The Truth About How To Create A Secure Retirement Income For Life

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There is so much conflicting information out in the media world about what to do with your money at retirement to make sure it is safe and lasts throughout your lifetime that all this information can just be mind numbing…causing a person to take a 'do nothing' approach and keep losing their life savings to the unpredictable stock market.

Let's take a look at available financial tools that are 'pitched' by financial salespeople to see how they will fare in our upcoming potentially high inflation and high tax environment. Before we do that though, let's look at how the average person or retiree may come up short if they do not anticipate massive tax increases and inflation in the future with a potentially volatile 'sideways' stock market for many years to come.

There have been periods in the past where retirees would've lost their shirt in the U.S. stock market due to inflation and no 'real' gains on their money over an extended period of years. If we take a snapshot of a 17 year period of history from October 1, 1965 to October 1, 1982, the Dow Jones Industrial Average (this is the daily average we hear about on the news) of the 30 industrial 'blue chip' stocks actually finished lower at the end of that 17 year period than it did at the beginning of that 17 years, including dividends and splits. But inflation during that 17 year period of time was 209%! This means that for every $1 you had on October 1, 1965 by October 1, 1982 you would need $3 to match the buying power of that 1965 dollar! You would need three dollars by 1982 for every one dollar you had in 1965 just to have the equivalent lifestyle and purchasing power. For those poor retirees that thought they could just walk into a brokerage firm and listen to their stock broker who may have recommended 'blue chip' stocks in the Dow for their retirement, they'd be near broke by 1982 because of 17 years of nothing happening with their money while inflation shot up a staggering 209%! I always get the market pro who says 'but what about dividends?'. Folks, these numbers included dividends and splits! So you cannot place your trust in the U.S. stock market to retire you and guarantee that you will not run out of money. What if you did run out of money because you made the wrong judgment call and the market did not perform as you expected? What would you do then? Who would you live with…your kids? You have to make financial decisions today that are responsible and that will carry you forward the next 30 or so years of retirement. Some people say to me, 'well, I won't live that long'. And my response to that silly comment is 'how do you know?'. You have to be prepared to weather the storm! If the storm is hunkering down on you and you fail to 'weatherize' your portfolio, then you could lose everything you've worked years to accumulate.

Let's take another snapshot of the last 11 years of the S&P 500 Index. If you had invested in the index 11 years ago (from mid 1998 to 2010), you'd be at about the same place then that you are at today in terms of value of your portfolio, because of the losses of any gains you would've experienced during that period due to the S&P500 Index's volatility. However, the pain doesn't stop there. If you take into account an average per year inflation rate during that 11 year period of approximately 3% per year, you're easily off 33% or more for that 11 year period. So even though you're where you were at 11 years ago, you'd be down over 33% due to inflation. Furthermore, this figure does not include fees if you were in mutual funds or managed accounts! With fees included, you could be down on your money much more.

