

The Money-Savvy Guide to

Maximum Retirement Income



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Four Money-Savvy Steps to Generate, Maximize and Preserve Retirement Income.

In the 1990s American television sitcom *Home Improvement*, Tim Allen starred as the host of a popular home improvement show called **Tool Time**. Tim ‘The Tool Man’ Taylor, his wife and three boys lived next door to a ‘wiser’ older neighbor named Wilson whose appearances always were mostly trademarked behind a high picket fence: only his eyes and signature fisherman’s hat, visible.

Most of the financial services industry focuses on ‘accumulators’ or those who are saving for retirement. Like Tim. Most investment policies, brokerage houses goals, advisors and tax strategists exist to cater to accumulators. **The Tool Men. Not the Wilsons.**

When preparing for retirement, a change in mindset is necessary. At RIA, we call it Crossover Risk. It’s sometimes a capricious transition in emotions when retirement is imminent. The period requires a rethinking of portfolio strategies too.

Think of it this way: When you’re working, you’re Tim. When retired, you’re Wilson. You cross to the other side of the fence and need to think and plan differently. As a retiree, you are now a distributor, not an accumulator. Would the same investment strategies that work well for a young family be effective for a retired household? **Most likely, no.**

That’s why we created the guide to **Four Money-Savvy Steps to Generate, Maximize and Preserve Retirement Income**. For the distributors who now need to derive income from their investments, Social Security and pensions (if they’re fortunate enough). You see, cash flow or income, is the lifeblood of a retirement household. In an accumulation household, income is important too. However, that income comes from career earnings and growth, not portfolios and lifetime income vehicles.

As distribution experts, the RIA team seeks to arm retirees and those planning for retirement with crucial information to help make sense of the transition. Our priority is to bust mainstream financial dogma that places a secure retirement in jeopardy.

Money-Savvy Step #1: Don’t Dismiss The Importance Of Social Security

“We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age.”

Franklin D. Roosevelt, Statement on the signing of the Social Security Act, August 14, 1935.

Don’t worry. Social Security will be there. The goal is to make smart, unemotional decisions to ensure a lifetime income for you, a spouse, and possibly minor children.

Without Social Security included, even those who are excellent savers may experience financial vulnerability in retirement. Include Social Security or an inflation-adjusted income annuity that lasts a lifetime, and a retiree may depend less on variable assets like stocks to create a dependable, predictable income especially during market cycles characterized by poor sequence of returns risk.

In other words, when investment assets do poorly over a series of years (believe it or not this does occur), lifetime income sources can pick up the slack and increase portfolio longevity – there’s less pressure to withdraw from variable assets that may require time to recover.

The fortunate few who have pensions AND Social Security can retire sooner and comfortably compared to their non-pension brethren, regardless of savings habits. According to Willis Towers Watson, only 16% of Fortune 500 companies offer defined benefits plans (pensions) to new hires (2017), compared to 59% in 1998.

According to surveys conducted by the Social Security Administration, roughly half the aged population live in households that receive at least 50% of total family income from Social Security. About a quarter of senior households receive at least 90% of household income from Social Security.

The 2021 OASDI Trust fund balance (thanks to Savvysocialsecurity.com), was \$2.852 trillion, \$56 billion less than it started with at the beginning of that year. As of 2022, Social Security expenses exceed income. The drawdown was expected and there is already legislation in Congress to halt the deficit.

Depending on costs, birth/death rates, job growth and various other factors, Trust fund projections are just that – educated guesses. At best, we know that based on payroll taxes alone the system is currently cash-flow negative. Yet, our planning team remains confident that both sides of the Congressional aisle will eventually come together to bolster the program. Why? **Simple.** *Social Security has become America's pension even though it was not designed to be.* Without it, America would face mass homelessness. We're not trying to be bombastic. It's a pragmatic assessment.

The failure of the program or reduction of Social Security benefits would lead to wholesale poverty. A retirement nest-egg comprised solely of variable assets like stocks and bonds doesn't cut it for most Americans. There are many reasons why defined contribution plans like 401ks are not as effective as previously thought – High costs, the ability to tap accounts for wants like house down payments (ridiculous), investing in the market just to break even most of the time. Also, defined contribution plans were originally designed to complement pensions, not replace them.

