The Period of One's Life Formerly Called "Retirement":

Sustainable Income Solutions™ and the Ideal of Choice, a Modern Framework

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Chapter I: Background

Introduction

Before reading this paper, close your eyes and imagine retirement. Where are you? Why are you there? What are you doing? Why are you doing it? Who is with you? Why are they with you? How old are you? Does this vision surprise you? How do you feel?

Open your eyes again, take out a pen or a pencil, and briefly write out this picture of your retirement below. The vision you create here will have a tremendous impact on the plans you make to validate this vision and make its achievability more certain than it is today.

Where are you?

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Why are you there?

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What are you doing?

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Why are you doing this?

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Who is with you?

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Why are they there?

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How old are you? ___________

Does this vision surprise you? ___________

How does this picture in your mind make you feel?

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For many of us, what we have written in these sections above likely represents the choices we want to be able to make in life. The freedom to make the choices to support this vision drives us to thoroughly, properly and carefully plan for retirement. However, achieving this vision takes careful planning. Steven Leacock, a Canadian writer and economist, paints a vivid picture of the alternative retirement that many are faced with. In his book *The Leacock Roundabout*, Leacock provides this advice on retirement "to all of you young fellows around 50:"

> *Have you ever been out for a late autumn walk in the closing part of the afternoon, and suddenly looked up to realize that the leaves have practically all gone? And the sun has set and the day gone before you knew it – and with that a cold wind blows across the landscape? That's retirement.*[1]
>
> *-- Stephen Leacock (1869 – 1944)*

1 "The Leacock Roundabout: A Treasury of the Best Works of Stephen Leacock", Stephen Leacock, p 229

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For too many Americans nearing retirement, Stephen Leacock's sentiment all too accurately represents their feelings associated with the realization that they may not have saved adequate income for their retirement. In fact, a recent study by the Center for Retirement Research at Boston College found that 45 percent of Americans are at risk of being unable to maintain their standard of living in retirement, and when health care costs were included, this number rose to 61 percent.[2] Given these figures, how accurate are our nation's retirement plans, and what does accurate retirement planning look like? With so many individuals at risk, the question becomes how do those approaching retirement or already retired address this problem? To provide an answer to this problem, this paper will discuss the retirement income conundrum, define the dynamic risks to sustainable income and present a course of action essential to the creation of a unique, personalized solution.

The following truths will shape the contents of this paper:

- We want choice of our own activities
- We do not want to be a burden to our family and friends
- We are not saving enough
- We will not have others to help us
- Our health may prevent us from generating income through wages (work)

Income Group	All	Early Boomers 1948 -1954	Late Boomers 1955-1964	Generation Xers 1965-1974
All	61%	50%	61%	68%
Top Third	53	48	52	59
Middle Third	57	44	57	67
Bottom Third	72	48	74	80

Figure 1 - Percent of Households 'At Risk' by Birth Cohort and Income Group, Including Health Care Expenses, 2006[3]

As we work to define the retirement problem facing Americans today, it is important to understand the generations for which planning for retirement is a concern. These generations include individuals who are decades away from retirement but must start planning today, those a few years away from or just entering retirement, and those who have been in retirement for many years. These generations possess very different attributes that influence how they earn their income from work and how they view their identities. Consequently, these same attributes will shape many factors in their retirement such as preparedness, the need for certainty, budgeting and the choices these individuals want to make.

As the objective of sustainable income is not to retire, but rather to maintain the freedom to make choices, early preparation for all generations is the key to controlling the ability to make choices.

2 *"Long-Term Care Costs and the National Retirement Risk Index."* Alicia H. Munnell, Anthony Webb, Francesca Golub-Sass, Dan Muldoon, April 2009

3 *"Do Households Have a Good Sense of Their Retirement Preparedness?"* Alicia H. Munnell, Francesca Golub-Sass, Mauricio Soto, and Anthony Webb, August 2008

A Demographic Shift

The future of sustainable income will be shaped by two momentous forces that are moving toward each other. A demographic shift in the makeup of the United States will likely have a dramatic effect on the long-term prospects for living standards. Incorporating an acknowledgement of this shift into any sustainable income plan is critical to ensuring the ability to make choices later in life.

The first converging force is the significantly changing composition of the U.S. population as the decline in birth rate following the baby boom, coupled with increasing longevity, leads to an older population. This shift is concentrated in the later part of the middle stage of life, with the number of U.S. citizens in retirement increasing at a greater rate than those in the workforce to support them. Moreover, an aging population has significant implications for U.S. government social programs, such as Social Security and Medicare.[4]

Second, as we stated before, nearly 45 percent of households are at risk of not having enough savings to maintain their current living standards in retirement.[5] Without enough income to maintain living standards and with fewer workers available to fund their retirement through social programs, all generations need to consider their personal plans for sustainable income in order to help ensure control over their choices later in life.

Dependency Ratio

The dependency ratio is a statistical measure that portrays the ratio between those needing social support (non-workers) and those providing social support (workers).

$$\text{(Total) Dependency ratio} = \frac{\text{(number of people aged 0 to 14)} + \text{(number of people aged 65 and over)}}{\text{number of people aged 15 to 64}} \times 100$$

4 *"A Primer on the Macroeconomic Implications of Population Aging,"* Louise Sheiner, Daniel Sichel, and Lawrence Slifman, September 2006

5 National Retirement Risk Index

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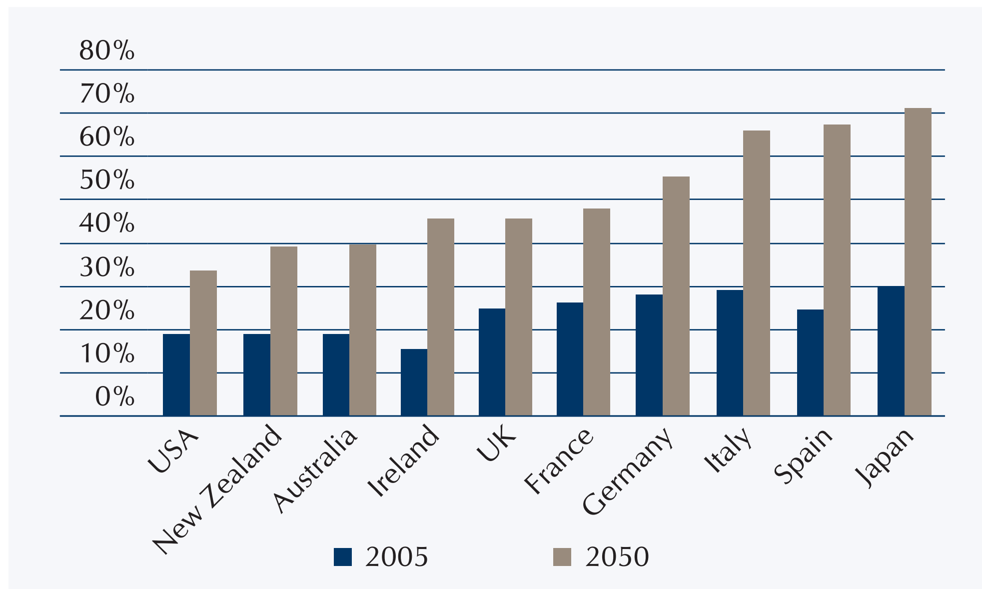

Figure 2 - World Dependency Ratios (2005 and projected 2050)[6]

As this ratio increases, there is an increased cost on the working part of the population to maintain the upbringing and pensions of the non-workers. While referred to in a technical sense, this ratio is important because it projects that one or more of the following outcomes must be true:[7]

- **Diminishing social benefits (Pension Plans, Social Security, Medicare, etc.)**

  Multi-employer pension plans, which almost exclusively cover union workers, peaked at 2,244 in 1980, and gradually declined to 1,567 in 2005. Single-employer plans, which generally cover non-union workers, sharply declined from 112,208 in 1985 to 28,769 in 2005.[8] One compelling number that describes the Social Security issue is **$12.8 trillion**, the present net value of Social Security's cash flow shortfall. In other words, it is the amount of money that the U.S. government needs to collect and invest today so that they can pay Social Security's promised future benefits forever.[9] For reference, the entire U.S. GDP, as of the fourth quarter 2008, is roughly $14.2 trillion. Further, Social Security Trustees expect the positive annual balances to continue only through 2016. Beginning in 2017, Social Security Trustees expect the annual balance to turn negative, when annual costs exceed annual revenues.[10] Finally, the Medicare Hospital Insurance (HI) Trust Fund projects to start running deficits in 2010. Current income and trust fund reserves will be sufficient to pay all hospital insurance benefits until 2019, when reserves are projected to be depleted.[11]

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6 Department for Work & Pensions (http://www.dwp.gov.uk/)

7 For academic sake it must be noted that while each outcome is also a solution, a fifth solution also exists, namely to encourage the immigration of individuals in their early working years (20s – 30s)

8 *EBRI Fact Sheet on PBGC*, Employee Benefits Research Institute, January 2007

9 *Philadelphia Conservative Examiner*, Clyde Middleton, February 2009

10 CRS Report for Congress - *Social Security: The Trust Fund*, Christine Scott, August 2005

11 *Trustees Reports Show Social Security Shortfall Manageable, Medicare's Problems More Daunting*, Paul N. Van de Water, April 2008

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- **Diminishing consumer consumption**

  Assuming there is no change in labor force participation by aging workers (retirement age held constant), every U.S. citizen would be required to reduce their consumption by 4.4 percent, starting immediately. If this cutback in consumption were to be delayed until 2029, the reduction would need to be nearly 14 percent.[12]

- **Increased Social Security taxes**

  Social Security Trustees estimate that increasing the payroll tax by 1.89 percent to 14.29 percent in total would be sufficient to make Social Security's Old Age, Survivors and Disability programs solvent.[13] While 1.89 percent might not seem like much, this would mean that a worker earning $35,000 annually would forego an additional $662 in pay every year. Raising payroll taxes by 1.89 percent would cost this worker, on average:

  - As much as he spends on gasoline over three months;
  - As much as he spends in two and a half months on clothing;
  - As much as he spends in one month on food for consumption at home; or
  - As much as he spends in two months on food outside of the home.[14]

- **Delayed retirement**

  If we raise labor force participation by increasing the retirement age for all workers by two years, the required reduction in consumption would be less than 1 percent.

  In October 2008, Fidelity Investments conducted a study on baby boomers' feelings about the timing of Social Security benefits.[15] This study reports that nearly half (45 percent) of Americans, age 61, are planning to begin taking Social Security at the age of 62, the first year that eligible recipients can apply. The top two reasons driving their decision to begin collecting are immediate financial needs and health and longevity concerns. <u>Seventy-three percent of those planning to start taking Social Security at age 62 are also making their decision without having a formal retirement income plan.</u>

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12 *"A Primer on the Macroeconomic Implications of Population Aging,"* Louise Sheiner, Daniel Sichel , and Lawrence Slifman, September 2006

13 *The Likely Economic Effects of Solving Social Security's Financial Imbalance Through Revenue Enhancements*, Testimony of William W. Beach, Director, Center for Data Analysis, The Heritage Foundation, Before the Subcommittee on Social Security of the Committee on Ways and Means of the United States House of Representatives, June 2005

14 Reference cited as "U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey."

15 *"Fidelity Investments Reports Nearly Half Of 61 Year-Olds Plan To Start Taking Social Security As Soon As Eligible,"* Fidelity Investments, October 2008

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Individuals should be aware that Social Security retirement benefits are dependent on the age at which Social Security benefits are received. While individuals can choose to retire as early as age 62, this action may result in a reduction of benefits by as much as 30 percent. Delaying retirement may result in significant yearly increases in benefits as shown in figure three.

Year of Birth*	Yearly Rate of Increase	Monthly Rate of Increase
1933 - 1934	5.5%	0.0458%
1935 - 1936	6.0%	0.500
1937 - 1938	6.5%	0.542
1939 - 1940	7.0%	0.583
1941 - 1942	7.5%	0.625
1943 or later	8.0%	0.667

Note: If you were born on January 1, you should refer to the rate of increase for the previous year.

Figure 3 - Social Security Increase for Delayed Retirement [16]

Each of the outcomes above influences choice in retirement by either requiring a reduction in earnings, a reduction in benefits or delaying the chance to make choices in retirement. Because the objective of sustainable income is not to retire, but rather to maintain the freedom to make choices, early preparation is the key to controlling the ability to make choices.

Retirement Savings

The second converging force on the demographic crisis is the emerging clarity regarding our preparedness for sustaining income for life without working.

The National Retirement Risk Index (NRRI) measures the percentage of working-age households who are at risk of being financially unprepared for retirement today and in coming decades. The calculations show that even if households work until age 65 and annuitize all their financial assets, including the receipts from reverse mortgages on their homes, 45 percent will be at risk of being unable to maintain their current standard of living in retirement. An extension of the analysis to account explicitly for health care costs in retirement raises the share of at-risk households from 45 percent to 61 percent.[17]

The length of retirement is increasing as the average retirement age hovers at 63 and life expectancy continues to rise. At the same time, wealth replacement rates are falling for a number of reasons. First, at any given retirement age, Social Security benefits will replace a smaller fraction of pre-retirement earnings as the full retirement age rises from 65 to 67. Second, while the share of the workforce covered by a pension plan has not changed over the last quarter of a century, the type of coverage has shifted from defined benefit plans to 401(k) plans. In theory, 401(k) plans can provide adequate retirement income. However, without the proper guidance, individuals make mistakes at every step along the way, and the median 401(k) plan balance for household heads approaching retirement is only $60,000. Perhaps even more alarming is that the majority of the

16 Social Security Online: http://www.ssa.gov/retire2/delayret.htm

17 *"Do Households Have a Good Sense of Their Retirement Preparedness?"* Alicia H. Munnell, Francesca Golub-Sass, Mauricio Soto, and Anthony Webb, August 2008

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working-age population saves virtually nothing outside of their employer-sponsored pension plan.[18] This issue is particularly critical in that it again indicates sustainable income for life will increasingly become the sole responsibility of individuals.

To the extent that we are living longer and will have increasing personal responsibility for our long-term well-being, it is crucial to consider how to sustain income for life without working in traditional wage-earning roles.

Recent Financial Market Impact

Between October 9, 2007, and March 9, 2009, the Dow Jones Industrial Average declined nearly 54 percent. Broader market indexes such as the S&P 500 Index and Wilshire 5000 Index fared almost as poorly, both dropping 57 percent over the same period. These market declines resulted in the average workplace savings account balance dropping 27 percent in 2008 to $50,200 from $69,200 in 2007.[19]

While recent events will no doubt take their place in history with other dramatic market downturns, such as those preceding the Great Depression, this most recent market decline presents a particularly relevant challenge due to the demographic shift discussed earlier. Due to the number of individuals quickly approaching retirement, time may no longer be a luxury for many individuals. Based on this fact an important question comes to light: How do Americans respond to such a dramatic financial crisis? Investors' reaction in response to the market decline beginning in 2007 gives us an answer.