Well, now that I've jolted your reality when it comes to stock investing for retirement, the next solution your broker may come up with is 'well, just buy bonds!'. How brilliant of them! It sounds like a no-brainer…we'll just take our money out of those 'risky' stocks and we'll go buy 'safe' bonds. But…there is one huge problem. Interest rates today are at all time lows and even financial institutions are buying 'one year U.S Treasuries' that are paying ZERO percent interest! Did I say zero? Yes…I said ZERO percent interest! You see, it's part of the Federal Reserve's 'zero interest rate policy' to stave off a great depression by lowering interest rates to unheard of levels. Financial institutions and large companies would rather invest their money with the U.S. Government and earn 'zero percent' on their money than risk it in the not so safe stock market or alternative investments. Their philosophy is that even though they are earning zero percent, it's better than losing money. Even the longer term 10-Year Treasuries are only paying rates in the mid 3% range today…and that means you'd need to hold that investment for the next 10 years! Now to the problem…bonds function opposite of interest rates. What this means is that as interest rates do rise, the value of your 10-Year ultra safe U.S. Government Treasury will go down. This is because when interest rates get back in the 5% range, why would I want to buy your 10-Year Treasury that only pays me in the mid 3% range when I can invest my money and buy a 10-Year Treasury that pays me in the 5% range? So as the investor holding that 3% U.S. Treasury, I have to offer you, the buyer, a 'discount' in order to entice you to buy it from me. That means that as the investor, I'll lose some of my principal value when I sell it to you. This same scenario plays out for Corporate Bonds, and Municipal Bonds. So again, as interest rates rise, these bonds values will fall. And bonds are NOT as liquid as stocks. They can take longer to sell and, again, could force you to sell them at a discount once interest rates begin to rise. So financial salespeople who are recommending the flight from stocks to bonds are just creating another potential disaster for their clients. You can lose principal with owning bonds! Now sure you could keep the bond through its maturity to recover your principal…maybe 20 years on a 5% bond today…but if you're 70 years old, doesn't 20 years for an investment sound ridiculous? Also, with regards to liquidity, you have none with bonds…except for the interest you receive every year. So talking about 'tying up my money'…bonds are the holy grail of tying up your money! But then your stockbroker or bond broker may recommend a 'bond mutual fund'…and well that's just even more brilliant! A bond mutual fund does not have a 'maturity date' like a regular individual bond issue does. Therefore, as interest rates rise and the value of the bond mutual fund goes down, because of the underlying bond portfolio,…you may not ever get any of your principal back, unlike a regular bond where you could wait out the maturity date and get a full recovery of principal. So again, today a portfolio of bonds could be a course for disaster in the not so far off future once interest rates start to make their rise.

Well, since stocks and bonds don't seem very logical for a retirement portfolio today where your serious retirement money is involved, then why not just 'put it in the bank'. That seems like a logical solution…right? Well, even in the 'safe' FDIC insured bank, your money has typically not even kept up with long term inflation…so you can still lose buying power at the banks current 1% or 2% rates of today even though your money is principal safe. Could you outlive your money with these kinds of returns? Absolutely! For an example…just to keep your principal intact at a 2% rate of interest at the bank, if you need an additional $20,000 per year to live, you'll need to have a bank account valued at $1 million dollars! How many retirees have a million bucks lying around that they cannot touch except for their interest? So the banks are good for short term savings and certificates of deposit, but not for your serious retirement money that you want to generate lifetime income streams off of.

So this brings us into a final class of financial products…Annuities. Shhhh, you shouldn't be saying that bad word…the media might get mad at you and certainly the stock brokerage and bond brokerage firms are not happy when you consider one of these! That's because when you buy an annuity, the money leaves them (the securities industry) and reverts to the insurance industry…where they have no control to keep collecting fees and commissions off of you. However, annuities come in many different flavors. Just like a fruit for instance…apples and oranges do not taste the same, but they are both fruits. So annuities come in the following flavors: variable, immediate and fixed/fixed index. But the media and your stockbroker will lend to the confusion by calling those 3 different products one word…'annuity'. No wonder there is so much confusion and conflicting opinion about annuities today! If I look for an annuity today, what kind of annuity should I buy? Well, that depends…and not all annuities are right for you. For example, a Variable Annuity is a registered security product…and this is what you'll most likely be sold or pushed into by your stockbroker or financial salesperson who has a securities license, because they get a large upfront commission and then with your nearly 2-3% in total year after year annual fees…they'll continue to receive backend commissions. This way the brokerage firm is not totally losing control of the money to the insurance company. They can keep making money off of you every year…it's not a one time commission amount. So is this a good product for retirees? I wouldn't give it my best high marks. I would say that there are 'lifetime income' riders that you can buy on Variable Annuities which principal protect your money in the case of a stock market decrease on your actual value, but to enjoy this principal protected or 'stepped up' value, you must either annuitize or take your money as a lifetime income stream…thereby hand tying you to the investment. I've listened to people come into my office who insist that their money grows at 6% or 7% per year no matter what the stock market does in these Variable Annuity investments and they claim they can just 'walk away' with that value after their surrender charge period has ended. But this is not the case. To get that value, they must take that value as a 'lifetime income stream' by following a lifetime withdrawal percentage formula or they must annuitize…and annuitizing is essentially giving up the value of the money for a stated income stream for a period of years or life. So the only advantage to a Variable Annuity is the 'lifetime income rider', which can work well if you need lifetime income. But your actual value of your investment could be in the 'toilet' if the stock market goes down. And fees with these types of annuities are in the 2% to 3% range if you look at the base fees plus all the riders.