Without Social Security considered, 1 out of every 6 plans completed are borderline successful or fail. When a retirement contains a pension to supplement Social Security, unsuccessful outcomes are rare. In the face of low-return headwinds for risk assets like stocks (due to extended valuations), Social Security should gain importance when it comes to positive plan results over the next 10 years when compared to the past decade, especially as remaining pension options offered by employers fade away.

Older adults believe women will live to 83.7. In actuality, they will live to 89 years old. On average, men will live to be 87. Older adults think men will live to be 81.6. Longer life expectancies warrant serious consideration to postponing Social Security until age 70, especially in the face of dwindling private pensions. In other words, guaranteed income is important to the survivability of an investment portfolio comprised of variable assets like stocks and bonds. During periods of future low investment returns which already may have started, the maximization of guaranteed income options can help retirees to adjust or reduce portfolio withdrawal rates.

If a future Social Security recipient **waits until age 70**, monthly payments can be 32 percent higher than the benefits earned at full retirement age. Currently, full retirement age is 66 and 2 months for those born in 1955; for people born in 1960 or later, FRA is 67.

To sum it up, Social Security retirement income planning is a crucial element of a retiree's overall retirement cash flow security, and the wrong decision can leave **thousands of lifetime dollars** on the table. Most of the time, filing for early Social Security benefits early is a poor idea and cut lifetime income for a couple and survivor income for the remaining spouse by 25 percent. Waiting to claim retirements until at least Full Retirement Age or age 70 if financial planning permits, is the best 'longevity insurance' available today.

It's important to partner with a financial professional who understands the devastating impact of impetuous Social Security claiming decisions. In numerous cases, RIA Certified Financial Planners® have prevented individuals from losing thousands of dollars in lifetime and survivor income benefits due to misinformation from brokers, friends with strong opinions and plain old misconceptions.

Last thought for women, exclusively: The right method to claim Social Security can make or break your household especially if you age alone and rely primarily on survivor benefits (all too common). Women suffer greater retirement insecurity than men since, generally, they're the ones who stay at home or have careers interrupted to raise children.

A stalled work history creates "a **ZERO problem**," whereby a female's Social Security statement reflects **years** of earning 0, resulting in lower lifetime benefits. Thus, a higher-wage earner must wait until age 70 to claim benefits to afford higher survivor benefits for a spouse.



Our team also suggests that the non-working spouse returns to the workforce and fill those zeroes with earned income. Tackling those zeroes makes a big difference in lifetime benefits.

Money-Savvy Step #2: Don't Discount the 'Surgical' Use of Annuities

I hate annuities. I'd rather go to hell than sell annuities."
Ken Fisher, money manager.

A good piece of advice as a retiree would be to ignore Mr. Fisher. A financial professional with a net worth of 500,000 Americans combined doesn't need to worry much about lifetime income or portfolio principal loss. Obviously, he doesn't believe you need to either, but there's a catch: **You absolutely do need to be concerned about lifetime annuities and planning for annuities can bolster retirement income.**

Sadly, annuities tend to be *sold*, not *surgically planned*. Consider that annuity is defined as a series of payments made at equal intervals. Examples of annuities are scheduled deposits to a savings account, monthly home mortgage payments, and pension payments. For our purpose, consider an annuity a sum of money, generally paid in installments over a contract owner's lifetime or that of the owner and a spouse or a beneficiary. Annuities are insurance products that guarantee a lifetime income stream.

Not every annuity product is 'the devil.'

Unfortunately, all annuity types get lumped together and blanketed by the same sordid reputation. Those who push annuities to collect attractive commissions ostensibly leave buyers confused (annuities by nature are complex), and regretful; these products are not explained well upfront and once the sale is complete, the consumer is usually left to figure out alone the intricacies of the contract.

Sales people tend to attach expensive riders (add-ons), to annuities that consumers may or may not need. Overall, the process is not a positive experience. Bad press and poor sales practices make annuities one of the most misunderstood products out there. It's a shame because annuities can help mitigate longevity risk and increase the survival rate of traditional stock and bond retirement portfolios.