Americans spend less instead of saving, earning more[20]

Sixty-seven percent of all Americans reduced their spending. Over half (55 percent) reduced their debt, while far fewer Americans tried to find a better paying job (22 percent). Of those who reduced spending:

- Seventy-five percent spent less on entertainment.
- Seventy-four percent ate out less often.
- Sixty-eight percent cut back on holiday gifts.
- Fifty-three percent put off a large purchase.
- Thirty-four percent delayed a routine or elective medical procedure.

An October 2008, AARP study[21] shows similar results amongst workers at least 45 years old:

- If the economy does not improve significantly, over six in 10 workers age 45 and older said it is likely they will spend less in retirement (69 percent) as well as delay retirement and work longer (65 percent). Far fewer (37 percent) said it is likely they will save more for retirement.
- Because of the 2008 economic changes, 24 percent of workers age 45 and above increased the number of hours they work and 20 percent actually stopped putting money into a 401(k), IRA or other retirement account.

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18 *Ibid.*

19 *"Fidelity Reports On 2008 Trends In 401(K) Plans,"* Fidelity Investments, January 200

20 SunLife Unretirement[SM] Index

21 *"Retirement Security or Insecurity? The Experience of Workers Aged 45 and Older,"* AARP, October 2008

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- Over a quarter (28 percent) of respondents felt their savings were not on track for retirement before the economic slowdown, and 58 percent thought they are not saving enough for retirement.

These factors undoubtedly affect individuals, and the confining fear of losing control of choices is causing extreme anxiety in all Americans – likely all citizens of the world. That is why 1st Global's methodology of building Sustainable Income Solutions™ is a three-part process that considers the methods to protect and grow our wealth, understands the unique risks each of us faces, and pairs solutions with those risks to help reduce them.

The market declines that began in 2007 not only had a significant impact on how individuals manage their expenses and savings, but also had a dramatic effect on the most popular retirement tools available to individuals today: the 401(k) and its contemporaries, the 403(b) and 457.

Recovery Time of 401(k) Balances

Many individuals are deeply concerned with the impact of severe market declines on the wealth they have saved for retirement through employer-sponsored plans like the 401(k). These individuals wonder how long it will be before their retirement accounts recover and if this will mean they need to delay their retirement. While individuals are powerless against the past, we do have control over our actions in the future. Unfortunately, the answer to the question of if and when the markets will recover is one to which the world struggles to find the answer. The regrettable truth is that the end can only been seen once it has passed, but history tells us that this bear market will pass, and that in the moment, each bear market feels different; however, in the end, they are strikingly similar. The focus of this paper is not the economic events that began in 2007; however, this statement is a worthy close to a question that has had countless pages written. By whatever measure of optimism you use, remain optimistic yet know that it is okay to be scared.

In regards to the recovery of 401(k) balances, studies show the impact of a bear market on the average retirement account for various categories of workers. According to the Employee Benefits Research Institute, the median time to recovery for an individual in the highest job tenure category is 1.8 years. To display the differences in each combination of employees, percentiles were used to determine how long it would take to recover. For example, the 10th percentile shows how long it takes for only 10 percent to return to their 2007 balances, while the 90th percentile shows how long it takes for 90 percent of employees to return to their 2007 balances. In this study, the 10th percentile is zero (no recovery time), due to the fact that at least 10 percent of the 401(k) participants in this category were estimated to have no losses in 2008. The 90th percentile is estimated to take 4.9 years before their 401(k) balances are expected to be equal to their January 1, 2008, level in nominal terms.[22]

These findings show that, at least for the median results, lower paid employees will have shorter recovery times than their higher paid counterparts, and in many cases, there is a significantly shorter recovery time for the lowest paid category of participants than those in the highest paid category. For example, with a 5 percent equity return assumption and a 6.3 percent non-equity return assumption, the recovery time for the lowest salary category ($20,000 to $30,000) with the highest tenure was 1.4 years. This number increases for virtually all categories until it reaches 2.3 years for those in the highest salary category (greater than $90,000). *Past performance is no guarantee of future results. This is a hypothetical example used for illustrative purposes only. It does not represent the return of any specific investment.*

22 ebri.org *Issue Brief*, February 2009, No. 326

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Delayed Retirement Appears Certain

We noted earlier that many individuals are anxious about the time it will take for their retirement account balances to recover. This anxiety is rooted in the concern that a lengthy recovery may lead to a delayed retirement. In January 2009, Sun Life Financial Inc. released the latest edition of their UnretirementSM Index, which gauges how economic, financial and societal forces affect working Americans. The index is also used to forecast future retirement decisions that will impact individuals, the government, employers and the broader economy. The most recent release of this index showed that 54 percent of American workers will delay their retirement by at least one year due to the current economic situation, with 24 percent saying they will need to work an additional five years.

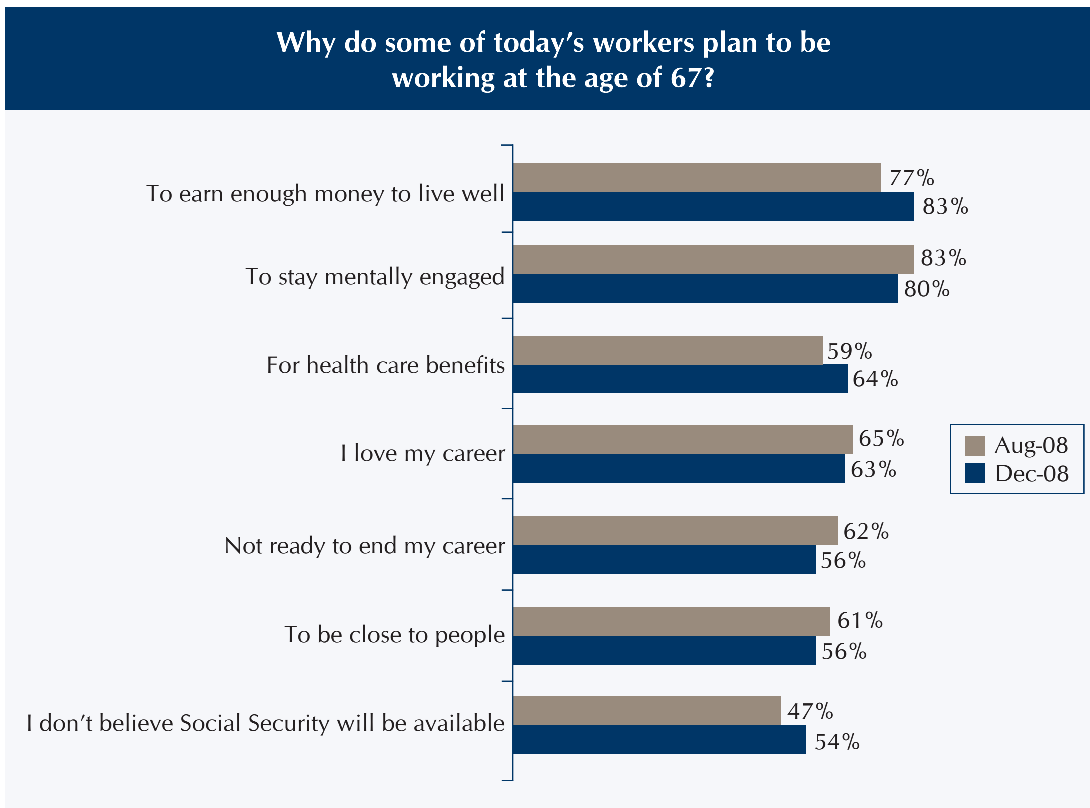

Figure 4 - Reasons Why Individuals Plan to be Working at Age 67

In addition to illustrating that many Americans are planning to work longer than originally planned for, figure four shows that the rationale for the decision to work longer has shifted away from an attempt to staying mentally engaged. Now many Americans feel they must continue to work longer to earn enough money to live well. While staying mentally engaged fell to the second most popular reason, the number of Americans who cite they will continue working "for health care benefits" rose from the sixth primary reason to the third most common answer.

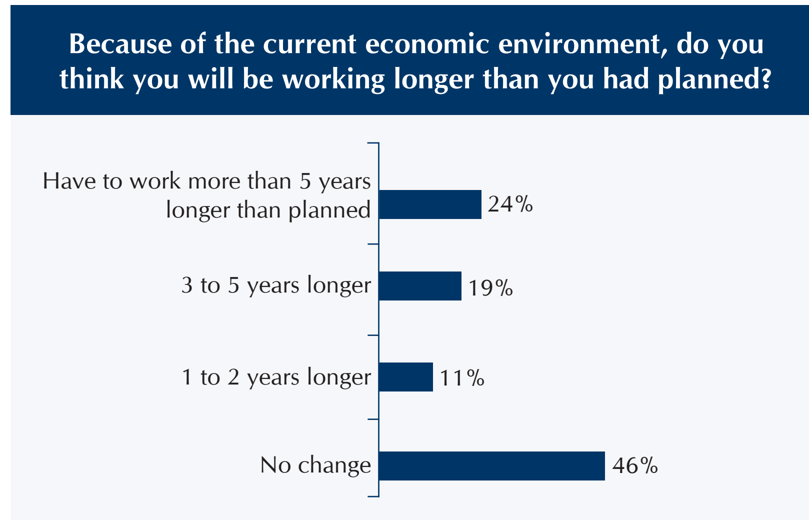

Figure 5 - Individual Feelings about Their Need to Work Longer Than Planned

Recent market events and the resulting effects on all individuals help underscore the importance of having a plan in place that not only addresses the need for growth and protection of wealth, but also addressing the dynamic risks facing individuals over time. 1st Global's methodology of building Sustainable Income Solutions™ addresses this need and helps maintain an individual's freedom to make choices in retirement.

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Chapter II: Retirement Income Planning Today

The Standard Response: Retirement Income Planning in America Today

In the early 1990s, I looked at the retirement saving and investment advice being offered by financial institutions, mutual funds and others. Much of it was fantastic – as in "fantasy." Calculations were based on saving a specified amount each year until retirement, earning a constant percent return each year on investments, spending a specified percent of total savings each year after retirement, then dying at an appointed hour. The typical output graph showed the total value of savings, growing steadily until retirement then decreasing steadily until the grim reaper's prearranged arrival date. As long as there was something left, the individual would be congratulated on having a "plan that works."

-- William F. Sharpe, Nobel Laureate[23]

Today, how individuals and their financial advisors work to address income in retirement is starting to take form. Many individuals currently use the same investment methods and strategies that they used while accumulating assets for retirement. Because of the significant changes facing future retirees, maintaining the power of choice will require strategies to go beyond the traditional methods used leading up to retirement. While many financial advisors understand the coming change, the necessary adjustments are often easier to acknowledge than to execute. This inability to execute is primarily related to the lack of developed processes to generate income for life in retirement. Innovation in the retirement income arena is largely seen through financial product rather than the process innovation that will be needed. Solving the problem of retirement income is far too complex for any one-product solution to address, no matter its level of "hybridization." These product innovations will matter, but will continue to be subordinated in priority to the looming process development that must occur.

Accumulation vs. Distribution

Much of the financial services industry has focused for years on helping individuals accumulate wealth. Many of the strategies used by financial advisors have focused on the goal of helping individuals save and accumulate wealth. Traditionally, measures of success have been investment performance and risk, stated in terms of the volatility one must tolerate in order to achieve higher investment returns. Accumulation strategies focus on the achievement of goals that relate to broad market performance, presumably to gauge whether advice providers have merit, regardless of the relevancy of the market to an individual's goals.

However, over the years, this focus began changing and measurements of success have become increasingly personal. Financial advisors at the forefront of this change are focusing on preserving assets and creating strategies to sustain and distribute these assets over an individual's lifetime. This developing "retirement advisor" focuses on a process for addressing the dynamic risks facing retirees, along with a growing suite of solutions to help their clients meet the increasing complexity of their needs.

23 *"Financing Retirement: Saving, Investing, Spending and Insuring,"* William F. Sharpe. Based on a public lecture given at Middlebury College, Vermont on Oct 6, 2006

Best Practice Advisors[24]

As outlined earlier, most financial advisors are aware of the impending changes facing the retirement income landscape, but few have made material shifts in their process for addressing sustainable income needs. As the landscape evolves, individuals will be well served to seek out and consolidate assets with advisors who have the expertise to address their dynamic risks and needs, and help ensure they will have the power of choice for the rest of their lives. While there are more than 300,000 financial advisors in the U.S., only a very small percentage of these advisors demonstrate "best practices" in serving individuals transitioning to or living in retirement. At present, estimates indicate that less than 5,000 advisors are among the pool of those heavily focused on retirement income and transition support. Furthermore, while the popular press may often characterize financial advisors as employees of large financial service conglomerates, the reality is that the largest number of financial advisors are actually independent contractors with the necessary freedom to fully deploy the broad solutions necessary to implement these best practices.

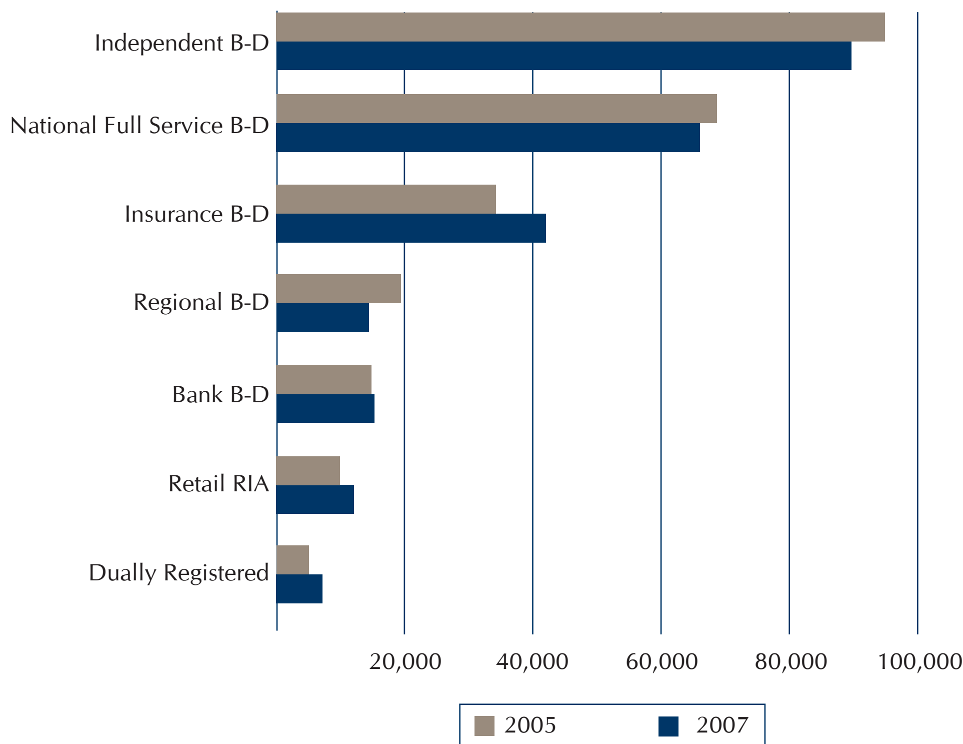

Figure 6 - Impact Breakdown of Total Number of Advisors by Channel[25]

24 Advisor Best Practices: Retirement Income & Transition Support by GDC Research & Practical Perspectives

25 Sources: Securities Industry Association, Investment News, Financial Planning, Bank Insurance Market Research Group, National Regulatory Services, Cerulli Associat

A number of factors separate the limited number of best practice advisors serving retirement clients:

- The marketplace for retirement support is still in its nascent stage and many financial advisors have yet to address the longer-term opportunity of serving the wave of baby boomers shifting to retirement;
- Many financial advisors have yet to feel sufficient pressure to shift their advice to focus on retirement rather than accumulating wealth. Best practice financial advisors have shifted from focusing solely on wealth accumulation to providing advice and building relationships; and
- Across the financial services industry, there is wide diversity in terms of business models and clients served, which makes it difficult to identify and apply standardized best practices when serving retirement clients.

