ a more aggressive asset allocation strategy, defer their retirement date, adjust their lifestyle or tap additional resources, such as real estate downsizing or reverse mortgages.

Successful retirement income planning requires key risk redefinition and management. Risk takes on new dimensions as people enter retirement. The types of risk that will have a significant impact on portfolios are: market risk, inflation risk, longevity risk and healthcare cost/medical risk.

While no investment is free of risks, there are a variety of ways to help the retiree manage risks as they enter retirement, these include: adjusting asset allocations strategies, discouraging market timing and emotion based withdrawals in response to market fluctuations, exploring longevity-risk mitigation alternatives such as immediate annuities and longevity insurance and factoring in future reductions in purchasing power for annuity-type fixed income sources.

It is important to avoid basing a plan only on historical market averages or a set rate of return. Traditional methods of creating forecasts of income and spending scenarios-known as *deterministic forecast modeling*-are flawed nearly to the point of uselessness. Of course, one scenario based on assumed averages can't account for the variables that life guarantees. A more realistic approach is to make use of more advanced *stochastic forecast modeling*-also know as Monte Carlo modeling-which can run thousands of simulations based on many crucial factors such as multiple income sources, risk tolerance, market volatility, tax efficient disbursement, changing income needs over time, varied inflation rates and required minimum distributions from IRA's. Tools like stochastic modeling also increase the transparency of the retirement process and provide a framework for open and honest discussions on the realities of retirement.

Lastly, it is important for retirees to understand the impact of today's decisions on tomorrow's outcomes. FP