So what about immediate annuities? This is what most of the media considers an 'annuity'. You give the insurance company a lump sum of money, then they give you an income for a period of years or life. But you never have access to that lump of money again. It's like retiring from an employer. Some employers give you a choice…take a reduced lump, or take the full value but give the full balance to us for a guaranteed monthly paycheck. The immediate annuity is the 'guaranteed monthly paycheck' but without any inflation adjustment or any access to the lump…once you do this transaction with the insurance company, you nor your heirs can ever get that lump of money back…so it's not the best option for a retiree.

Finally we have the Fixed/Fixed Indexed Annuity. On a purely 'fixed' annuity product, it functions like a bank CD to offer you a stated rate of interest. Whatever the insurance company declares, that's what you get. However, there is a hybrid product called a 'Fixed Indexed Annuity'. With this, you don't have to accept the insurance company's stated rate…instead you can opt to 'link' to a stock market index, typically the S&P 500. If you link your performance to a stock market index, you might do better than the rate the company is declaring. But the index could also go down. But with these products, unlike the Variable Annuity, you will not lose value or any previous year gains if the stock market goes down. Those previous gains are locked in and 'ratchet' up. The downside is you will not get the full up ride of the market…typically you're 'capped' on your interest gain and there are different 'crediting methods' which allow you to perform differently depending on the volatility of the market. For example, you may choose a crediting method whereby the 'cap' is 6%. So if the market goes up 10%, you'll end up with 6%. But you'll never lose that gain in a down market. The worst you could do in a given year is 'zero percent gain'. These products are NOT registered securities and are NOT sold by prospectus. It's just like buying a bank account that could tie its interest rate to a stock market index's performance. You're never actually in the stock market taking risk on your money or paying fees like the Variable Annuity. The media gets this so mixed up. They never differentiate this product from the Variable Annuity and it's like eating an apple versus an orange. Both are annuities, but they taste much different. You can also buy 'lifetime income' riders on these products just like the Variable Annuity. So why pay 2-3% per year in total fees in a Variable Annuity when I can buy a Fixed Indexed Annuity whereby I can also buy a 'lifetime income' rider which will also guarantee that my 'income value' of the account can increase at 6% to 8% per year no matter what the stock market or interest rate market does. Another false downside that I hear from the media about annuities is that you 'tie up your money' when you buy one. This is just not true…unless it's the Immediate Annuity that I discussed earlier. With the Fixed or Fixed Indexed annuity, I can take 10% per year…each and every year…without any penalty at all. If you take 10% per year out of any account…you'll be out of money before you die…pretty much guaranteed! So 10% is plenty of access to money. Also, you don’t put all your money in an annuity…just the serious money you want to guarantee will be there to generate a lifetime income to you or that you want safety and principal protection on. With the ‘lifetime income rider’ that I mentioned a minute ago, even if the annuity runs to ‘zero’ balance, you’ll still get the same income stream for the rest of your life as when you started. If properly structured, these can also be setup to allow a spouse to takeover the income stream when you die.

So what is a retiree to do today to make sure that their money grows regardless of what the market or interest rates do? Buy an annuity for your serious money! But make sure it’s the right kind and is designed the way you need it to be so that you have flexibility and control.

About the author: *Mark Kennedy is President of Kennedy Wealth Management, LLC, a Registered Investment Advisor. With over 16 years of experience and focusing on retirees and pre-retirees, Mark specializes in lifetime income planning and safe money retirement strategies. Mark is also an IRA and retirement planning expert and has been featured in Ed Slott’s best selling book, ‘Parlay Your IRA Into A Family Fortune’, as one of Ed’s pre-screened and recommended IRA advisors. Mark is also a member of the Million Dollar Round Table organization’s ‘Top of The Table’ elite group, whereby only the top 1% of financial advisors worldwide are invited to become a member. Mark has had his own retirement radio show and has written for several publications about issues regarding retirement. Visit Mark Kennedy’s website,* ***www.kennedywealthmgmt.com*** *to learn more.*