This last point is especially significant. Despite a recent decline in the number of financial advisors overall, this marketplace has evolved substantially over the past 20 years across multiple business segments that include:

- Traditional outlets, such as "wirehouse" firms like Merrill Lynch, regional broker/dealers and private banks. Characterizing these firms are financial advisors who are employees of their institution;
- The retail bank marketplace, including national banks, community banks and credit unions;
- Insurance companies;
- Independent broker/dealers where the financial advisors operate within independently owned financial advisory practices. As mentioned earlier, this model now represents the largest number of financial advisors in aggregate; and
- The Registered Investment Adviser (RIA) model, which focuses on a fee-only pricing model for services rather than commissions or a combination of commissions and fees for services provided.

Retirement Income Planning Approaches

While there is significant diversity in the business segments that financial advisors are a part of, the methods used to address income needs have more commonality. Also, the ease of implementation of these methods can vary from firm to firm. Overall, retirement advisors fall into two distinct philosophical segments in how they approach generating retirement income for their clients – total return focused or investment pool focused. Notably, there is variation in the method of executing income strategies within each of these segments as some advisors combine elements of each approach. Nonetheless, as figure seven shows, there are clear differences that emerge which reflect underlying distinctions between the two groups.

Total Return Approach	Investment Pool Approach
• Emphasis on diversification, performance and risk management across the entire portfolio • Assets drawdown at a rate that reflects client circumstances and needs, generally between three and six percent annually • Portfolio not generally managed with income as a specific goal • Create reserve account for short-term income needs • Typically invest in a mix of mutual funds, exchange-traded funds, individual securities, separate accounts, and annuities	• Emphasis on establishing specific pools of assets each with a particular objective, time horizon and risk/return target • Generally establish different pools with progressive five-year horizons and increasing risk/return dynamics • Specific short-term pools designed to generate income regardless of current market environment • Longer-term pools, those with horizon of 10 or more years, invested more aggressively to sustain purchasing power over time • Typically invest in a mix of mutual funds, exchange-traded funds, annuities, separate accounts, and short-term vehicles

Figure 7 - Approaches to Generating Income: Key Characteristics[26]

The segment of advisors who are total-return-focused seek to deliver competitive returns across the investment portfolio, consistent with an individual's comfort with volatility. These advisors do not specifically invest to generate current income, but instead target an annual withdrawal rate from the entire portfolio, the source of which can be earnings from the portfolio (interest, dividends) or redemptions of principal.

The second segment of advisors are more focused on creating distinct investment pools or buckets, with certain pools oriented to generating current income and other pools targeted for longer-term growth. These advisors invest specific portions of a portfolio to create sufficient income to meet client needs and do not focus on a specific drawdown or withdrawal rate across the entire portfolio.

26 Source: Advisor Best Practices: Retirement Income & Transition Support by GDC Research & Practical Perspectives

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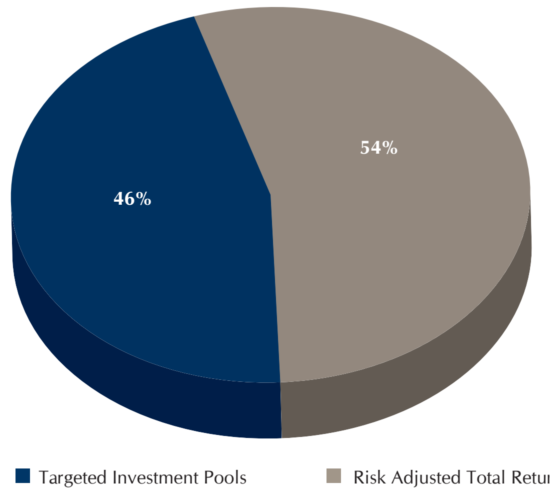

Figure 8 - Advisor Approaches to Generating Retirement Income[27]

While advisors vary in how they approach retirement income, some consistent themes emerge. In general, advisors recognize the importance of sustaining income over an extended life span and typically focus on both short-term and long-term horizons and client needs. Consequently, advisors seek a balance between retirement income and growing assets to stay ahead of inflation. Consistent with this philosophy, advisors employ broad diversification of client portfolios across asset classes and investment selections.

Advisors also factor in an individual's risk tolerance. They will adjust how they construct portfolios and create income to reflect differing comfort levels with volatility, depending on the feelings found among their client base.

Investment Pool Approach

While just under 50 percent of all advisors use the Investment Pool Approach, this approach appears to be gaining in popularity and represents the current consensus view of advisors affiliated with 1st Global. However, in our experience, the Investment Pool Approach does not represent a singular implementation philosophy. In fact, 1st Global's recommended approach is a clear subset of the broader "mental accounting" focus of the Investment Pool Approach.

27 Source: Advisor Best Practices: Retirement Income & Transition Support by GDC Research & Practical Perspectives

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Time-Based Pools

The traditional Investment Pool Approach focuses on the creation of time- or duration-based pools, such as one to five years, six to 10 years, and beyond 10 years. Time-based investment pools focus on segregating assets (mentally or physically) into segments based on time frames relative to the individual. In the time-based Investment Pool Approach, individuals typically consume assets from the near-term segment, with a portion of each pool cascading down to the nearest pool in duration.

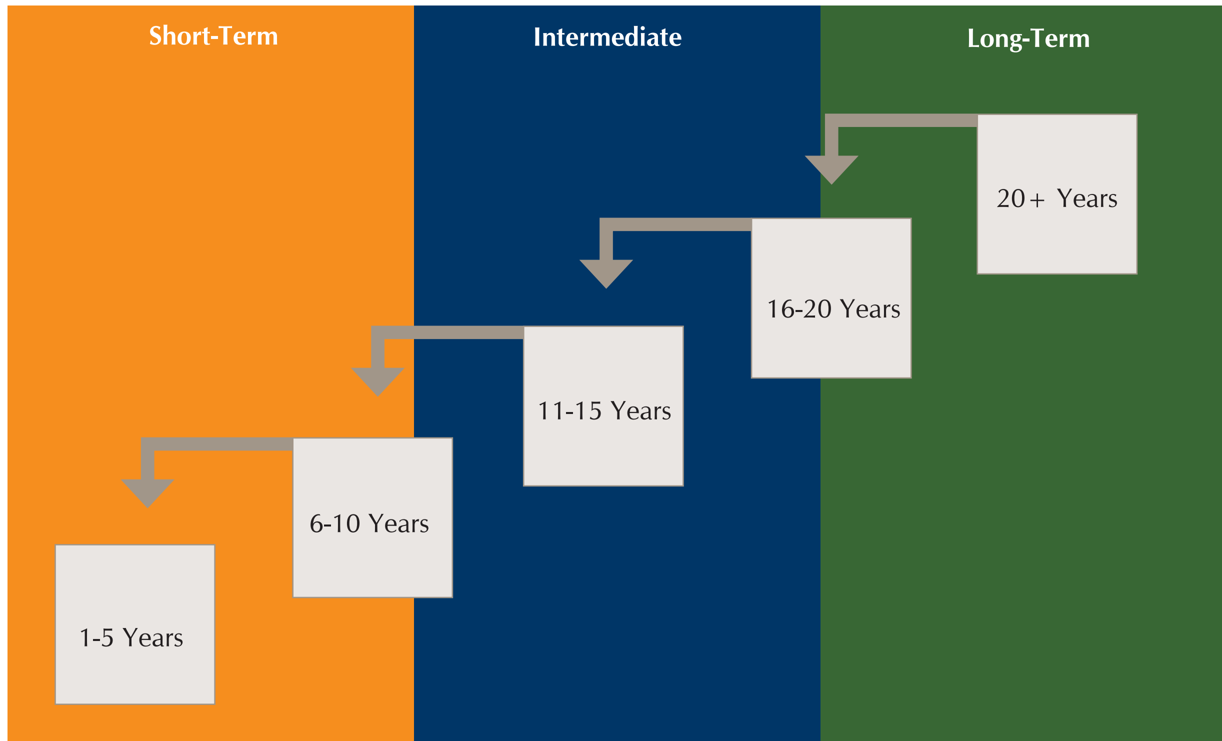

Figure 9 - Time-Based Investment Pool Approach

While figure nine certainly has appeal, the reality of implementing the time-based Investment Pool Approach can be challenging at times. Each individual has a dynamic situation, and the durations and outcomes of the investment or risk management tools used to implement Sustainable Income Solutions™ are also dynamic. Because of these dynamics, it is not as clean to implement the "waterfall," where assets flow down from one bucket to the next as the conceptual figure shows. The motivation for this strategy runs deeper than this approach superficially demonstrates. By delving deeper into the purpose for implementing a time-based Investment Pool Approach, we discover a better way, Outcome-Based Investment Pools.

Outcome-Based Investment Pools

The motivation for time-based investment pools would appear to be twofold. First, the approach appears to seek stability and certainty of assets needed sooner as compared to assets needed later, with the need for stability and certainty decreasing the farther away wealth is from consumption. Second, the approach appears to endeavor to create mental separation in the minds of individuals to prevent thinking of wealth as one total pool of assets, but instead as many pools of assets, each with their own purpose and performance. The field of behavioral finance has long taught "asset segregation" or "mental accounting" as a behavioral *flaw*; however, acceptance of our illogical human tendencies allows us to use these "flaws" in our favor. We know our tendency is to separate our wealth into separate mental accounts that are attached to purposes in our minds, such as money to send children to college, for retirement, for discretionary expenses, to leave to the grandchildren, etc. We can use this tendency then to design a new set of mental accounts rather than avoid mental accounting.

If you were to ask financial advisors why they were using the approach that they chose, you would likely receive a consistent answer: to meet your stated goals. All three approaches, total-return-based, time-based and outcome-based, are universal in their desire to meet goals. In other words, they strive to maximize the certainty of achieving a particular outcome.

By working backward and addressing the motivation behind choosing a method, we are able to directly address a universal goal: to maximize the certainty of specific, personal outcomes. In our case, we seek to minimize or eliminate the eight retirement risks that will be outlined in the next chapter, and provide sustainable income for life. By choosing an Outcome-Based Investment Pool Approach, we create investment pools based on their ability to achieve an articulated outcome, *which may be time-based*, but we do not choose time as the highest order of the separation of pools. Therefore, 1st Global's approach to creating Sustainable Income Solutions™ plans will rely on the Outcome-Based Investment Pool Approach.

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Chapter III: The Risks to Retirement Planning

Risks to Sustainable Income

The first step is to acknowledge that uncertainty abounds. We don't know what most investments will return. We don't know when we will die. We don't know the magnitudes of future medical expenses. And so on. Individuals can mitigate or even avoid some uncertainty but not all. Societies can reduce overall economic uncertainty but they cannot eliminate it. They can, however, assist in allocating societal risk among people efficiently.

-- William F. Sharpe, Nobel Laureate[28]

In the financial world, we have thought of risk in a mathematical way for far too long. In fact, many noted finance authorities, such as William Sharpe and Peter Bernstein, have been quoted as saying, "Risk is not a number."[29]

In fact, risk is an emotional feeling of regret based on knowledge of an act of omission (or commission). Risk is not sending your child to college; risk is the thought of losing one's home. Risk is the thought of not honoring a promise to a loved one. The American Heritage Dictionary defines risk in part as "the possibility of suffering harm or loss."[30] The possibility of harm or loss shapes this section as we discuss the possibility of losing our wealth.

The situations or events that may cause wealth to run out before we pass or transfer our wealth to others are important to discuss when establishing sustainable income for life. Figure 10 shows the risks to sustainable income:

28 *"Financing Retirement: Saving, Investing, Spending and Insuring,"* William F. Sharpe. Based on a public lecture given at Middlebury College, Vermont on Oct 6, 2006

29 *"Risk is Not a Number,"* Scot Blythe, May 2007

30 *The American Heritage® Dictionary of the English Language, Fourth Edition.* Retrieved March 01, 2009, from Dictionary.com Web site: http://dictionary.reference.com/browse/risk

Longevity Risk		Market Risk	
Entitlement Risk	Excess Withdrawal Risk	Sequence of Returns Risk	Asset Allocation Risk
The risk that social funding sources like Social Security, Medicare and pension plans that you have paid into will not deliver expected or promised benefits.	*The risk of running out of money because of taking too much out of your accounts each year.*	*The risk of poor stock and bond market returns irreparably harming the amount of money you can take out of your accounts each year. This risk is greatest in the three to five years before withdrawals begin and the three to five years after they start.*	*The risk of investing too conservatively in an attempt to reduce fluctuations in account values. The risk is realized when a conservative allocation is unable to keep up with the combination of inflation and withdrawals over long periods of time.*

Inflation Risk		Confiscation Risk	
Purchasing Power Risk	Medical Expense Risk	Tax Risk	Relationship Risk
The risk of not being able to purchase goods and services in the future due to their rising costs. By failing to account for these rising costs, you may underestimate the amount of money you need for retirement.	*The risk of having to pay uncertain medical expenses later in life. Uncertainty refers to both the timing and size of these expenses, as we do not know what medical ailments may befall us nor do we know the cost of medical care later in life.*	*The risk that taxes will erode your wealth at too great of a rate and prevent you from having adequate income for life.*	*The risk that changes in personal relationships, such as with a spouse or business partner, will damage the results of any prior or current planning for creating sustainable income for life from your accumulated wealth.*

Figure 10 - Risks to Sustainable Income

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Longevity Risk

The concept of longevity risk originally stems from the pension plan and insurance world, where plans and insurers were concerned about having to pay out benefits for longer than they had accounted for. More recently, this concept has become more personal as we each consider the risk of outliving or being unable to pass to others the wealth we have accumulated. As we continue to live longer, we dramatically increase the risk of outliving our wealth unless we make substantial changes to the choices we make in retirement.