Good-intentioned and knowledgeable financial professionals also fall for pervasive annuity horror stories when in fact they could be doing their clients a disservice by ignoring benefits annuities can bring to the table for those who have high probabilities of outliving assets that generate income in retirement.

Real Investment Advice's Financial Guardrails Or Rules To Consider Before The Purchase Of Annuities

- 1. Annuities tend to get sold, not planned.** Annuities are primarily product-sales driven. Comprehensive financial planning which includes your current asset allocation, ongoing savings and investing habits, anticipated income needs in retirement and survivability of investment assets based on estimated life expectancies either for you or you and a spouse, should be a mandatory first step. Most annuity salespeople are not going to undertake a holistic planning approach before an annuity solution is offered; it's important to partner with a Certified Financial Planner who is also a fiduciary to complete a financial plan before you commit resources to annuities. A plan can determine whether an annuity improves retirement income sustainability and specifically, how much investment to commit. If your plan reflects the probability of meeting your retirement goals at 90% or greater, forgo the annuity and create an action plan to bolster savings, reduce debt or work a year or two longer.
- 2. Consider fixed indexed annuities as intermediate to long-term bond replacements.** Or to improve risk-adjusted portfolio returns during market cycles of extended stock valuations and/or less potential for appreciation in bond prices (like we're in now). Roger Ibbotson estimated that a 60% stock, 20% traditional bond, 20% fixed indexed annuity allocation returned 8.12% from 1927-2016 in periods where bond returns were below median, compared to a traditional 60/40 portfolio which returned 7.6%. If future returns for traditional risk assets will be muted due to rich stock valuations and lower capital appreciation for bonds (which we believe is the case), a fixed indexed annuity may be employed to replace up to 20% of a total fixed income allocation. A FIA may provide attractive returns compared to stocks and bonds combined with zero downside risk.
- 3. Understand surrender charges, costs, tax, and withdrawal penalty implications.** Annuities must be considered long-term products designed solely to meet retirement goals. Deferred annuities will include a hefty 5-10 year decreasing annual percentage charge to discourage liquidations. There will be ordinary income taxes incurred and possibly penalties (if younger than 59 ½), upon withdrawals. Charges are incurred for commissions and cost of

insurance, too. Most annuities will permit up to 10% annual withdrawals free of surrender charges. It's important to understand how to withdraw as a last resort if a financial emergency arises.

4. Slow your riders. Riders are supplementary features and benefits that can add anywhere from .35 to 1.50% in additional costs per year. Available riders range from enhanced liquidity benefits (ELBs) which allow surrender-charge free return of premiums in the second year, ADL (activities of daily living such as bathing & dressing), or custodial care withdrawals that provide access to up to 100% of accumulation value without surrender charges, to the most popular – GLWBs or Guaranteed Living Withdrawal Benefits for one life or for you and a spouse. Lifetime income is guaranteed even if the accumulation value of the annuity falls to zero. Many annuity owners can't explain why they purchase riders or how they're supposed to work and this is a major failure for salespeople who can do much better for their customers. Unless a comprehensive financial plan indicates a 25% or greater probability of outliving your retirement savings (75% success rate) and expected single or joint life expectancies are age 95 or older, paying 1-1.5% a year for a living withdrawal benefits rider seems excessive. If outliving your investment source of retirement income is a concern, there are deferred and immediate income annuities on the market that can fill the gap along with other solutions like reverse mortgages.

5. Seek a second opinion. An annuity is a long-term financial commitment. Before purchase, due diligence is mandatory. A fiduciary professional can outline the pros and cons of your prospective purchase. A deliberate, well-researched decision will minimize regret, later. Contact us for objective guidance.

A new study reveals guaranteed income sources help retirees overcome a psychological barrier to spend.

Per a June 28, 2021 paper for NBER by David Blanchett and Michael Finke entitled *Guaranteed Income: A License to Spend*, retirees who are behaviorally resistant to spending down savings may better achieve their lifestyle goals by increasing the share of their wealth allocated to annuitized income.

