Retirement Income and Legacy Planning – Can You Do both?

A client wants to retire comfortably and leave money for his kids.

Recently, a new client came into my office with two financial goals. Here's what he told me: "First, I want to know if I can retire today without worrying that I will run out of money. Second, It's important to me to leave a legacy for my kids and granddaughter."

For context, he is 66 and has two adult sons. He was smiling when he shared that he had just become a grandfather for the first time. He has saved up a $1.2 million nest egg between his 401(k) and IRAs and has a monthly income need of $6,500. He had already looked into an immediate annuity, where he would be required to give a lump sum to an insurance company in exchange for a monthly payment for the rest of his life.

While a monthly payment for life was intriguing, he decided an immediate annuity was not for him. He did not like the idea that it would take years for him "just to get my money back and break even" and that "the insurance company would keep my money, rather than my kids getting

it, if I pass away prematurely." We worked backwards to create a plan designed to help him reach his goals. Here's what we discussed.

Evaluate his needs. We started with his retirement income needs and talked about his vision for retirement. He said he could live very comfortably and "do all the things I want on $6,500 per month." He was already receiving a combined $3,500 per month (net of taxes) from an old pension and his Social Security income. We were left with a need of $3,000 per month in retirement income to be generated from his savings. The good news is that taking a 3 percent annual withdrawal rate on his $1.2 million nest egg generates $36,000 per year, or $3,000 per month.

Determine his risk tolerance. Next, we reviewed his risk tolerance and the fact that he wanted to plan for 40 years in retirement – just to be "extra safe." We discussed the realities that retirees face, such as the erosive effects of inflation, the likelihood of rising health care costs in retirement, the effect of his sequence of returns as well as managing his portfolio during substantial market declines.

Construct a potential portfolio allocation. Then we needed to construct a portfolio allocation that suited his risk tolerance. While originally reviewing a portfolio of 20 percent stocks and 80 percent bonds, my client shared that he would prefer to be more aggressive to increase his chances to pass on more assets to his kids and granddaughter. Considering these factors, we began evaluating a moderately conservative asset allocation of 40 percent stocks and 60 percent bonds.

Run a probability simulation. We next ran a Monte Carlo analysis where we generated 5,000 simulations of what hypothetically could happen to this portfolio during retirement by looking at a wide variety of potential market scenarios and fluctuating market returns. Each simulation includes up and down markets of various lengths, intensities and combinations. This allows us to have a realistic assessment and probability framework to evaluate his portfolio in the context of his retirement income need.

Analyze the results. The result of the Monte Carlo analysis was a 96 percent probability of reaching his goals. With this chance of success, the likelihood is increased that my client would not only achieve his retirement income goals, but also be able to effectively pass along assets to his kids and granddaughter. Of course, any hypothetical results are for illustrative purposes only and should not be deemed a guarantee of future results.

Next steps. The next steps were to create his written financial plan, implement his designed portfolio allocation and meet with our estate-planning attorney. For multigenerational wealth transfer strategies, advanced planning is a fundamental component.

http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/articles/2016-02-11/retirement-income-and-legacy-planning-can-you-do-both