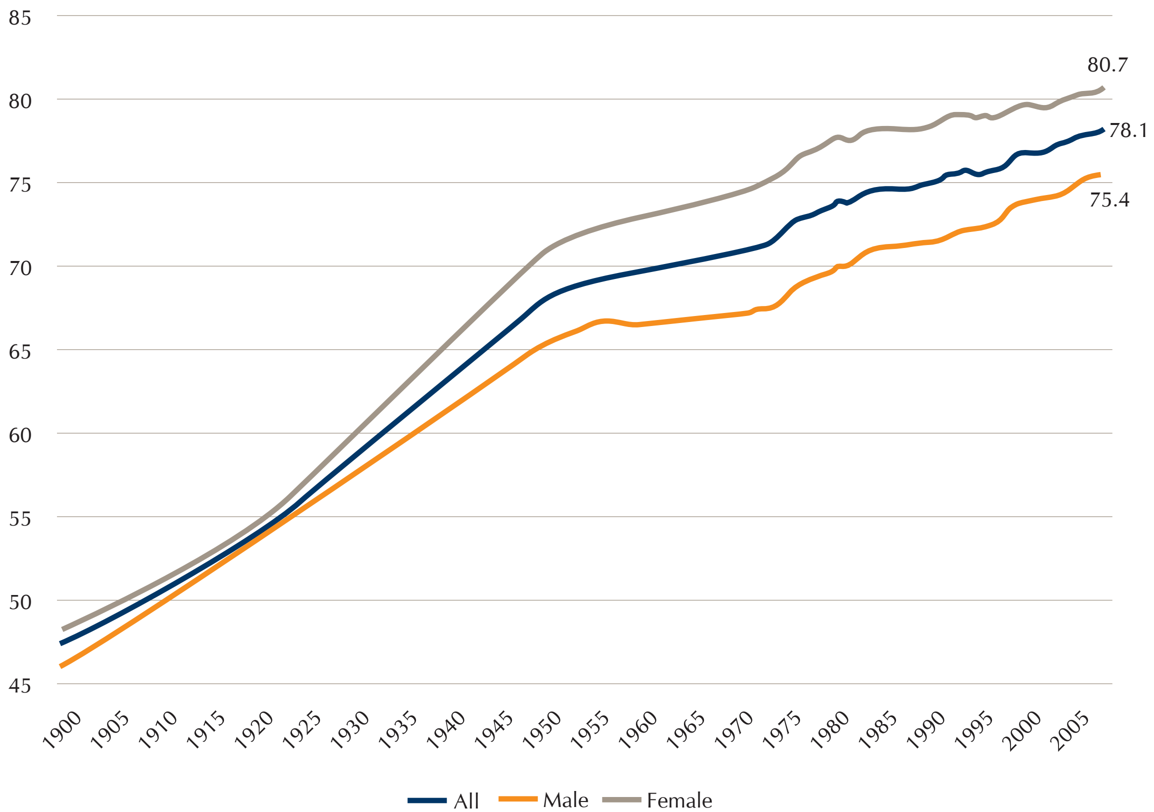

Figure 11 – Life Expectancy at Birth[31]

31 *Life Expectancy at Birth, 65 and 85 Years of Age, US, Selected Years 1900-2005*, CDC Health Data Interactive http://205.207.175.93/HDI/TableViewer/tableView.aspx?ReportId=169

	Male	Female
From Age 65 to Age:	Probability of Still Being Alive	Probability of Still Being Alive
66	98.7%	99.0%
70	92.2%	94.0%
75	80.1%	84.6%
80	62.8%	71.0%
85	41.1%	52.9%
90	19.6%	31.7%
95	5.8%	13.4%
100	1.0%	4.0%
105	0.1%	0.9%

Figure 12 - Probability of Survival by Age[32]

Figures 11 and 12 clearly show that we are living longer. Those individuals born in 2006 should expect to live to age 78, a full 13 years after the "normal retirement age" of 65. In fact, 20 percent of all men and one-in-three women who are 65 years old in 2009 will live to age 90. This is 25 years past "normal retirement age" and illustrates the need to find solutions that will sustain income after wage earning years have ended. Longevity risk has two major sources that we can assess and plan for: entitlement risk and excess withdrawal risk.

Entitlement Risk

Simply stated, entitlement risk is the risk that social funding sources that you have paid into, like Social Security, Medicare and pension plans, will not deliver expected or promised benefits. This paper has already discussed the grim realities of these programs. Many of us need to consider how we will sustain income for our lifetime if these programs are unavailable or exist in a dramatically different form. While this risk may not affect baby boomers who are currently 62, younger baby boomers, who are merely 45 in 2009, most certainly need to consider how to plan for this risk.

Entitlement risk will affect more and more individuals as each of us becomes increasingly responsible for our personal retirement and longevity planning.

32 Society of Actuaries RP-2000 Combined Healthy Mortality Table

Excess Withdrawal Risk

As individuals live longer, the amount of wealth we annually consume will dramatically affect the sustainability of accumulated assets. Numerous academic studies have attempted to identify the "ideal" withdrawal rates for individuals in retirement. While the outcomes of these studies vary, commonly accepted guidelines are 4 to 5 percent annually as an acceptable drawdown rate.

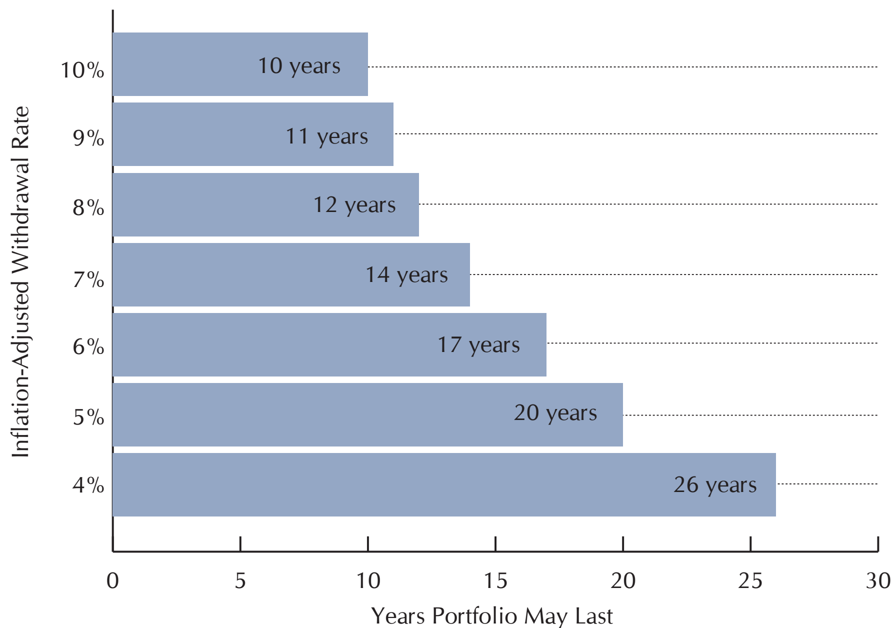

Figure 13 - Number of Years Portfolio May Last, Based on Percentage of Assets Withdrawn Each Year (90 percent Confidence Level)[33]

Americans are living longer than ever. At the start of the Social Security system, we were expected only to live on average a few years in retirement; now, many individuals might live 30 years or longer after income from their vocation stops. With such long life expectancies, individuals must examine their expense needs and determine *more* than what is *necessary* to maintain their lifestyle in retirement. Then they must address what is *realistic* based on the very real possibility that their assets might need to last 30 years or longer. To address these long-term objectives, it becomes necessary to move away from absolute drawdown assumptions and use an age-based or longevity-based withdrawal rate to control market risk for retirees.

Market Risk

Market risk is the potential to lose wealth through investments, either temporarily or permanently. This is the largest and most common risk we face while investing and accumulating wealth. In traditional wealth accumulation sense, this is the objective of performing a risk assessment: to determine how much market risk you are willing to accept. The "riskier" a portfolio, the greater the opportunity for growth, but the trade-off is a greater opportunity for loss. The less "risky" a portfolio is, the lower the chance of loss. However, the trade-off for more certainty is less appreciation potential, which could cause assets to not sufficiently increase in order to deliver income needs in the future.

33 Fidelity Research Institute, 2005

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When moving away from the accumulation to the consumption phase of wealth, the question becomes, "how does market risk affect sustainable income?" There are two components of market risk that impact sustainable income: asset allocation risk and sequence of returns risk.

Asset Allocation Risk

Asset allocation risk is the risk of investing too conservatively to keep up with inflation over long periods or grow a portfolio of assets to a level that can sustain realistic drawdown rates over long periods. Conversely, asset allocation risk is also the risk of investing too aggressively with short-term objectives. While the uncertainty surrounding market returns is something that all investors face, it is especially burdensome for retirees because the benefits of long-term time horizons are often lost. The uncertainty of short-term market fluctuations may result in retirees falling prey to asset allocation risk.

Commonly, traditional accumulation-based risk profiles mandate larger amounts of fixed income assets relative to equity assets as an individual's comfort level with market risk decreases. Retirees living on fixed income are much more sensitive to the short-term fluctuations of equity assets. This contributes to the tendency to overweight investment portfolio asset allocations with fixed income assets and underweight equity assets. While this methodology helps to minimize short-term fluctuations in account values, it exposes these assets to the risk of not growing sufficiently over time (inflation risk) to sustain adequate withdrawals for life (longevity risk).

Vast, significant research has tested the long-term performance of accounts holding varying levels of fixed income assets and all reached similar results: without exposure to enough equity assets, individuals run an increasing risk of not having enough earnings to sustain their lifestyle throughout retirement.

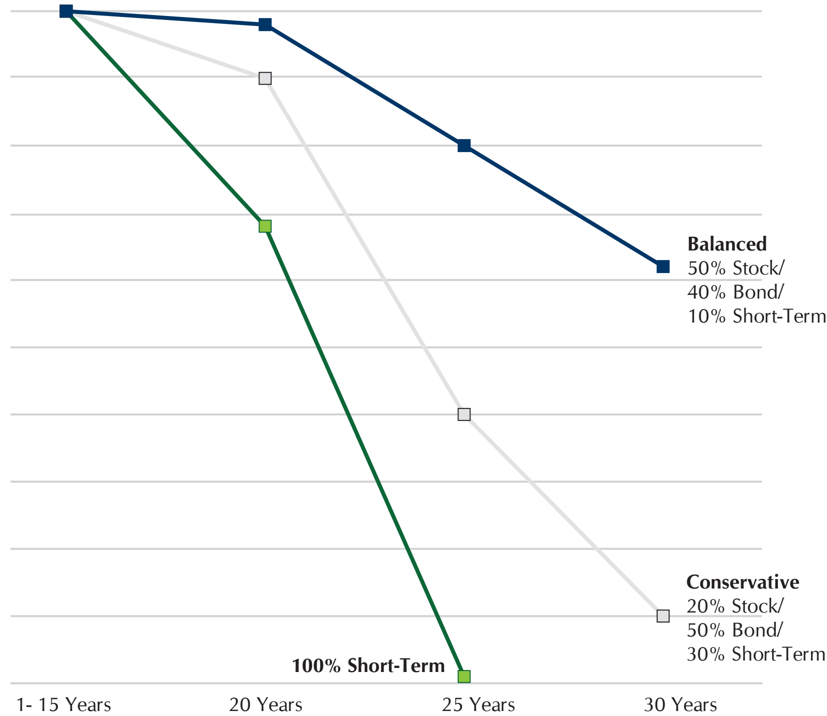

Figure 14 – Historical Likelihood of Exhausting Assets[34]

An investment cannot be made directly in an index. Past performance is no guarantee of future results.

This figure is not intended to project or predict the present or future value of the actual holdings in an investor's portfolio or of the performance of a given model portfolio of securities. Hypothetical value of assets held in an untaxed portfolio of stocks, bonds, and short-term investments with inflation-adjusted withdrawals of 5%. Historical monthly data from 1926 through 2002 is from Ibbotson Associates; stocks, bonds, and cash are represented by S&P 500, U.S. Intermediate Government Bonds, and U.S. 30-day T-Bills. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%). Actual inflation rates may be more or less. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. Investors may be charged fees when investing in an actual portfolio of securities, which are not reflected in illustrations utilizing returns or market segments.

Several hundred financial market return scenarios were run to determine how the asset mixes may have performed. The percentage shown is designed to indicate whether, based on historical market conditions, there may have been enough money for the asset mixes to last for each of the time periods indicated. For example, if in 125 of 250 scenarios the money would have lasted 20 years, the chart would display 50% underneath 20 years. The 50% number would illustrate that in half of the market simulations, the asset mix would have lasted 20 years.

Figure 14 illustrates the differences in longevity for three different mixes of asset classes. While each mix exhibits a high probability of success for the first 15 years, as we move out only five more years, the two portfolios with greater than 50 percent exposure to fixed income assets — bond and short-term investments — sharply decline in their probability of lasting over an extended amount of time. After 25 years, the 100 percent fixed income (short-term) portfolio has almost a zero percent probability of sustainability, and the conservative portfolio with 80 percent in fixed income only has a 40 percent chance of lasting beyond 25 years. The probability of assets lasting up to 30 years is even bleaker as the 80 percent fixed income portfolio has just a 10 percent probability of success. To further illustrate the importance of equity exposure in retirement, the balanced portfolio with 50 percent equity exposure shows an 80 percent probability of success at 25 years and just over a 60 percent probability of lasting beyond 30 years.

34 © 2003 FMR Corp.

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While the idea of having at least 50 percent equity exposure in an income-producing retirement portfolio may seem counterintuitive, this action makes sense when examined in the context of inflation, discussed in detail in "Purchasing Power Erosion Risk." Simply stated, inflation affects retirees' ability to maintain their chosen retirement lifestyles.

Despite the long-term performance of fixed income assets, retirees have a propensity to overweight portfolios with these assets in an effort to:

1. Sustain potentially excessive withdrawal rates
2. Decrease short-term portfolio volatility

Given the eventual damage that these decisions can have on the longevity of a retiree's assets, it forces one to consider, "Is conservative the new risky?"