In other words, a guaranteed income gives retirees psychological breathing room to spend! The delay of claiming Social Security until age 70, an employer pension, an income annuity from a private insurer are examples of guaranteed income.

Annuities add clarity to the spending decision. Intuitively, it makes sense. After all, if I don't need to worry about income running out, bear markets, and fluctuating portfolio withdrawal rates, I feel more comfortable increasing my spending psychologically.

From the study: *Annuities can both reduce the risk of an unknown lifespan as well as allow retirees to spend their savings without the discomfort generated by seeing one's nest egg get smaller.*

Annuities Must Be Planned, Not Sold

Generally, annuities get a bad rap because they're sold to consumers who rarely understand them. Imagine purchasing an airplane and never being taught how to operate the cockpit. Instead, you sit and stare at the dials and switches, regretting the decision and wondering why you own this plane in the first place.



Not everyone needs an annuity. Most people have Social Security. That's their annuity. However, a comprehensive plan can flush out a need for additional guaranteed income vehicles. Frankly, I don't understand how annuities are sold like used cars. I mean, how can I even offer you an income annuity if I don't know your needs, wants, wishes, household cash flow, income sources, and health status?

Regardless, the study makes sense. A guaranteed income vehicle makes the *unknowable knowable*. I don't know how long I'm going to live. I don't know if a bear market is going to wipe me out. Thus, the comfort of knowing about that check coming in no matter what is a great relief. Thus, I feel free to spend knowing I can never run out of money!

Last, annuity is not such a scary word if you unpack it and gain knowledge. In some cases, it's the difference between a secure retirement and financial distress. Along with a strategy backed by a comprehensive plan, annuities can be employed to minimize losses, enhance portfolio returns and most important, create an income stream a retiree *cannot* outlive.

Money-Savvy Step #3: **Tax Management Doesn't Stop** **in Retirement**

Mainstream financial guidance makes an erroneous assumption that most of today's retirees will find their incomes taxed at the lowest marginal brackets.

In the 80s and 90s when U.S. demographics were favorable and national debt was 31-50% of GDP, this advice was valid. Today, the urgency to raise tax revenue along with the financial pressure on social safety nets such as Medicare, has never been greater.

With taxation of Social Security benefits and IRMAA charges on Medicare premiums considered, **many retired Americans will find themselves paying higher tax rates than anticipated.** But there are a few ways to control tax liabilities and ostensibly, increase your retirement income. If you're a few years from retiring or in retirement, preparing for greater tax control NOW is crucial.

CPAs, professionals in the financial industry and the media constantly tout the advantages of pre-tax accounts like traditional 401ks and deductible IRAs to help consumers reduce their current tax liabilities.

The sole focus on tax reduction today could be a shortsighted mistake paid for dearly down the road.

As mentioned previously, financial professionals advise with an **accumulation** mindset. The emphasis is to help clients accumulate and invest primarily in tax-deferred accounts with little consideration to tax implications of this guidance when the day arrives to withdraw funds at retirement.

The rationale for this tax-deferred myopia is based on a compelling three-part story: First, the 'snowballing' of compounded investment returns which occurs as would-be annual tax dollars work 100% for the investor sheltered from taxation for years, perhaps decades.

Second, a company retirement account contribution is generally a dollar-for-dollar reduction of gross income which ostensibly reduces taxable income.

Finally, the blanket statement about how households are going to drop to the lowest tax bracket in retirement is stubbornly alive and well. Only one component of this story remains valid as RIA expects future investment returns to be.

So, what if marginal tax rates do indeed move higher? Wouldn't it be worth maximizing savings in tax-deferred accounts while still working? Well, that is clearly the conventional wisdom – *worry about taxes today, never tomorrow (and tomorrow arrives sooner than you think!)*

However, unless there's a proactive strategy to the invest tax dollars that are saved by maxing out pre-tax accounts, (in an after-tax account or Roth IRA), why not bite the bullet, pay taxes now while you're a career-driven, human capital earnings machine, as opposed to the time when you are no longer in the workplace and need every tax-friendly dollar to live comfortably?

