

Retirement: Does Your Withdrawal Strategy Need a Second Look?

In its simplest terms, a withdrawal rate is the percentage you withdraw from an investment portfolio in any particular year. However, in retirement income planning, what's important is not just your withdrawal rate, but your sustainable withdrawal rate.

A sustainable withdrawal rate represents the maximum amount (expressed as either a dollar amount or a percentage) that can be withdrawn from your retirement assets each year with reasonable certainty that the portfolio will provide income for as long as it's needed (for example, throughout your lifetime).

A commonly expressed rule of thumb states that your portfolio should last for your lifetime if you initially withdraw 4% of your balance (based on an asset mix of 60% stock and 40% fixed income securities), and then continue withdrawing that same dollar amount each year, adjusted for inflation. However, this rule of thumb has been under increasing scrutiny, and like any rule of thumb, it may not apply to you.

Why is it important?

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money. You want to find a rate of withdrawal that gives you the best chance to maximize income over your entire retirement period.

Withdrawal rates are based on a number of assumptions, including your living expenses, projected lifespan, risk tolerance, projected rates of return and inflation, asset allocation, taxes, and whether you wish to leave a portion of your estate to others. As you progress in retirement, you'll have empirical data against which you can evaluate these assumptions. Plus, your investment horizon will be getting shorter. That's why it's important to periodically revisit your withdrawal strategy during your retirement to see if your assumptions are still accurate and whether your strategy needs to be modified.

Dealing with market volatility

If you're currently withdrawing a fixed percentage of your investment portfolio each year, the amount you receive will fluctuate with the performance of your portfolio. Small changes may not significantly impact your lifestyle. But what if your portfolio suffers a serious decline

due to a market downturn? Will you be able to meet your expenses with the reduced withdrawal amount you'll be receiving? If you're currently withdrawing a fixed dollar amount each year, you may be able to meet your expenses, but can your reduced portfolio continue to support that same dollar amount or will your assets be depleted much too soon?

The converse of this is also true. If your portfolio realizes a gain that's significantly greater than your assumptions, a fixed percentage withdrawal will provide you with more dollars than you had been taking. Do you need the additional income? If you're taking a fixed dollar amount each year, is it time to give yourself a raise?

Market volatility may also lead you to consider changes in your asset allocation. If your portfolio is down, you may be inclined to become more conservative to avoid additional losses; conversely, when your portfolio is up, you might contemplate becoming more bullish. But if your asset allocation is designed to produce sustainable long-term income, changes should be considered carefully and only implemented as part of a disciplined strategy.

Other factors to consider

When you review your withdrawal strategy, make sure you consider the following:

Inflation: Inflation erodes your buying power. If you've underestimated the inflation rate, you may need to increase your withdrawals. If your portfolio can't support additional withdrawals, you'll need to reduce your expenses, or find another source of income (e.g., part-time work) to maintain your lifestyle. If inflation is lower than you've anticipated, you may be able to withdraw less and prolong your portfolio's income-producing ability.

Lifestyle: You may find that your expenses during retirement decrease from your initial estimate as you travel less or downsize a home—or they may increase because of health care or other costs.

Legacy: A decision to increase or decrease the amount you leave to heirs or charities can have a significant impact on your withdrawal strategy.

Revisiting your withdrawal strategy will allow you to focus on changes that have occurred during your retirement and fine-tune your strategy going forward, helping to ensure your retirement will be a financially secure one.

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money.



2009 Year-End Tax Planning Considerations

Here are some things to consider as you weigh potential moves between now and the end of the year.

Year-end moves and the AMT

Deferring income to next year—for example, by delaying a year-end bonus—is a common year-end tax planning strategy. Similarly, individuals often look for ways to accelerate deductions into the current year—for example, by paying deductible expenses in December rather than in January. If you're subject to the alternative minimum tax (AMT), however, these traditional year-end maneuvers may actually hurt you.

Essentially a separate federal income tax system with its own rates and rules, the AMT effectively disallows a number of itemized deductions, making it a significant consideration when it comes to year-end tax planning. For example, if you're subject to the AMT in 2009, prepaying 2010 state and local taxes won't help your 2009 tax situation, but could hurt your 2010 bottom line.