While discussed in terms exclusive to those approaching retirement or currently in retirement, this risk also affects younger individuals working toward retirement. Short-term fluctuations within the equity markets often cause individuals to rethink their ability to accept volatility. While adjusting asset allocations to conservative weights in response to equity downturns may give investors some level of added emotional comfort, it does not remedy any past losses and only limits future asset growth. The ramifications of *short-term decisions* on an individual's ability to meet *long-term objectives* can be substantial. Proper education on the possible ramifications of these short-term decisions is imperative to maintaining progress toward known future objectives.

Sequence of Returns Risk

In addition to asset allocation risk, the second form of market risk is sequence of returns risk, the risk of receiving lower or negative returns early in a period when making withdrawals from the underlying investments.[35] As individuals move closer to drawing sustainable income from their wealth, avoiding negative returns becomes critical if withdrawals are coming from traditional investment assets. Unfortunately, given the unpredictability of capital markets, avoiding negative returns is not particularly easy to do over short time periods, which is why individuals typically use traditional investment assets for accumulation and long-term growth. However, if individuals spend these traditional investment assets as part of a sustainable income plan, negative returns during the early years of withdrawals dramatically affect the longevity of one's wealth.

Figure 15 illustrates the effects of sequence of returns risk. This illustration shows the effects of withdrawing $5,000 annually (adjusted for inflation) from a $100,000 portfolio invested in the S&P 500 Index. The results are dramatically different depending on the sequence of returns. Figure 15 also shows a portfolio with withdrawals beginning in 1987 and ending in 2003, and uses the actual sequence of returns of the S&P 500 Index. This portfolio has an ending value of almost $384,000.

Figure 16 uses the same variables, but it merely reverses the order of the S&P 500 Index returns, earning the 2003 return in 1987, and the 2002 return in 1988, etc. This portfolio ends with just under $252,000, a difference of 34 percent! This distinction is so important because while each portfolio achieved the same annual returns, achieving them in *reverse order* creates a dramatic difference.

35 Retrieved March 07, 2009, from *Investopedia.com*, http://www.investopedia.com/terms/s/sequence-risk.asp

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Year	Portfolio Value - Beginning Of The Year	Value After Inflation-Adjusted Withdrawal	Rate Of Return	Portfolio Value-End Of The Year
1987	$100,000	$95,000	5.25%	$99,988
1988	99,988	94,788	16.61	110,532
1989	110,532	105,124	31.69	138,437
1990	138,437	132,813	-3.11	128,683
1991	128,683	122,833	30.47	160,261
1992	160,261	154,177	7.62	165,926
1993	165,926	159,599	10.08	175,687
1994	175,687	169,107	1.32	171,339
1995	171,339	164,496	37.58	226,314
1996	226,314	219,198	22.96	269,525
1997	269,525	262,124	33.36	349,569
1998	349,569	341,871	28.58	439,578
1999	439,578	431,573	21.04	522,376
2000	522,376	514,051	-9.11	467,221
2001	467,221	458,562	-11.89	404,039
2002	404,039	395,035	-22.10	307,732
2003	307,732	298,367	28.68	383,939
	Average Annual Return		13.47%	

Figure 15 - Normal Sequence of S&P 500 Index Returns

The data above is derived from the returns of the S&P 500 Total Return Index. This is an unmanaged index of common stocks with dividends reinvested. An investment cannot be made directly in an index. Past performance is no guarantee of future results.

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Year	Portfolio Value - Beginning Of The Year	Value After Inflation-Adjusted Withdrawal	Rate Of Return	Portfolio Value-End Of The Year
1987	$100,000	$95,000	28.68%	$122,246
1988	122,246	117,046	-22.10	91,179
1989	91,179	85,771	-11.89	75,573
1990	75,573	69,948	-9.11	63,576
1991	63,576	57,727	21.04	69,872
1992	69,872	63,789	28.58	82,020
1993	82,020	75,694	33.36	100,945
1994	100,945	94,365	22.96	116,032
1995	116,032	109,189	37.58	150,222
1996	150,222	143,105	1.32	144,994
1997	144,994	137,593	10.08	151,462
1998	151,462	143,765	7.62	154,720
1999	154,720	146,715	30.47	191,419
2000	191,419	183,094	-3.11	177,399
2001	177,399	168,741	31.69	222,215
2002	222,215	213,210	16.61	248,625
2003	248,625	239,257	5.25	251,821
	Average Annual Return		13.47%	

Figure 16 - Reversed Sequence of S&P 500 Index Returns

The data above is derived from the returns of the S&P 500 Total Return Index. This is an unmanaged index of common stocks with dividends reinvested. An investment cannot be made directly in an index. Past performance is no guarantee of future results.

Inflation Risk

1959: 4¢

2009: 42¢ (950 percent more)

A simple example to show the impact of inflation is to look at the cost of a U.S. postage stamp. Fifty years ago, in 1959, a postage stamp cost 4 cents. In May 2008, a stamp cost 42 cents, and exactly one year later, the cost rose to 44 cents. In order for your assets to keep up with the price of stamps, your investment portfolio would have to earn 950 percent over the past 50 years, or 4.82 percent each year just to be able to afford the cost of the things you purchase each and every day. Without adequate exposure to growth-oriented assets, retirees run the risk of not increasing their wealth enough to sustain their current standard of living or pay for the increasing cost of medical expenses.

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Purchasing Power Erosion Risk

As the time spent in retirement continues to increase, individuals in retirement as well as those preparing to enter retirement must remain aware of the effects of inflation on their ability to maintain their lifestyle in retirement. Inflation can be defined in one of two ways:

1. The increase in the prices of goods and services over time
2. The decline in the real value of money, often called "purchasing power erosion"

An important reality for all individuals as they move through life is that over time, things will become more expensive, as figure 17 shows. As individuals prepare for their retirement, this concept is often discounted and overlooked. During the time period spent working toward retirement, individuals often have the benefit of wage increases that may generally keep up with, or exceed, inflation over time. The responsiveness of our earnings to inflation often mutes the effect of goods like stamps, bread, milk or cars increasing in price. Individuals preparing for retirement must address and plan for the reality that, over the span of time, goods and services will increase in cost. Not planning for this reality forces individuals to either adjust their lifestyle or draw excessively from their retirement assets.

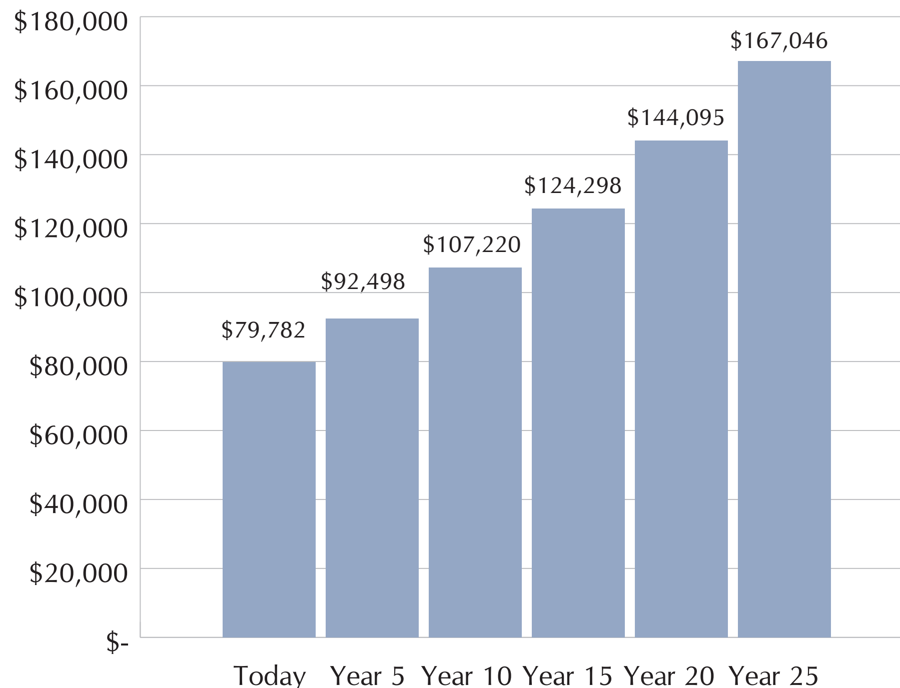

Figure 17 - Effect of Inflation on Purchasing Power over Time

$79,782 was the annual expenditure for individuals age 65 or over with income greater than $70,000 fromthe U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditures 2006-2007 report. All other numbers were calculated based on hypothetical 3 percent rate of inflation (historical average from 1926 through March 2003 was 3.06 percent) to show the effects of inflation over time; actual inflation rates may be more or less.

Medical Expense Risk

According to research provided by the AARP, 69 percent of individuals age 65 will require some level of long-term care at some point in their life, with a duration of need of about three years.[36] Couple that with inflation rates for medical costs and treatment costs increasing at greater levels than general inflation, and you end up with a significant possibility of an unforeseen or unplanned-for medical event dramatically altering retirement plans. This is referred to as medical expense risk. The uncertainty surrounding both the timing and size of these potential expenses is often impacted by many factors, including age, income and gender.

These aggregate complexities are referred to as medical expense risks, which are shaped by three truths:[37]

1. Women outlive men by several years;
2. There is large variation in life expectancy, conditional on permanent income and health status; and
3. Even in presence of health insurance, out-of-pocket medical and nursing home expenses can be large and generate significant net income risk for the elderly.

While it is common practice to look to measurements like the Consumer Price Index (CPI) as a gauge of inflation, retirees face specific, additional challenges. First, merely keeping up with inflation is not enough, as CPI numbers do not truly reflect the increasing costs of medical care and expenses. Traditionally, incorporating health care costs into the overall retirement income need identified for an individual is part of the planning process. While this consideration is important, it does not fully address the risk involved. For retirees, the perfect storm is as follows:

- Individuals are living longer, particularly women
- Medical costs for retirees are increasing at a greater rate than general inflation
- Fewer retirees are covered by private employer medical plans
- The future of Medicare is uncertain

All of these issues pose a great risk to retired or retiring individuals. Medical expenses are the sum of what an individual spends out of pocket on insurance premiums, drug costs and expenses for hospital care, nursing home care, doctor visits, dental visits and outpatient care. However, medical expense risk is much more than the increase in cost associated with health care in retirement. The real risk is that improper planning for such unknown needs will force retirees to draw down on retirement assets to the point where either their savings are exhausted or they must forgo certain health care expenditures.

While many individuals currently in retirement may have the benefit of employer-sponsored retiree health care coverage, that trend is quickly dissipating. As more employers look to shift the financial burden of health care during retirement to individuals, this places a greater strain on those moving into retirement. The importance of early planning for this increased burden is imperative to ensure individuals are able to maintain the lifestyle they planned for in retirement.

36 Kemper, P., Komisar, H.L., and Alecixh, L., "Long-Term Care Over an Uncertain Future: What Can Current Retirees Expect?" *Inquiry* 42(4):335-350, 2005

37 Federal Reserve Bank of Chicago, *"Differential Mortality, Uncertain Medical Expenses, and the Saving of Elderly Singles,"* Mariacristina De Nardi, Eric French, and John Bailey Jones, September 2006

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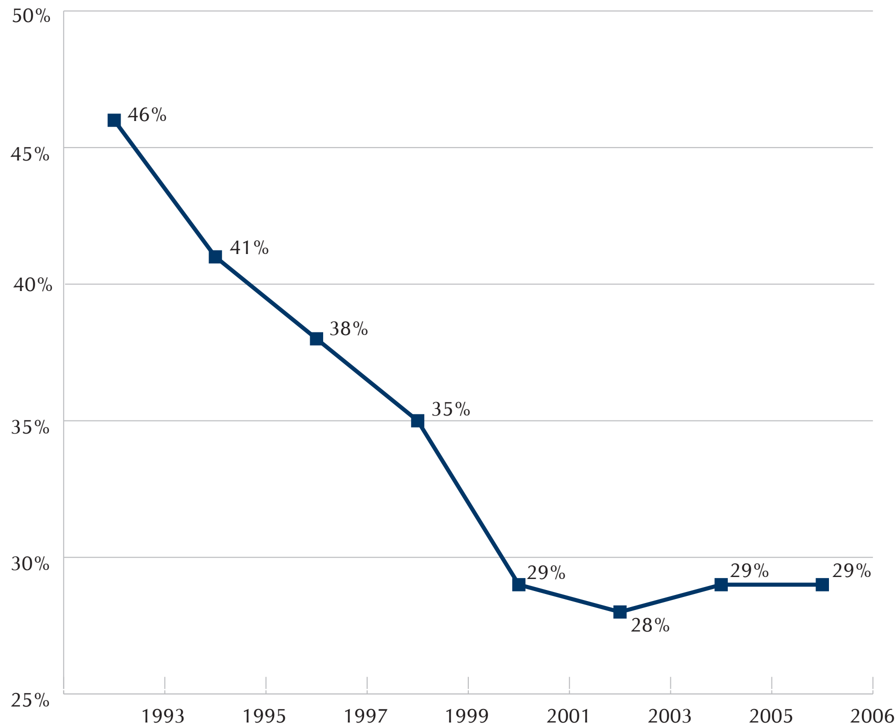

Figure 18 - Employer-Sponsored Retiree Health Coverage among Organizations with 500+ Employees[38]

A brief by the Center for Retirement Research at Boston College calculated the present value of out-of-pocket health care expenses for individuals retiring at different points in time, and of considerable note is the significant increase in projected costs over time.

Year of Retirement	Required Annuity	
	Single	Couple
2010	$102,966	$205,932
2020	141,752	283,503
2030	188,899	377,798
2040	245,767	491,534

Figure 19 - Required Annuity to Cover Projected Out-of-Pocket Health Care Costs, 2010 – 2040, 2007 Dollars[39]

Calculations based on U.S. Bureau of Labor Statistics (2007); Centers for Medicare and Medicaid Services (2007a, 2007b); Internal Revenue Service (2007); and U.S. Social Security Administration (2003).

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38 Mercer Human Resources Consulting, 2006. EBRI Issue Brief No. 312, December 2007. www.ebri.org

39 *Health Care Costs Drive Up The National Retirement Risk Index*, Alicia H. Munnell, Mauricio Soto, Anthony Webb, Francesca Golub-Sass and Dan Muldon, February 2008

Compounding this issue is the fact that bad health is a very persistent state. If a 70-year-old woman was in bad health one year ago, there is almost a 90 percent chance that she will be in bad health this year.[40] Furthermore, wealthy people are more likely to return to good health as having high permanent income reduces the probability of being in bad health in the present, conditional in being in bad health in the past.

Income Percentile	Healthy Male	Unhealthy Male	Healthy Female	Unhealthy Female	All[41]
20	8.2	6.21	13.8	11.9	12.0
40	9.1	7.0	14.8	12.9	13.0
60	10.1	7.9	15.9	14.1	14.1
80	11.2	9.1	17.0	15.5	15.2
By Gender[42]					
Men					10.2
Women					15.0
By Health Status[43]					
Healthy					15.3
Unhealthy					11.9

Figure 20 - Life expectancy in years, conditional on reaching age 70[44]

Note: Life expectancies calculated through simulations using estimated health transition and survivor functions.