If we consider taxation on Social Security benefits and couple that with future disappointing investment returns, it makes sense that investors should place greater focus on tax-free account vehicles such as Roth vs. traditional pre-tax choices which just postpone future tax pain.

If you're a rare breed of taxpayer who believes marginal tax rates will fall in the future, taxation on Social Security benefits is not eventually headed higher and Medicare IRMAA surcharges will only increase down the road for higher-income households, then there's no reason to consider a change to your current focus on pre-tax retirement accumulation.

If you believe taxes have one direction to go (and that's up), then read on.



With the proliferation of exchange-traded funds, investors now have a great opportunity to invest tax-efficiently in after-tax brokerage accounts. The inherent tax-efficiency of ETFs allows investors to still buy in to the snowball compounding tale (if they must), of stocks, but in a tax-friendly manner.

The advantage would be the reduction of ordinary income tax liability and increase in long-term capital gains, which are currently taxed at lower rates. For example, a married retiree with income at the 22% marginal tax rate (married filing jointly with taxable

income of \$19,401-\$78,950), would pay a more palatable 0 – 15% on long-term capital gains on the sale of investments held for a year or longer.

Keep in mind, short-term capital gains (gains from a sale on assets held for a year or less), are currently taxed as ordinary income. Noted, there's always a risk that favorable long-term capital gain rates are not as tax-friendly in the future. Personally, I'm willing to take the risk as I believe long-term capital gain rates will always be taxed favorably vs. current income as the wealthiest Americans (including members of Congress), don't survive paycheck-to-paycheck. They thrive off capital gains.

At the least, maintaining pre-tax, after-tax, and tax-free accounts allows for greater lifetime tax control. It's especially important throughout the retirement income distribution phase.

At RIA, we teach the importance of 'diversification of accounts' whereby a retiree is able to maintain greater distribution flexibility and control over tax liabilities when unexpected expenses arise or ordinary-income distributions risk placing a retiree in the next highest marginal tax bracket.

For example, a client required \$50,000 to pay off the mortgage on his primary residence. Because he believes in account diversification, we were able to withdraw \$20,000 from his pre-tax rollover IRA, \$10,000 from his Roth conversion IRA and the remainder from his after-tax brokerage account which helped minimize the overall taxes he would have incurred if the entire \$50,000 needed to be distributed solely from his pre-tax rollover IRA.

Unless you've undertaken holistic financial planning that includes tax-friendly retirement income distribution planning modeled for the sunset of current tax laws in 2025, and then know for a fact you're going to be in the lowest tax bracket in retirement, here are several other tax-friendly ideas to consider:

Maximize Annual Contributions To ROTH IRAs

A Roth comes in two flavors: Contributory and conversion. People tend to mix them up. So, let's start with the smarter, more handsome sibling of the traditional IRA: The contributory Roth IRA. Roth accounts overall offer tax-free growth and most important: **Tax free withdrawals.**

Since Roth IRAs are funded with after-tax dollars obviously, a current tax deduction is not available (*remember the commentary about focusing on taxes tomorrow vs. taxes today?*). After a five-year period, which begins January 1st of the year a contribution is made, earnings may be distributed 100% tax free. If younger than 59 1/2, unfortunately, a 10% premature distribution penalty applies to withdrawn earnings.

Contributions, which are after-tax, may be withdrawn at any time without taxes or penalties. For many investors, the five-year waiting period for earnings is a quick walk in the park as funds should be considered long-term for retirement.

Keep in mind, a Roth IRA is not subject to required minimum distribution rules where at 70 1/2, distributions from traditional retirement accounts must begin or a retiree may face a draconian 50% penalty on the amount that should have been withdrawn.

Another benefit to Roth IRAs and Roth 401(k) options: *Withdrawals are not included in the provisional income formula used to tax Social Security; distributions will not add to income that may generate Medicare IRMAA surcharges.*

Keep this in mind if you follow a Pay Yourself First strategy: In almost every case a Roth is a better choice. We're not concerned about your current tax bracket; nor are we worried about your possible tax bracket in retirement. WE DO care about how you're going to gain more consumption dollars in retirement and the impact of taxation on Social Security benefits.

