Income for Life

Creating a practical, sustainable financial plan to capture your goals for the retirement chapter of life

For too many people, making a financial plan for retirement comes down to this: “I’ll save what I can and hope for the best.”

It is daunting to estimate how much income you’ll need many years from now, and choosing the “right” mix of investments in a 401(k) or IRA to achieve long-term objectives can be confusing and intimidating. However, as the saying goes, “hope is not a strategy.” You need to know, with some certainty, whether or not your Social Security benefits along with savings invested for retirement will be sufficient to meet your needs.

While Social Security benefits are a source of consistent income, few people expect it to be enough. That means we have to plan our investing not only to achieve growth over time, but also to generate additional retirement income. That’s a real strategy and one in which a variable annuity can play an important role. Let’s examine the realities of today’s retirement saving landscape to see why that’s the case.

A hierarchy of retirement lifestyle goals

Each one of us has our own goals for the retirement chapter of life. It can be helpful to categorize these goals to determine how much retirement income you will need to cover the things you want to be able to do, such as:

- Cover basic living expenses, large and small, which are likely to increase with inflation
- Provide a reserve to cover emergencies
- Allow for discretionary expenses, such as travel and other activities
- Pay for big-ticket items, such as replacing the roof, updating appliances, buying a car, etc.
- Leave something for your heirs – the size and importance of this item can vary considerably, depending on one's values, circumstances and other factors

You can think of these retirement goals as a hierarchy, with some having a higher priority than others. Next, you can estimate the minimum amount of income that would be required to cover the items at the top of your list—the things you truly need—and how much additional income it would take to cover the other goals in your hierarchy. Finally, you can get specific about the sources of this future income.

Will your Social Security benefits plus withdrawals from retirement accounts (such as a 401(k), an IRA, or other savings and investments) be enough to cover the essential goals on your list? Will there be any extra to meet some of the others? That depends on many things, including how much you withdraw from your retirement savings each year, the return your savings earn between now and then, how long you live, and other factors.

The "4% Rule"

You may have heard that you can count on withdrawing 4% of your savings per year in retirement[1]. While that was a general guideline of retirement planning for a long time, it's likely now that taking 4% may be too aggressive, creating a risk of outliving your savings. Why? This guideline assumes you can earn at least 4% *after taxes* on the money that remains invested after you make your annual withdrawals. The question is, can you realistically and reliably earn an after-tax return of 4%, year after year? Maybe not, for the following reasons:

Interest rates are low compared to where they have been for much of the past 100 years, largely because, during most of that period, inflation was much higher than it is today. This means the returns offered today by low-risk investments are also fairly low. For an investor in a 25% tax bracket, earning a 4% return *after taxes* from U.S. Treasury and high-quality corporate bonds would require a pre-tax return of about 5.33%. That return may not be available in today's investment environment. Therefore, expecting to earn 4% after tax from low-risk bonds may not be realistic.

Since bonds may not provide a 4% after-tax return, you might be inclined to shift your savings to stocks. In most years, and certainly over the long term, the return from stocks has been higher than for bonds. However, in some years stocks can perform worse than bonds – occasionally a lot worse. If the market has a bad year (or two) and you are too heavily invested in stocks, your retirement savings would shrink by a lot and could take many years to recover. That's not necessarily a huge problem when you are in your 20s or 30s, but as you get older it could be a significant setback. And once you have retired, if your savings decline because you were heavily invested in the market in a "down" year, withdrawing money from your savings at a 4% rate will make it that much harder for your savings to build back up again. So, switching *most* of your money into the market may not be a reliable way to generate the additional income you will need to meet your retirement goals.

So, instead of counting on withdrawing 4% from your savings each year, you might consider another approach. To compensate for a lower withdrawal rate, you could establish a variable annuity that includes a living benefit with a minimum guaranteed[§] lifetime income payment (available for an additional charge). This way, you can participate in the growth potential of the stock market while guaranteeing a minimum level of income. In other words, while you expect to consume a smaller slice of your retirement savings "pie" every year, you add an annuity to your overall retirement savings mix that can help to supplment your retirement income.

What is a Variable Annuity?

Variable annuities are long-term, tax-deferred investments designed for retirement, involve investment risks and may lose value. Earnings are taxable as ordinary income when distributed and may be subject to a 10% additional tax if withdrawn before age 59½.

Investing involves risk, including possible loss of principal.
§ Guarantees are backed by the claims-paying ability of the issuing insurance company.

Investing: balancing growth & risk

As noted above, to help ensure you can achieve the lifestyle you want in retirement, you might want to invest some of your savings in the stock market, to participate in the higher returns (compared to bonds) the market usually offers. However, investing *too* much of your savings in the market could be risky. In fact, one of the most important concepts in investing is that balance between potential growth and risk.

Taking on too much risk with your retirement accounts in an attempt to generate big returns on all your investments could end up falling short of the minimum assets you are relying on to meet your basic retirement goals. That could be a source of stress for everyone. However, investing too conservatively means your retirement savings may not keep pace with inflation. The key is to have a mix of investments that meet your risk profile so that overall you strike a balance – not too aggressive, not too conservative.

Unless you are among the shrinking pool of employees in the U.S. with a pension (a defined benefit plan), it is up to you to manage the way your retirement savings are invested, so you can achieve that balance between growth and stability. Many people seek guidance from a qualified financial advisor to help strike such a balance.

Financial professionals typically recommend shifting a greater percentage of your investments into more conservative investments, typically bonds (also known as "fixed income") and holding less in stocks as you approach or enter retirement.

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However, many believe that most people have too little of their assets invested in equities, limiting their chances to participate in the stock market's higher returns.

We typically think of this in terms of how the money in our 401(k), IRA and other investments are allocated across stocks and bonds. However, there's another investment option that can also balance risk and growth in retirement: a variable annuity that includes a minimum guaranteed payout.

A variable annuity that includes a protected monthly income for life can help you to manage the balance of growth and stability you need to enjoy your life in retirement.

The guaranteed§ lifetime income component* of a variable annuity (which is available for a charge in addition to the cost of the variable annuity annuity) provides regular, predictable payments, while the underlying investments offer the potential for higher growth if invested in the stock market. A variable annuity that includes a protected monthly income for life can help you to manage the balance of growth and stability you need to enjoy your life in retirement.

Constructing a practical, sustainable financial plan to deal with something that is still many years away can feel abstract and imprecise: many of us don't know where we will end up living in retirement or what our expenses are likely to be—and none of us knows how long we will live. But uncertainty doesn't mean we should postpone things for now and promise to think about it later.

Instead, make a plan based on what is most likely to occur, so that you can take the necessary steps today to help ensure you will be able to meet the goals you have for your next phase of life.

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* Optional benefits are available for an extra charge in addition to the ongoing fees and expenses of the variable annuity.

Before investing, investors should carefully consider the investment objectives, risks, charges and expenses of the variable annuity and its underlying investment options. The current contract prospectus and underlying fund prospectuses, which are contained in the same document, provide this and other important information. Please contact your Internal Wholesale to obtain the prospectuses. Please read the prospectuses carefully before investing or sending money.

Guarantees are backed by the claims-paying ability of the issuing insurance company and do not apply to the principal amount or investment performance of a variable annuity's separate account or its underlying investments. They are not backed by the broker/dealer from which the annuity contract is purchased, by the insurance agency from which the annuity contract is purchased or any affiliates of those entities, and none makes any representations or guarantees regarding the claims paying ability of the issuing insurance company.

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1. Four Percent Rule, Investopedia, July 2018

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