The takeaway from these statistics is that individuals working toward retirement need to plan for this inevitable increase in health care costs. Retirees, and those quickly approaching their retirement years, must urgently address this issue. The Center for Retirement Research at Boston College also found that the inclusion of health care expenses increases the percentage of working-age individuals who will be unprepared for retirement as measured by the National Retirement Risk Index (NRRI).

40 Federal Reserve Bank of Chicago, "Differential Mortality, Uncertain Medical Expenses, and the Saving of Elderly Singles," Mariacristina De Nardi, Eric French, and John Bailey Jones, September 2006

41 Calculations use the same (permanent-income-unconditional) gender-health distributions across all permanent income levels.

42 Calculations use the health and permanent income distributions observed for each gender.

43 Calculations use the gender and permanent income distributions observed for each health status group.

44 *Ibid.*

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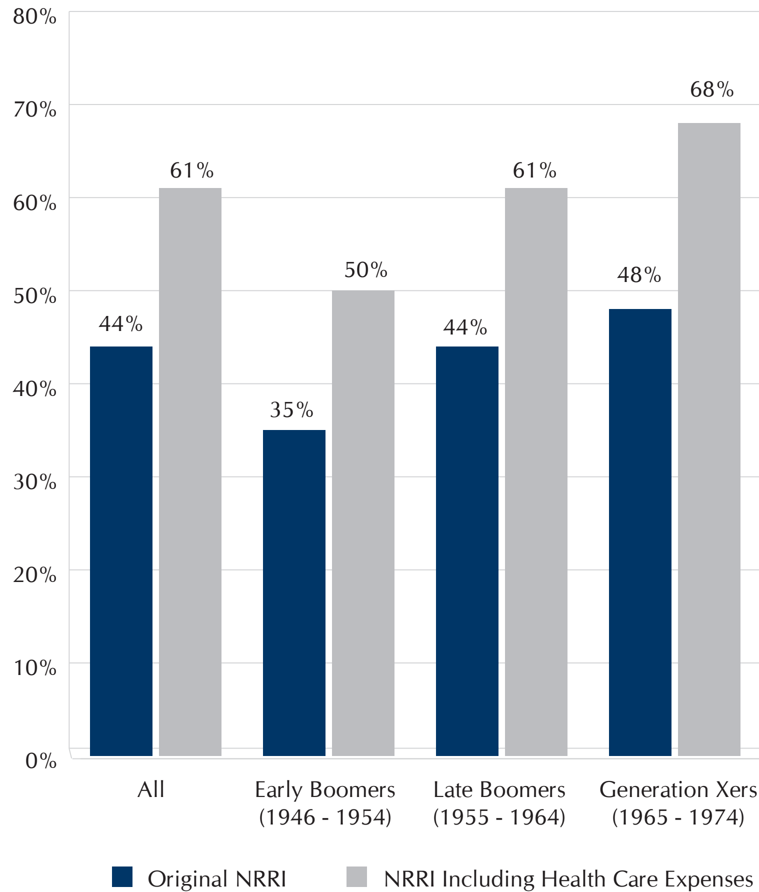

Figure 21 - Effect of Health Care on the National Retirement Risk Index, 2006[45]

Figure 21 also illustrates the increased percentage of individuals "at risk" of being unable to maintain their standard of living during retirement. While this chart includes individuals of all income groups, even isolating out the top third of wage earners paints a bleak picture.

Income Group	All	Early Boomers (1948-1954)	Late Boomers (1955-1964)	Generation Xers (1965-1974)
All	61%	50%	61%	68%
Top Third	53%	48%	52%	59%

Figure 22 - Individuals "at Risk" by Income and Age Group[46]

45 *Health Care Costs Drive Up The National Retirement Risk Index*, Alicia H. Munnell, Mauricio Soto, Anthony Webb, Francesca Golub-Sass and Dan Muldon, February 2008

46 *Ibid.*

While those in the top third income group have less risk, the percentage of individuals considered to be "at risk" is still above 50 percent for late baby boomers and Generation Xers, and just under 50 percent for early baby boomers. High income groups are not immune to this risk, even though they should logically have greater capacity for self-insurance. Medical costs are a large determinant of the saving behavior of the elderly, especially for those with high permanent income, for whom those costs are especially high and are relatively less insured by the government-provided consumption floor.[47] These retirees are reducing their current consumption to pay for the high out-of-pocket medical costs they expect to bear at the ends of their lives.

However, how do we quantify the risks of the unknown? A study by the Federal Reserve Bank of Chicago found that those exposed to the risk of the unknown, where the unknown is represented by medical expenses greater than 47.7 percent of average medical expenses, were exposed to 6.41 times the average medical expenses.[48] This study concluded that medical expenses are much higher and more volatile than had been previously estimated; that they rise very fast with age; and at very advanced ages (about age 80 and up), medical expenses are very much a luxury good, i.e., expenses are much higher for elderly with higher permanent income.[49]

"Given the size of our estimated medical expenses; even wealthy households can be financially decimated by medical expenses."[50]

While this analysis of the impact of health care costs is eye-opening and important to consider, it does not contemplate one important reality more and more aging individuals must face: the need for long-term care. Improper planning for such possibilities can result in a dramatic strain on retirement assets, resulting in the possible exhaustion of one's wealth or an unsustainable altering of an individual's retirement lifestyle. Private room nursing home care costs on average $213 a day or $77,745 a year. In 2006, in-home care averaged $19 an hour. Forty percent of those who need long-term care need it for two years or more, and the costs can be a significant drain if self-insured.[51] Individuals cannot ignore the increased importance of long-term-care planning. Addressing this issue earlier rather than later is imperative for those who are working to ensure that they are able to enjoy their retirement years with dignity and continue to be able to fulfill the important promises they make.

Individuals who do not choose to plan for these increased health care costs in retirement, or who do not have the time or the means to compensate for this increased cost, will be forced to alter their retirement lifestyles at the expense of non-health consumption items. As such, not addressing this issue will leave many individuals unable to maintain the lifestyle they planned for in retirement.

47 Federal Reserve Bank of Chicago, *"Differential Mortality, Uncertain Medical Expenses, and the Saving of Elderly Singles,"* Mariacristina De Nardi, Eric French, and John Bailey Jones, September 2006

48 *Ibid.*

49 *Ibid.*

50 *Ibid.*

51 Metlife Mature market Institute 2006, 2007

Confiscation Risk

A common adage within the financial community is, "It's not what you make; it's what you keep." For individuals both in retirement and approaching retirement, this truism could not be more important. For individuals approaching retirement, keeping as much of what you have saved for retirement helps to ensure that you are properly prepared. For retirees, the situation is even more important. Even with the best planning, numerous situations can affect the amount of your wealth. By being aware of the non-capital-market, non-macroeconomic and non-health-care risks that can confiscate your wealth and cause damage to your retirement plans, you can begin to make plans to protect these assets. We classify these confiscation risks as tax risk and relationship risk.

Tax Risk

Tax burdens affect all individuals. For those working toward retirement, maximizing tax-deferred opportunities helps to ensure assets earmarked for future retirement can compound at a greater rate. Periodic tax liabilities on these assets serve as "tax drag," an additional hurdle for assets to clear. Much of the focus of ongoing tax management is on minimizing current tax liabilities. It is important for individuals to not only understand the short-term benefits of tax management but also the long-term benefits that are often much more valuable.

For retirees, "tax drag" decreases the overall retirement asset base and affects the longevity of your wealth. Keeping more of what you make ensures you have more wealth to spend over a greater amount of time. Unfortunately, many retirees either ignore the issue of taxes or discount their severe impact based on inaccurate assumptions.

Often, individuals assume that during retirement they will be in a lower tax bracket because of a perceived decrease in income during retirement. However, there are serious flaws to this assumption:

1. *Uncertain future tax rates:* In the 1940s, the highest marginal tax bracket was 94 percent, while as recently as the 1970s, it was actually lower, reaching only 70 percent. Given the astounding growing national debt, is it safe to assume that the historic low tax rates we enjoy today will continue?
2. *Loss of deductions:* Elimination of deductions like mortgage interest and dependents are likely over time.

While it is common to think of pre-retirement wage replacement rates in the range of 75 to 90 percent, if the impact of taxes on future income is not fully considered, dramatic errors will occur in these assumptions. Accurate future projections of taxes and plans to minimize the impact of taxes are critical to executing a viable long-term cash flow plan.

Another personal income tax issue is the rising percentage of taxpayers subject to the alternative minimum tax (AMT). Not indexing AMT to inflation has continued to affect more and more upper-middle-income individuals. Furthermore, ongoing uncertainty surrounding the tax rates for capital gains and dividends is a very serious issue for retirees. Because these gains and dividends are a major component of future cash flow, the rate at which these gains and dividends are confiscated can dramatically influence what you keep and cause what you keep to be very different from what you make. Finally, individuals face the probability of an increase in the amount of Social Security benefits being taxed if the current thresholds are not indexed for inflation.

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Considering the potential for "tax drag" during retirement planning is very important. Those who wait too long to plan for such issues will be faced with a difficult decision to either adjust their retirement lifestyle, delay retirement or both.

Relationship Risk

In addition to tax risk, another form of confiscation risk is relationship risk; all individuals run the risk of having personal events disrupt their Sustainable Income Solutions™ plan. These personal events can include the dissolution of a marriage, the consequences of improper business planning, the financial burden of caring for a living parent or adult child, or a combination of one or more of these events. While planning for these unforeseen events is difficult, at a minimum, individuals must acknowledge them to create a well-designed plan for retirement.

While no married couple wants to incorporate the possibility of a failed marriage into a retirement plan, posing the question as a "what if" may be a very prudent exercise. Divorce rates in the United States continue to be high, and divorce rates for second marriages tend to be even higher. Given this unfortunate reality, couples must consider the impact of these statistics on both the ability to sustain the implementation and adjustments to their plans, as a couple and as separate individuals. A Sustainable Income Solutions™ plan may be very sound based on aggregate expenses as a couple, but if this wealth were to be divided, would individual expenses only be half of what the collective expenses are? Understanding the implications of this answer is critical to ensuring that your Sustainable Income Solutions™ plan can work for you, both together and as an individual. Without understanding the outcome, the result is likely an alteration to retirement lifestyles or an increase in individual longevity risk.

Privately owned businesses tie up a fair amount of net worth, and subsequently retirement wealth, for many individuals. For these individuals, proper business planning is essential to maintaining that wealth for later use as part of a Sustainable Income Solutions™ plan. Improper business planning can result in an abrupt alteration of an individual's ability to maintain their desired level of choice in retirement. For business owners, business planning is imperative to ensuring that the value they have built through many, many years of hard work will be there for retirement.

Studies by the Pew Research Center[52] state that half of baby boomers are raising one or more children and/or providing primary financial support to one or more adult children. Some 63 percent of boomers report that they have at least one adult child (ages 18 and older), and of this group, about two-thirds say they are supporting an adult child financially, either as the primary (33 percent) or secondary (35 percent) source of support. The study also shows that 20 percent of baby boomers are providing a parent some level of financial support. Of those boomers with a living parent, 29 percent report that in the past year they provided financial assistance to a parent, while 19 percent report that they received financial assistance. While difficult to plan for, understanding this risk and the possible ramifications of relationship risk is an important exercise for individuals to go through.

Working hard, saving and living frugally is sometimes just enough to get individuals to where they need to be to achieve the retirement lifestyle for which they had planned. For those who suddenly become responsible for all or part of the financial support of another loved one, this new responsibility can dramatically affect the necessary progress toward maintaining control over choice in retirement.

52 *"Baby Boomers: From the Age of Aquarius to the Age of Responsibility,"* Pew Research Center, December 8, 2005.

Relationship risk is particularly unique as compared to the other risk types discussed in this paper, as it can only be determined through proper discovery and discussion with a retirement advisor. Unlike risks such as purchasing power erosion risk or asset allocation risk that are foreseeable and can be addressed specifically in the planning process, relationship risk is different in that it is binary in its outcome: you are totally exposed or you are totally unexposed. There are no shades of grey with relationship risk as there are with the other seven types of risk.

While there are a number of challenges associated with a large disparate group of risks to deal with, identifying the risk is only half of the battle. The ongoing challenge is dealing with the dynamic nature of retirement risks and providing solutions that transition with individuals over time. This is achieved through ongoing interaction between clients and their retirement advisor, along with proper risk assessment based on each client's unique situation. With greater understanding of the eight retirement risks, it becomes easier to identify how these risks affect individuals over their lives. This process of client segmentation greatly enhances the customized nature of the solutions provided to clients.

"Age Band" Segmentation

In order to properly implement a Sustainable Income Solutions™ plan, we must begin the process of "personalizing" universal outcomes. This next section discusses how these universal outcomes, and the eight risks discussed earlier, tend to vary by age group and act as the first step in understanding how your retirement advisor will personalize Sustainable Income Solutions™ to meet your unique objectives. Understanding the differences between age groups is necessary to begin to paint a picture of how the eight risks change over time.

Segmenting individuals based on risk aversion has served as the most common method for grouping those accumulating assets. For individuals approaching and moving into retirement, identifying solutions based on the ability to accept volatility is still important; however, individuals must now take a different view of "risk."

1st Global's philosophy understands that risks, like needs and objectives, evolve over time. Because of this continued evolution, exposure to one or more of these eight risks is more likely to occur for individuals at different points in their life.

		Long-Term Pre-Retirees < 50s	Near Retired 50 – 65	Early Retirees Retired Pre 62	Retirees 65 – 75	Mature Retirees 75+
Longevity Risk	Entitlement Risk	✓				
	Excess Withdrawal Risk			✓	✓	✓
Market Risk	Sequence of Returns Risk		✓	✓	✓	
	Asset Allocation Risk	✓	✓	✓	✓	✓
Inflation Risk	Purchasing Power Erosion Risk			✓	✓	✓
	Medical Expense Risk		✓	✓	✓	✓
Confiscation Risk	Tax Risk	✓	✓	✓	✓	✓
	Relationship Risk	✓	✓	✓	✓	✓

Figure 23 - Exposure to Sustainable Income Solutions™ Risk by Age Band

As figure 23 shows, various risks affect individuals at different points in their life. The benefit of continually focusing on which of these eight risk factors you have the highest likelihood of experiencing is that the underlying solutions used for your unique plan must evolve as your risks change.

Long-Term Pre-Retirees

Individuals who have anywhere from 15 to 30 or more years until retirement may seem out of place given this paper's focus on generating sustainable income in "retirement." However, significant research shows that remedying many of the issues facing individuals in retirement, or those approaching retirement, comes by working longer, saving more or both. Therefore, the earlier individuals begin preparing for retirement, the higher their probability is of living the lifestyle they want to in retirement.

