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THIS MENTAL BLOCK COSTS INVESTORS INCOME

Americans want to spend freely in retirement without outliving their savings. Can they have both?

By: Rebecca Lake - February 23, 2018

Retirement is such a numbers game that a common mental block of retirees and pre-retirees doesn't get the attention it deserves: Investing needs and wants don't always match.

In a recent Gallup poll, 85 percent of non-retired investors strongly agreed it was important to have a guaranteed stream of income in retirement to supplement Social Security. But only 27 percent strongly agreed they'd be willing to give up access to some of their money now to provide that guaranteed income. Meanwhile, 50 percent said they wanted the freedom to spend in retirement, even if it increased the risk of running out of money.

Given the dimming outlook for Social Security and the disappearing pension, investors are wise to want a guaranteed income stream from somewhere. "Retirees highly value their Social Security and pension income, and often seek additional ways to get these paychecks for life," says Dylan Huang, senior vice president and head of retail annuities at New York Life in New York.

Adding guaranteed income sources to a portfolio resolves a couple of problems, including the possibility of retirees outliving their savings, a risk that may be higher than people realize. For instance, 77 percent of investors were unaware of how much they could safely spend in retirement, according to a New York Life survey. "Guaranteed income can mitigate the worry that comes with relying on withdrawals," Huang says, a worry that market volatility only complicates.

Guaranteed income also can solve the problem of investors pushed into retirement ahead of schedule because of their health or an employer restructuring. For couples, supplementing Social Security with another guaranteed income stream can ease concerns about reduced benefits when one spouse passes away.

The challenge lies in reconciling the need for guaranteed income with the desire to spend freely in retirement. By connecting those two ideas and making them part of a retirement savings strategy, investors may be able to satisfy both goals without compromising their long-term financial health.

Time for a reality check. A realistic assessment of your pre- and post-retirement spending can give you an idea how likely it is that your savings will last and how necessary a guaranteed income may be. "When you're planning for retirement, you want to save as much as you can now to have the freedom to spend your savings later," says Chris Scalese, founder and president of Fortune Financial Group in Dunmore, Pennsylvania. Your investments and savings should grow at a rate that will keep pace with your projected spending in retirement.

Paula Nelson, president of retirement at Indianapolis-based Global Atlantic Financial Group, says retirees don't have to choose between freedom and guarantees. A well-defined income strategy should identify different income sources to meet different income needs in retirement. One approach is to "consider guaranteed lifetime income sources for essential expenses, while using another asset, like an investment portfolio, for discretionary spending."

The advantage of dividing income streams is that it insulates against risk while still providing flexibility. When an investor uses a portion of assets to create guaranteed income, that income is independent of what the economy or markets are doing, says Joe Heider, president of Cirrus Wealth Management in Cleveland. "Their personal spending on discretionary items, such as travel, can be reset, based upon their portfolio's performance."

The right guaranteed-income vehicle. If you're looking for a true guaranteed income stream that mirrors the benefits you would receive from Social Security or a pension, an annuity is an obvious choice.

But annuities aren't all alike. "There are literally hundreds of different annuities that belong to a number of different categories or types," says Michael Tove, president and founder of AIN Services in Cary, North Carolina. Immediate annuities are like traditional pensions, while deferred annuities allow you to defer guaranteed-income payments until a future date. Variable annuities combine insurance benefits with stock market portfolios. Indexed and fixed-indexed annuities offer indirect participation in markets without market risk.

Plus, annuities can offer other benefits that retirees may appreciate, such as guaranteed enhanced death benefits or benefits for long-term care needs. Some annuities will protect your investment principal without sacrificing growth potential.

What works for one investor won't necessarily work for another, and the annuity you choose should reflect your goals. "Do you want a guaranteed income stream? A portfolio with zero downside risk in the event of a stock market crash? Are you looking for a lump payout at a specific time, or to pass your annuity on to your beneficiaries," says Merlin Rothfeld, host of Power Trading Radio and an instructor at Online Trading Academy, an investing education resource in Irvine, California. "There are products to achieve all these goals, but you better know how they work."

As you compare annuities, consider two specific criteria. "The most important is the overall expense ratio," says Kimberly Foss, founder and president of Empyrion Wealth Management in Roseville, California. "Especially with variable annuities, which work in many respects like mutual funds, a lot depends on what portion of the investment gains go into the annuitant's account and how much is pocketed by fund managers."

Foss says annuity buyers should also look carefully at the financial rating of the issuing company. "Because an annuity isn't backed by government guarantees, it's only as solid as the finances of the issuer." She recommends sticking with annuity products issued by companies with a Moody's or Standard & Poor's rating of AAA. A financial advisor can help determine an annuity's quality if you're unfamiliar with how ratings systems work.

The risks of other income options. There are other ways besides annuities to expand your income in retirement. Dividend stocks, rental properties or a reverse mortgage, for instance, can add to your income streams but don't offer the same guarantees or may have other drawbacks. "Dividends don't pay monthly, and [they] decrease proportional to investment losses when a market correction occurs," Tove says. Rental property income is contingent on finding reliable renters and having a vibrant housing market. Reverse mortgages can deplete how much wealth you're able to pass on to your heirs.

Tove recommends talking with a financial advisor to evaluate which income sources are appropriate for your saving and spending plan. "Making retirement income mistakes can result in harm later in life when it's too late to do anything about it."