John Beshears a behavioral economist and assistant professor of business administration at Harvard Business School in a study – "Does Front-Loading Taxation Increase Savings? Evidence from Roth 401k Introductions," along with co-authors, outlines that plan participants who place their retirement savings on autopilot and direct a percentage of gross income, say 10%, into a Roth vs. a traditional pre-tax 401k, will wind up with more dollars to spend in retirement.

It's rare when a financial rule-of-thumb is a true benefit. And you don't need to do much to receive it! The reason the strategy works is front loading of taxes. In other words, sacrificing tax savings today (when working and paying the taxes isn't as much of a burden as it would be in retirement when earning power drops dramatically), and failing to adjust the percentage of auto-pilot savings to compensate for the current tax impact of switching from pre-tax to Roth, allows for additional future consumption dollars.

From Lauren Lyons Cole Business Insider article on the study: *“If a worker saves \$5,000 a year in a 401(k) for 40 years and earns 5% return a year, the final balance will be more than \$600,000. If the 401(k) is a Roth, the full balance is available for retirement spending. If the 401(k) is a traditional one, taxes are due on the balance. Let’s say the person’s tax rate is 20% in retirement. That makes for a difference of \$120,000 in spending power, which a life annuity will translate into about \$700 a month in extra spending.” John Beshears*

Switch To A ROTH 401(k) At Work

We know. Sounds weird. We’ve been so brainwashed to invest in traditional pre-tax 401k plans; it just feels odd to consider a Roth alternative. Most likely, your place of employment offers a Roth 401k; you just never bothered to check – they never bothered to make a big deal about offering it.

A Roth 401k operates the same as the traditional brethren with several important differences – contributions are after-tax; there is no current tax benefit for paycheck contributions. In other words, if you decide to max your employee contributions (we hope you do), then \$19,000 (\$25,000 if 50 or older), will not reduce your household income. Employer-matched contributions remain pre-tax and deposited in your traditional, pre-tax 401k.

But Rich, this is painful! I get it. As you recall, tax savings realized in the current can be a tax enemy in waiting when retirement arrives and you require *every tax-free dollar to maintain a lifestyle*. Let’s consider a compromise (*and I do need to make this deal. Sometimes the tax-deferred story is too deeply ingrained to discount completely*).

You decide to ignore my advice. I have no idea what I’m talking about. Fine. So, you make the maximum contribution to a pre-tax 401(k). Hey, I’m just happy you’re saving money! Now, please go ahead and ask your tax advisor how much was saved in current taxes due to the contribution. Whatever that sum turns out to be, I want you to please contribute 100% of it if possible, in a Roth contributory IRA. See? I’m all about compromise. At the least, you’ll be working on diversification of accounts. For that, I commend you.

I’m proud of how we’ve helped attendees at our Right Lane Retirement Classes and clients to realize the long-term benefits of Roth. So much so, we have many clients who max their Roth 401k AND Roth contributory accounts on a consistent basis.

If your company doesn’t have a Roth retirement plan option, I’d suggest you speak to your benefits department to inquire as to why one isn’t offered. In the meantime, my recommendation is to invest up to the match in your tax-deferred plan and continue the remainder of your savings in an after-tax brokerage account.

Consider Annual Surgical Roth Conversions

People ask me about the viability of Roth considering massive federal government deficits. RIA is not concerned about the government changing the tax-free status of Roth for the majority. Why? They’re like J.G. Wentworth! They need cash now! However, we are extremely concerned how both political parties envision tax-deferred accounts as fatted calves – all too tempting not to bring to eventual tax slaughter.

The \$100,000 AGI ceiling on Roth conversions was removed years ago to allow traditional IRA owners to convert to Roth without limitation (J.G. Wentworth!).

A Roth conversion allows withdrawals from a pre-tax retirement account, most likely a rollover IRA, and subsequent conversion to Roth. Withdrawals are taxed as ordinary income. Therefore, careful analysis and discussion with a financial and tax advisor is crucial.