Early preparation for retirement carries with it a number of risks, notably entitlement risk, asset allocation risk, tax risk and relationship risk. While we have identified four individual risks, the simplest hedge against these risks for long-term pre-retirees is simply a combination of awareness and sufficient asset allocation to equity investments like stocks and real estate.

The probability that entitlement programs will look very different 20 years from now is a significant risk for those who do not acknowledge this reality now and plan accordingly. Long-term pre-retirees must make their plans under the assumption that entitlement programs will provide little income, or possibly no income, toward their sustainable income plan. This assumption poses a trade-off between working longer and delaying retirement, and leading a leaner lifestyle during the accumulation phase, allowing for greater savings. The virtue of delayed gratification is necessary for long-term pre-retirees.

Long-term pre-retirees also must ensure that they have sufficient allocation to equity investments so that their wealth grows over time to meet retirement goals. Those with a smaller entitlement assumption will bear greater personal responsibility for larger amounts of their retirement income. The best way to begin a plan to generate this income is to start saving early, save often and invest according to your time horizon.

As long-term pre-retirees age, their use of non-taxable and taxable investments will change. Early on, the majority of an individual's assets will likely be concentrated in tax-deferred assets like 401(k) plans and IRA accounts. As some individuals age, they may place an increasing amount of their investment assets into taxable accounts. At this point, it is important for these individuals to remember an adage highlighted earlier, "It's not what you make; it's what you keep." Over time, tax risk can significantly strain the overall growth of taxable assets for those in this age band. It is important for these individuals to maintain a tax-aware stance in constructing their investment portfolios to ensure they keep as much of what they save for retirement as possible.

Near Retirees

Near retirees encompass the famed baby boomer generation and are those who have been planning for retirement and are approaching the point in life where the timing of their decision to switch from their normal wage earnings and move to earnings from retirement assets is becoming a reality. The key for this age band is to make sure that the light at the end of the tunnel is not a rapidly approaching train. For these individuals, emotions and accompanying behaviors come into play. At times, fears of short-term uncertainty lead to decisions that have long-term impact. Near retirees

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face multiple key risks as a group: sequence of returns risk, asset allocation risk, medical expense risk, tax risk and relationship risk.

Assuming a "normal retirement age" of 65, near retirees are anywhere from three to 15 years from retirement. Note that this time frame represents the point where the eight risks are likely to be different, as opposed to the five to seven years from retirement where the nature and frequency of meetings with your advisor change substantially. Individuals with more than seven years to retirement continue to have the benefit of time, but someone five years away from retirement must seriously consider the impact of market volatility on their wealth. Carefully considering the uncertainty surrounding market returns in the five years before retirement is a necessity. The S&P 500 Index experienced one of its worst years ever in 2008, finishing down 37 percent. While this kind of market activity understandably causes all individuals to consider abandoning their wealth accumulation plans, for many near retirees, this volatility represents their worst nightmare.

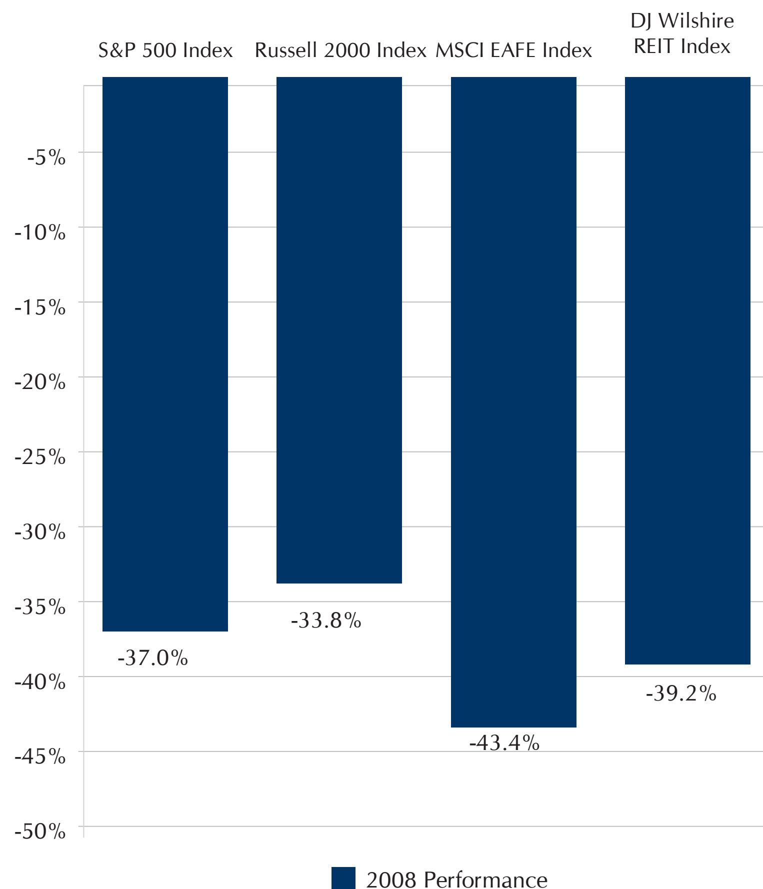

Figure 24 - 2008 Performance for Major Indices[53]

Past performance is no guarantee of future results. These indexes are unmanaged indexes of common stocks, bonds or REITs. An investment cannot be made directly in an index.

As near retirees approach retirement, the risk of significant drops in account value just before or after retirement will dramatically alter the longevity of their retirement assets. Near retirees must address this sequence of returns risk to ensure they are able to maintain the retirement lifestyle for which they planned.

53 Morningstar Advisor Workstation, 12/31/08

Near retirees approaching retirement are also prone to altering their asset allocation to align with their age and wealth accumulation. While a certain level of caution is prudent, near retirees also need to ensure they do not trade short-term wealth preservation for increased inflation risk and purchasing power erosion. Increased fixed income exposure is prudent for most individuals; however, earlier you saw that total allocations of investment assets, where less than 50 percent is in equity assets, will dramatically increase longevity risk.

Underestimating the increase in health care costs is another risk near retirees are subject to. In addition, as near retirees approach retirement, analyzing needs for long-term care insurance becomes critical. While it is certain that the earlier individuals put these protections in place the better, they must also fully explore long-term care insurance needs and ultimately implement a plan before reaching their late 50s. Prior to age 50, it may be difficult for individuals to come up with the financial assets to fund a long-term care policy, and the cost of this protection rises, often dramatically, as one ages.

How Near Retirees View Retirement

Many studies have looked at the ways that near retirees (baby boomers) view retirement. Here are highlights from one of these surveys:[54]

- While 76 percent of baby boomers intend to keep working and earning in retirement, on average they expect to "retire" from their current job/career at around age 64, and then launch into an entirely new job or career.
- Taking advantage of their "longevity bonus," baby boomers will create a completely new life stage. Baby boomers plan to be younger longer and work longer. Sixty-five percent of baby boomers will stop working for pay and retire in the traditional sense at some point. However, that phase is more likely to begin in the late 60s than at age 60 or 65.
- Baby boomers reject a life of either full-time leisure or full-time work. When asked about their ideal work arrangement in retirement, the most common choices among baby boomers in the survey would be to:
    - Repeatedly "cycle" between periods of work and leisure (42 percent)
    - Have part-time work (16 percent)
    - Start their own business (13 percent)
    - Work full time (6 percent)

  Only 17 percent of the baby boomers in the survey reported that they hope never to work for pay again.

- While 37 percent of the baby boomers in the survey indicate that continued earnings is a very important part of the reason they intend to keep working, 67 percent assert that continued mental stimulation and challenge are what will motivate them to stay in the game.
- The "me" generation has grown up – now with deep concerns for the well-being of their children, their parents and their communities. Baby boomers are now 10 times more likely to "put others first" (43 percent) than "put themselves first" (4 percent).

54 *"The 2005 Merrill Lynch New Retirement Study: A Perspective From Individuals and Employers"*

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- The unpredictable cost of illness and health care is by far baby boomers' biggest fear. They are three times more worried about a major illness (48 percent), their ability to pay for health care (53 percent) or winding up in a nursing home (48 percent), than about dying (17 percent).
- Accumulating the resources baby boomers believe they need for retirement freedom (81 percent), rather than age (56 percent) or any other variable, was cited as the most decisive factor for when they choose to retire. Moreover, recognizing the growing uncertainty of government entitlements like Social Security, baby boomers who have a plan and feel prepared are twice as optimistic and far less fearful than those who do not have a plan.

Early Retirees

Early retirees make up a special reclassification of the age band and describe those individuals who decide to "retire" prior to traditional retirement age, or scale back their traditional wage earning vocation and take on a new full- or part-time vocation, regardless of compensation. Generally, for these individuals, there are a number of risks to consider, including sequence of returns risk, excess withdrawal risk, asset allocation risk, purchasing power erosion risk, medical expense risk, tax risk and relationship risk.

Individuals retiring early must wait for partial Social Security benefits starting at age 62 (in 2009), or full benefits starting at age 65 (in 2009). During the "gap period" representing the period between changing wage earnings and the beginning of Social Security, these individuals must be cognizant of sequence of returns risk and asset allocation risk for the same reasons as near retirees.

Early retirees must also address an additional risk: excess withdrawal risk. Given the presumed smaller asset base due to a shorter working life, as well as the gap period between retirement and the ability to collect Social Security benefits, individuals must rely heavily on their accumulated wealth. In scenarios like these, maintaining realistic drawdown rates is required to help control the premature reduction of wealth and longevity risk.

The propensity to be overly "income-focused" during retirement causes many to overweight assets to "income–oriented" products like fixed income assets, and it is a potential cause of the early stages of asset allocation risk. Our previous example portrayed investing too conservatively to reduce the discomforting feelings associated with the short-term fluctuations common with equity assets. A variation of this scenario includes individuals who invest too conservatively because of their focus on "income–generating" assets. While seeking the comfort of a recurring interest or dividend payment is a reasonable approach for many individuals later in retirement, when early retirees take this approach, it creates the chance of much greater *discomfort* later in life. Inflation will eventually erode the purchasing power of the early retiree using too much of this solution. Magnifying this danger is the point in time when the ability to buy less for the same amount of money intersects with rising health care expenses. The inclusion of *properly* diversified assets that have enough exposure to equity assets is imperative to help control inflation for early retirees.

Early retirees are also subject to medical expense risk, just like near retirees. While the risks are the same for these two groups, early retirees may be facing increasing costs of long-term care insurance, depending on their age. As mentioned earlier, the need for an open discussion with a retirement advisor about long-term care insurance increases with each passing day.

This paper has continued to recite the adage, "it is not what you make, but what you keep," as it is critical to consider how taxes will influence retirement assets. While letting the "tax tail wag the investment dog" can be

counterproductive, awareness of this issue and prudent tax management will ensure early retirees keep more of what they make. Proper initial and ongoing tax planning that involves tax-advantaged solutions will help to mitigate tax risk and ensure individuals have a greater likelihood of living the retirement lifestyle they planned.

Retirees

Individuals who retire with full or partial Social Security benefits are subject to the same risks as early retirees, but do not have to plan for the "time gap" that early retirees must. The major risks that retirees must address as a group are sequence of returns risk, excess withdrawal risk, asset allocation risk, medical expense risk, tax risk and relationship risk.

The first few years after individuals begin to draw down their wealth, they must fully plan for the crippling effects of sequence of returns risk. Negative returns in the early years of decumulation can dramatically affect retirees' ability to maintain predetermined spending plans, without running the risk of fully exhausting their wealth too early.

A realistic rate of withdrawal is a critical consideration and significantly affects a retiree's ability to sustain his spending budget. As longevity continues to increase, proper budgeting and accurate assessment of both essential and discretionary expenses is imperative. While the budgeting process is important in the years leading up to retirement as well as in the early years of retirement, it is also important to forecast expenses over the long term and account for inevitable increases due to general inflation and, more importantly, to the increasing level of medical expenses over time. Incorporating future medical expense increases in the early planning of expenses allows retirees to establish a realistic drawdown rate that can address both current and future needs, and allow enjoyment of retirement years without the worry of prematurely exhausting their wealth.

While all too often it was assumed that "retirement" meant to completely cease all working activities, today's reality is that most individuals expect to work to some degree during their early retirement years, although perhaps in a very different vocation, with very different objectives. For these individuals, tax risk is an important consideration. Not only are wages from earnings subject to taxation, but the government may tax a portion of Social Security benefits as well. Being aware of these issues and incorporating ongoing tax planning into their plan will help retirees keep more of what they make and minimize the impact of taxes on their retirement assets.

Mature Retirees

For individuals well into their retirement years, many of the risks accounted for during their earlier retirement years remain; however, the specifics of some of these risks begin to change. While issues like medical expense risk and purchasing power erosion continue to be significant risks for this group as a whole, due to the statistically narrowing life span of mature retirees, issues like asset allocation risk and excess withdrawal risk decrease in magnitude. Tax risk and relationship risk, however, remain as key risks for this group.

As individuals move further into retirement, the risk of "health shocks" increases dramatically and the high cost of significant medical issues can have a disastrous impact on their remaining wealth. Health shocks are the development of new and serious health problems, such as a stroke or heart attack, rather than chronic health problems like diabetes.

Studies conducted by researchers at Ohio State University, and subsequent research by the Department of Consumer Sciences, found that elderly individuals who experience health shocks later in life deplete a greater amount of their

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wealth as compared to those individuals who experience health shocks earlier in life. These studies found that individuals who maintained their health were 6 to 7 percent more likely to retain a greater portion of their retirement assets, relative to those who experienced health issues.[55]

Mature retirees should remember that it is imperative to incorporate robust assumptions about future health care costs as soon as possible. Individuals with pre-existing conditions or family histories of serious health problems should consult with their medical professionals and develop a realistic sense of their future health care needs. In addition to good planning, leading a healthy lifestyle before and throughout retirement is very important.

55 (Lee and Kim 2003)

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Chapter IV: 1st Global's Philosophy

Defining 1st Global's Philosophy

1st Global's Sustainable Income Solutions™ represent the aggregation of realistic answers to the complex problems of generating enough income to provide adequate cash flow for life depending on your long-term goals.

While cash flow is the ultimate measure of the success of your individual plan, income represents the flow of wealth to cover expenses, both non-discretionary and discretionary.

The complexity of developing plans to achieve sustainable income for both the long lives we expect to live and the many choices we want to make stands in dramatic contrast to the need for sophistication in plans of those even one generation ago. Bill Sharpe, a Nobel Prize winner for Economics, summed up this emerging complexity well when he said:

Today I'm going to talk about something that used to be a problem primarily for the rich. In my generation, average people had very few decisions to make about financing their retirement. You worked for an employer, retired, got your checks from the government and the employer until you died. And, if your partner outlived you, he or she got checks after you were gone. No risk, no decisions. And, of course, no upside potential.