Legislation earlier this year forestalled a dramatic spike in the number of individuals subject to AMT by temporarily increasing AMT exemption amounts for 2009. If you're one of the millions of individuals still expected to be subject to AMT in 2009, however, that won't be much comfort. Taking the time to determine whether or not you may be subject to AMT before you make any year-end moves can save you from making a costly mistake. If you're not sure, talk to a tax professional.

RMDs suspended for 2009

When you reach age 70½, you're generally required to start taking required minimum distributions (RMDs) from any traditional IRAs or employer-sponsored retirement plans you own. Individuals are required to take these distributions each year, withdrawing the minimum amount by the end of the year (individuals who turn 70½ during the year generally get until April 1 of the following year to take their first RMD).

Legislation in late 2008, however, suspended RMDs for 2009. (This suspension of RMDs also applies to amounts required to be paid to beneficiaries after an IRA owner's or plan participant's death.) This presents an opportunity for those normally required to take RMDs to postpone the receipt of taxable income.

2010 Roth conversion rules

It's also worth looking ahead to the special rules that will apply in 2010 when a traditional IRA is converted to a Roth IRA. Current limitations based on income and filing status that prevent many individuals from converting to a Roth IRA will be eliminated. Additionally, if you convert in 2010, half the income that results from the conversion can be reported on your 2011 federal income tax return and half on your 2012 return.

This 2010 conversion opportunity might influence your 2009 year-end planning. For example, if you're currently working but aren't eligible to contribute to a Roth IRA, you might consider making nondeductible contributions to a traditional IRA for 2009 in anticipation of making a conversion in 2010.

Also worth noting

- A tax credit up to \$8,000 is available in 2009 for qualified first-time homebuyers.
- The first \$2,400 of unemployment compensation received in 2009 is excluded from income for federal income tax purposes.
- If you itemize deductions, 2009 is the last year you'll have the option to deduct state and local sales tax in lieu of state and local income taxes.
- The temporary deduction for sales and excise tax relating to the purchase of a qualified new automobile, light truck, or motorcycle applies to vehicles purchased through December 31, 2009.
- The above-the-line deduction for qualified tuition and related expenses expires at the end of 2009.
- The provision allowing small businesses to take an additional 50% in first-year depreciation expires at the end of 2009; the expanded \$250,000 Section 179 expensing limit for small businesses also expires at the end of 2009.

Stay informed

It's always possible that legislation late in the year could extend some of the provisions above, or add new wrinkles—so stay informed. A financial professional can help you evaluate your situation and determine which year-end moves make the most sense for you.



AMT "triggers"

You're more likely to be subject to the AMT if you claim a large number of personal exemptions, deductible medical expenses, state and local taxes, and miscellaneous itemized deductions. Other common triggers include home equity loan interest when proceeds aren't used to buy, build, or improve your home, and the exercise of incentive stock options.



Investment advisory services offered through Hill Financial Group, a registered investment advisor.

Securities offered through LPL Financial, member FINRA/SIPC. Hill Financial Group is a separate entity from LPL Financial.

Ask the Experts



What is a short sale?

A short sale occurs when a mortgage lender allows a borrower (the short seller) to accept a sale offer that is less than ("short") the balance due on the outstanding loan.

Lenders generally will consider this option only when (a) the market value of the home is less than the mortgage balances due, and (b) the borrower, having fallen behind on mortgage payments, has little hope of bringing the mortgage current even if it were modified. The lender expects the proceeds from the short sale will be greater than what could be expected in a foreclosure.

If the proceeds from the sale don't satisfy the total mortgage and/or lien balances due on the property, one or more deficiencies may occur. Short sellers should always find out (in writing) what will happen to any deficiencies. If a deficiency isn't forgiven, the lender may be able (depending on state law and how the mortgage note or lien is structured) to pursue the borrower for it.

Junior liens (e.g., second mortgages, home equity loans, or other liens) are not dissolved in short sales (as they are in foreclosures). As a result, either the short seller or the first lien holder may have to give some consideration (something as low as pennies on the dollar) to junior lien holders to satisfy their claims. The short seller should again get notification in writing of what will happen to any remaining deficiencies.

Forgiven deficiencies can have tax consequences; the IRS generally considers debt forgiven or cancelled by a lender to be taxable income. However, recent legislation allows (for calendar years 2007 through 2012) up to \$2 million of forgiven debt (\$1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

After completing a successful short sale, borrowers may be eligible to apply for a new mortgage on another home after two years; foreclosures require a five-year waiting period.