Let’s take for an example, a ‘young’ gentleman retiree – 57 years old, with a surgical Roth conversion strategy. A proper retirement income plan outlines a five-year surgical Roth conversion analysis to fully maximize the 22% tax bracket.

Considering a 37-year life expectancy, he’s able to estimate an increase in his lifetime withdrawal and/or legacy plan of \$871,466 compared to conventional wisdom whereby he remains passive and just distributes money every year from his tax-deferred accounts beginning at age 60, to meet specific spending goals. With the surgical Roth strategy, this retiree is also able to reduce overall tax liability and loss of tax control that comes with required minimum distribution requirements.

And for retirees already in required minimum distribution mode from IRAs and retirement plans (usually at age 70 ½ or 72)? It’s not too late to think Roth! RMD recipients should plan to convert IRA dollars post-RMD up to the next marginal tax bracket. Simply, retirees can look to distribute more than their required minimums and convert those dollars to Roth. Unfortunately, RMDs cannot be converted.

Roth continues to grow in popularity. The writing is on the wall. Higher taxes are coming, and many retirees will not be spared.

Money-Savvy Step #4: Think Outside (Or Inside) The Retirement Income Box

Much of the wealth of middle-class households sits on a foundation. According to Visual Capitalist, a principal residence for over 61% of households with a net worth of \$0 and \$471K represents the cornerstone of wealth. So, why not consider the equity in a house an untapped source of retirement cash flow? Why not use your home to help increase spending in retirement?

Reverse mortgages or home equity conversion mortgages have a bad reputation even though they have changed dramatically over the years. No longer predatory, HECMs can be a powerful income tool in a fiscally responsible retiree's arsenal.

Facts About Reverse Mortgages

Reverse mortgages have several layers of costs (nothing like they were in the past), and it pays for consumers to shop around for the best deals. Understand to qualify for a reverse mortgage, the homeowner must be 62, the home must be a primary residence, and the debt limited to mortgage debt.

One of the smartest strategies is to establish a reverse mortgage line of credit at age 62, leave it untapped, and allow it to grow along with the home's value. The line may be tapped for long-term care expenses or to generate a monthly distribution for increased spending in retirement.

Also, consumers can use the reverse mortgage line for income in years where portfolios are down, thus buying time for the portfolio to recover. Once assets do recover, rebalancing proceeds or gains may be used to pay back the reverse mortgage loan, consequently restoring the line of credit.

Keep in mind, if you plan to remain in your residence through retirement or age in place (the most popular option for older Americans), a reverse mortgage doesn't require repayment.

In summary, RIA Certified Financial Planners® suggest retirees utilize a home equity conversion line of credit as an income bridge to postpone Social Security benefits until age 70, as support for in-home custodial care for long-term care expenses or as risk mitigation funds for large emergency expenses.

A recent groundbreaking study by the Center for Financial Security at University of Wisconsin-Madison,

connects the access to home equity to retiree health. When serious medical conditions occur, older Americans scrimp, avoid care and the doctor thus worsening their health. The analysis followed the health of 4,000 homeowners for 15 years after being diagnosed with one of four conditions – lung disease, diabetes, heart conditions or cancer. Retirees who accessed equity in their homes were better able to control their diseases compared to people who didn't.

From the Center for Retirement Research at Boston College: Withdrawing home equity, the researchers said, has “large, positive, and economically significant” health benefits.

How Do You Fare When It Comes To Retirement Income?

As a rule of thumb, consider where you fall when it comes to retirement income sustainability using the following three types of investors as classified by RIA. Obviously, comprehensive financial planning is the best way to determine how to generate a retirement ‘paycheck.’ However, a simple calculation may motivate you to complete a retirement income analysis with a financial professional who has your best interest at heart.

Inspired by the work of entrepreneur and author David Macchia who focuses on the processes of retirement income planning, there are three categories investors who require retirement income fall into.



Let's Review

1. **Sheltered investors.** This group requires portfolio withdrawal rates of 1-2% from a stock and bond portfolio. They are sheltered from volatility of the market due to more than 80% of their retirement income derived from guaranteed income vehicles such as Social Security, pension and deferred income annuity periods. 90 to 100% of their fixed, mandatory expenses are covered by these payments

with portfolio assets used to fund discretionary expenses such as vacations and hobbies.

2. **Funded investors.** These investors require portfolio withdrawal rates of more than 2 and up to 4% from a stock and bond portfolio. It's common for responsible savers to fall into this category whereby Social Security along with stock and bond portfolios, generate retirement income. This group should monitor their portfolio withdrawal rates annually, especially during times of market volatility and bear cycle. This group should look to be more flexible overall when it comes to household spending from year-to-year.



3. **Underfunded investors.** An underfunded investor requires a portfolio withdrawal rate that exceeds 4% annually on a consistent basis. This group is not necessarily made up of poor savers, just bigger spenders. In addition, they are projected to have longer life expectancies than the mortality tables dictate. For this group, supplemental lifetime income vehicles such as annuities and the maximization of Social Security are especially important. Also, underfunded investors tend to work longer, learn to micro-budget, or find part-time employment to better manage withdrawal rates.



So, Which One Are You?

The best way to find out is to calculate a simple income-to-assets ratio. Divide the income required from investments by the total amount of savings to produce income.

An example: James after budgeting and analysis, believes he requires retirement income of \$6,500 a month.

First, we calculate: **Required Monthly Income – Social Security – Pensions = Income Gap.** James expects \$2,100 from Social Security. So, \$6500-\$2,100 = **\$4,400.** This is James' income gap that needs to be withdrawn from his investment portfolio.

Second, James has been a good saver. His portfolio value is worth **\$1,250,000.**

Third, let's calculate his income-to-assets ratio: He needs his savings to produce \$52,800 annually.

$$\text{\$52,800 divided by \$1,250,000} = 4.22\%$$

James is an underfunded investor. So, what's the solution? In James' case, it's not difficult to get him to funded. He can work a couple of years longer, decrease his expenses, bolster his savings rate while working, possibly look to a reverse mortgage tenure, or monthly payment option. All manageable ideas. He can even look to add a guaranteed income annuity or create his own pension which would relieve the stress on his variable assets to produce the income he requires through years of market distress or lower returns.

Last, James decided to work two years longer. This brought is withdrawal rate down to 3.5%.

And speaking of working longer:

Bet you didn't know that something as easy as working three to six months longer boosts retirement income by as much as increasing retirement contribution percentages by one percentage point over 30 years of employment. Yes, you read that correctly.

The analysis is from another NBER Working Paper titled Working Longer Can Sharply Raise Retirement Income. The authors discover that primary earners of ages 62-69 can substantially increase their retirement living standards by working longer.

Conclusion: there are several obvious reasons why working longer helps increase income, which can bolster spending in retirement. Older workers still

contribute to savings, postpone withdrawals, can purchase income annuities, and, cheaper and most importantly, wait to take Social Security.

As the analysis outlines:

The largest factor is the increase in Social Security benefits from claiming later. For example, if an average 66-year-old works one year longer and claims Social Security one year later, that person sees a 7.75 percent rise in retirement income, the researchers calculate. Some 83 percent of the gain comes from the rise in Social Security benefits. The federal program offers a higher benefit to a given individual if that person claims benefits at age 67 rather than at age 66.

Working Longer Is Good For Your Health. No, Really It Is. And For Spending Too!

A strong positive correlation exists among employment, longevity, and social engagement. For example, a Pension Research Council Working Paper by Tim Driver and Amanda Henson from The Wharton School links working longer to health and longevity.

After retirement, there's a greater chance of cognitive decline in older adults. Work staves off the adverse effects of social isolation. Interestingly, most older workers polled for a survey referenced in the paper would rather work a job completely different from what they've done in the past.

Vibrancy in retirement comes from feeling important to ourselves and the community. Of course, a part-time job provides many internal rewards outside of the money but, the extra cash to increase spending in retirement doesn't hurt!

Income and cash flow are the lifeblood of retirement.
Just ask Wilson.

We hope this guide is helpful.

For assistance crafting your own retirement income strategy, contact our planning team at www.RealInvestmentAdvice.com.

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