How times change. In my children's generation, average people now have to decide how much to save for retirement and how to invest it. When they retire, they have to decide whether or not to buy an annuity from an insurance company that will pay them until they die and, if they do so, whether the annuity payments will be fixed or will vary with the level of the stock market. If they don't use all their money to buy an annuity (and most don't), they have to decide how much to spend each year and how to invest the rest. Not surprisingly, many average people are ill-prepared to make the complex financial decisions that are now required.

-- William F. Sharpe, Nobel Laureate[56]

Sustainable Income Solutions™ is the process that helps average people, with the help of a competent retirement advisor, make these complex decisions.

Sustainable *income* is the focus of this paper; however, an independent assessment and management of expenses is a necessity to ensure that the right *cash flow* is the result. This paper will discuss the expense and budgeting components that complete the cash flow equation; however, we acknowledge that income, rather than *cash flow*, is the primary focus of our writing.

56 *"Financing Retirement: Saving, Investing, Spending and Insuring,"* William F. Sharpe. Based on a public lecture given at Middlebury College, Vermont on Oct 6, 2006

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Income and Cash Flow: Understanding the Difference

Income is "the amount of money received during a period of time in exchange for labor or services, from the sale of goods or property, or as a profit from financial investments."[57] This differs significantly from the accounting definition of income, in which income is the "excess of revenues over expenses and losses for an accounting period."[58]

Cash flow is defined as "the pattern of income and expenditures, as of a company or person, and the resulting availability of cash,"[59] or "the excess of cash revenues over cash outlays in a given period of time."[60]

It is important to focus on the definition of these words to avoid confusion. For purposes of this writing, income is the money you will receive from your accumulated wealth before it is spent. Similarly, cash flow conveys the net result of income minus expenses.

When we refer to income, we will be referring only to inflows, which we feel meets the individual (non-accounting) definition of this term, while cash flow will refer to the cumulative process of addressing income, as well as budgeting and risks to budgets for unplanned expenses such as medical bills. We acknowledge that these terms may not meet technical accounting or financial definitions; however, they do meet personal use definitions.

The 1st Global Philosophy: Sustainable Income Solutions™

The following tenets describe 1st Global's philosophy on Sustainable Income Solutions™:

- **"Retirement" no longer exists.** The traditional, sedentary concept of "retirement" has passed us. The dictionary defines "retire" in part as, "To withdraw, as for rest or seclusion."[61] We know that withdrawing from life does not meet your vision for the last 30 years of your life. As we age and spend more time being active after our wage-earning years, the line between work and retirement is blurred. We want choice: the choice to work, for income or emotional gain; to travel; to nurture others; to participate in the myriad of other activities that provide meaning to our existence. Merely withdrawing to a few years of quiet rest does not fit our definition of "retirement."
- **Sustainable Income Solutions™ are a multi-generational need.** While developing a plan for sustainable income for life is most critical to those closest to and in retirement, Sustainable Income Solutions™ are not only for these individuals. Implementing Sustainable Income Solutions™ sooner, rather than later, offers a greater certainty of outcome. While the implementation for a Gen-Xer will vary from a baby boomer's implementation, the need to understand the future and develop a plan is meaningful to all generations.

57 Income. (n.d.). *The American Heritage® Dictionary of the English Language, Fourth Edition*. Retrieved April 07, 2009, from Dictionary.com Web site: http://dictionary.reference.com/browse/income

58 Dictionary of Accounting Terms, 4th edition, by Joel G. Siegel, Ph.D., CPA, and Jae K. Shim, Ph.D., published by Barron's Educational Series, Inc.

59 Cash flow. (n.d.). *The American Heritage® Dictionary of the English Language, Fourth Edition*. Retrieved April 07, 2009, from Dictionary.com Web site: http://dictionary.reference.com/browse/cash flow

60 Cash flow. (n.d.). WordNet® 3.0. Retrieved April 07, 2009, from Dictionary.com Web site: http://dictionary.reference.com/browse/cash flow

61 Retire. (n.d.). *The American Heritage® Dictionary of the English Language, Fourth Edition*. Retrieved April 11, 2009, from Dictionary.com website: http://dictionary.reference.com/browse/retire

- **By necessity, sustainable income must be the responsibility of the individual.** Since there is no assurance that government-funded programs, like Social Security and Medicare, and corporate pension plans will be available to provide us with sufficient income in retirement, it becomes the responsibility of the individual to ensure their capacity to sustain income for life. Excepting the benevolence of others, there can be no alternative.
- **Sustainable Income Solutions™ is an outcome-based process, designed to tie clearly articulated outcomes and advice together.** Outcome is defined as "a final product or end result; consequence; issue."[62] Sustainable Income Solutions™ focus on the end result, namely the ability to offer you the ideal of choice for the rest of your life. The Sustainable Income Solutions™ process identifies and creates your personal vision of retirement and develops a plan designed to provide the highest level of certainty for you to realize your stated vision. Rather than focusing on tactical elements such as action, Sustainable Income Solutions™ focus instead on purpose.
- **The key to Sustainable Income Solutions™ is proper identification and inoculation against specific risks, unique to individuals and their families.** Sustainable Income Solutions™ is a process that begins with understanding and assessing your exposure to the eight distinct risks in four categories. Through careful analysis with a retirement advisor, you will discover your exposure to these risks and come to understand how they are unique to you. Also unique to you are the decisions about which of these eight risks you choose to bear and which you choose to share. By choosing to share risk, you begin to increase the certainty required for a successful Sustainable Income Solutions™ plan. Because your exposure to these risks is unique, there can be no template or "model" for implementation, and a plan can only be developed though thorough self-analysis, guided by the advice of a retirement advisor.
- **Certainty and liquidity are inversely related. The cost of high levels of certainty is illiquidity. The cost of high levels of liquidity is less certainty of outcomes.** Providing sustainable income for life is the process of creating a balance between many factors. Sustainable Income Solutions™ addresses the balance between bearing and sharing risk, preserving and growing assets, and control over wealth and certainty of outcome. Certainty in Sustainable Income Solutions™ does not refer to the protection of principal or the certainty that wealth will continue to exist, but rather to the certainty that you will have sustainable income for the rest of your life. While there are alternatives that can provide this certain outcome, their cost is loss of control over all or part of your wealth. Conversely, solutions that allow you to both maintain control and provide a ready market to redirect your wealth as you please have a cost in their inability to create a certain outcome. Maintaining liquidity in conservative investments, such as money market funds, with too great an amount of wealth may mean an inability to afford the rising costs of goods and services. Maintaining liquidity in aggressive investments, like common stocks, may subject this wealth to irreparable loss.
- **Sustainable Income Solutions™ require more than income generation; they require income protection.** A Sustainable Income Solutions™ plan is not only about generating income but also about providing certainty to the amount of income you need in the future. Throughout our lives, and increasingly as we age, there are unexpected financial traumas, such as the cost of medical care or supporting family members, which can dramatically change the amount of income we need for life. The three solutions available within Sustainable Income Solutions™ can help inoculate you from exposure to these risks and create more certainty about the amount of sustainable income you need for life.

62 Outcome. (n.d.). Dictionary.com Unabridged (v 1.1). Retrieved April 11, 2009, from Dictionary.com website: http://dictionary.reference.com/browse/outcome

- **The closer the need to consume savings, the more protection is required; the farther the need, the more growth is required. These "pools" must remain separate.** The closer you are to spending your accumulated savings, the more you must seek to protect these savings. However, it is unlikely that you will spend all of your savings in the near term. It is imperative to consider both the beginning and the end, and separate the wealth you need sooner from the wealth you need later. The inability to make this separation creates the risk of investing too conservatively and not keeping pace with the rising costs of goods and services, while investing too aggressively may cause irreparable loss to your wealth. Sustainable Income Solutions™ provides the method to create this balance.
- **Cautious use of equity investments is important, but only for specific purposes.** As demonstrated in the inflation risk section, investing too conservatively can irreparably damage your ability to provide sustainable income for life. In order to stay ahead of the rising costs of goods and services, we believe that some ownership of equity assets is required.
- **Sustainable Income Solutions™ are not product-based. Investment and risk management products are and will always be diverse and changing. Products are the tools that represent decisions; they are not the decision itself.** Sustainable Income Solutions™ is a process that defines an income plan unique to you and your needs. While perhaps forensically interesting, the proliferation of investment and risk management products is far less material to your plan *than is the plan itself.* Failing to understand the risks to which you are exposed, and failing to develop a vision of your future, will render the products you choose immaterial. The right advice coupled with below-average products will always be much more effective than below-average advice coupled with above-average products. Implementation of your plan through investment and risk management products is necessary and careful selection is important; nevertheless, this process is secondary to the Sustainable Income Solutions™ process of identifying outcome-based solutions through an advice-based process. As a result, this paper will discuss investment and risk management product types, not the merit of any particular product or product provider.
- **Wealth at an increasing level simplifies implementation and reduces risk, but there is no bright line.** It is indisputable that there are certain levels of family or personal wealth that sustain generations. It is equally indisputable that there are individuals whose personal or family wealth is large enough where the need for a plan to deliver income in retirement is not a purposeful exercise. However, what is that specific amount? What level of wealth can guarantee sustainability and that there is no chance of it disappearing? Would the clients of the alleged Ponzi-scheme perpetrator, Bernard Madoff, have considered their need for sustainable income? How might they perceive this need today? There can be no specific answer to the amount of wealth needed to invalidate the need for Sustainable Income Solutions™; however, an individual assessment of wealth diversification and exposure to the eight risks outlined in this paper will serve as a guide for your personal answer to this question.
- **There is no "right answer" to the retirement income problem.** This paper will clearly demonstrate that Sustainable Income Solutions™ is about trade-offs. The "retirement income problem" is infinite in both its permutations and its possibilities. There can be no "right" plan, and there can be no "cookie-cutter" implementations. Your plan, developed with the advice of your retirement advisor, will be personal and evolving. What is "right" for you today may be different from what is "right" for you tomorrow. Lives change, dreams change, and the tools that bind plans and dreams change. Sustainable Income Solutions™ will help you define your vision, identify your risks, create a plan and implement it. Sustainable Income Solutions™ cannot provide you an "answer," but it can provide you something more personal: advice that can offer you the ideal of choice.

Outcome-Based Solutions

Sustainable Income Solutions™ are outcome-based. We offer these solutions on the universal premise that individuals want a safe, stable and certain income in retirement. While individual needs differ, in a collective sense, Americans in or nearing retirement have a universal and shared set of needs and outcomes. Each of us has a need for certainty in the wealth that will sustain us in the near term and will accept less certainty in later years. It is important to realize that "less" is a very personal concept and is specific to each individual. We also share a universal need for an assurance of independence, dignity and the ability to control our choices throughout the remainder of our lives.

Sustainable Income Solutions™ focus on developing clearly articulated outcomes for two reasons:

1. Individuals are living longer in retirement
2. Individuals often make emotionally charged, irrational decisions

When we did not need to sustain income for long periods, planning for and forecasting errors were less problematic. Furthermore, with social funding available for retirement, the accuracy of planning and forecasting desired outcomes was less risky. However, now we must base many plans on a high probability of living to age 90 and beyond. Time frames such as these require a high degree of oversight, monitoring and adjustment to avoid the very real impact of taxes and inflation.

Additionally, the science of investing assumes that we are all equally informed, rational individuals who can make prudent decisions about the trade-offs between risk and return. While these assumptions provide a comfortable framework, they are inherently flawed and from time to time, unforeseen conditions test the validity of these assumptions. Given the limitations of these assumptions, we must focus our solutions on additional universal outcomes, specifically working to help counteract the opposing forces of fear and greed that challenge our fortitude. Short-term emotional reactions can devastate the most intricate plan and cause dramatic long-term financial damage.

Sustainable Income Solutions™

1st Global's Sustainable Income Solutions™ represent the aggregation of realistic answers to the complex problems of generating enough income to provide adequate cash flow for life depending on your long-term goals. While cash flow is the ultimate measure of your individual plan's success, income represents the flow of wealth to cover expenses, both non-discretionary and discretionary.

Sustainable *income* is the focus of this paper; however, an independent assessment and managing of expenses is necessary to ensure that the right *cash flow* is the result. This paper will discuss the expense and budgeting components that complete the cash flow equation. We will also discuss methods to put Sustainable Income Solutions™ in place that will allow you to meet your target cash flow and ensure that the plans you put in place are updated regularly to help ensure they continue to meet your goals.

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With the eight risks and age band segmentation discussed in chapter two as our overriding framework, this paper will now discuss:

- The process for implementing a Sustainable Income Solutions™ plan
- The types of solutions that are available to solve the sustainable income problem and can be used to build a long-term plan
- Case studies on how to solve the problem by combining different types of solutions

Solution Segmentation

Personal planning for sustainable income is important and so are the various solutions that are available to begin to hedge the myriad risks of planning for later in life. This section is a description of the types of solutions that are available to individuals who are intent on building a Sustainable Income Solutions™ plan to ensure that they have the ability to make the choices that matter to them throughout their lives. With the advice provided by your retirement advisor, these solutions will combine to develop a comprehensive plan for implementation. Individual investment and insurance products will ultimately be the means by which we execute the Sustainable Income Solutions™ plan you make; however, the actual products in a portfolio should largely be irrelevant to the consumer. What matters is how solutions combine to give an overall distribution of possible outcomes.[63]

As we begin to provide education on the types of solutions available, we will classify solutions into three buckets:

1. Income solutions
2. Risk management solutions
3. Growth solutions

By design, these three solutions work together to create a dynamic and long-term plan for both the accumulation of wealth and the preservation and consumption of wealth. Depending on your stage in life and preferences for certainty, these three solutions will combine to address your unique needs and hedge risk specific to you, your needs and your wants. Figure 25 describes how the evolution of use of these solutions might look for an individual as they approach and move through retirement. The combined use of these solutions is two-fold:

1. These solutions are designed to provide you with income that will sustain your ability to make choices for life; and
2. The combination of these solutions presents an aggregated approach to address the eight risks outlined in chapter two.

63 *"Choosing Outcomes versus Choosing Products: Consumer-Focused Retirement Investment Advice,"* Goldstein, Johnson, Sharpe, Journal of Consumer Research, Inc. Vol. 35, October 2008

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The combined use of these three solutions does not represent a prescribed method, such as an asset allocation policy might represent, but rather represents how the use of these solutions might change for an individual over time. The reason that there cannot be a pre-set or prescribed mix of these solutions is also two-fold:

1. The way these eight risks manifest themselves is unique to just you and your family; and
2. Your need for certainty is also unique to you and your family, and will dramatically alter the way figure 25 appears.

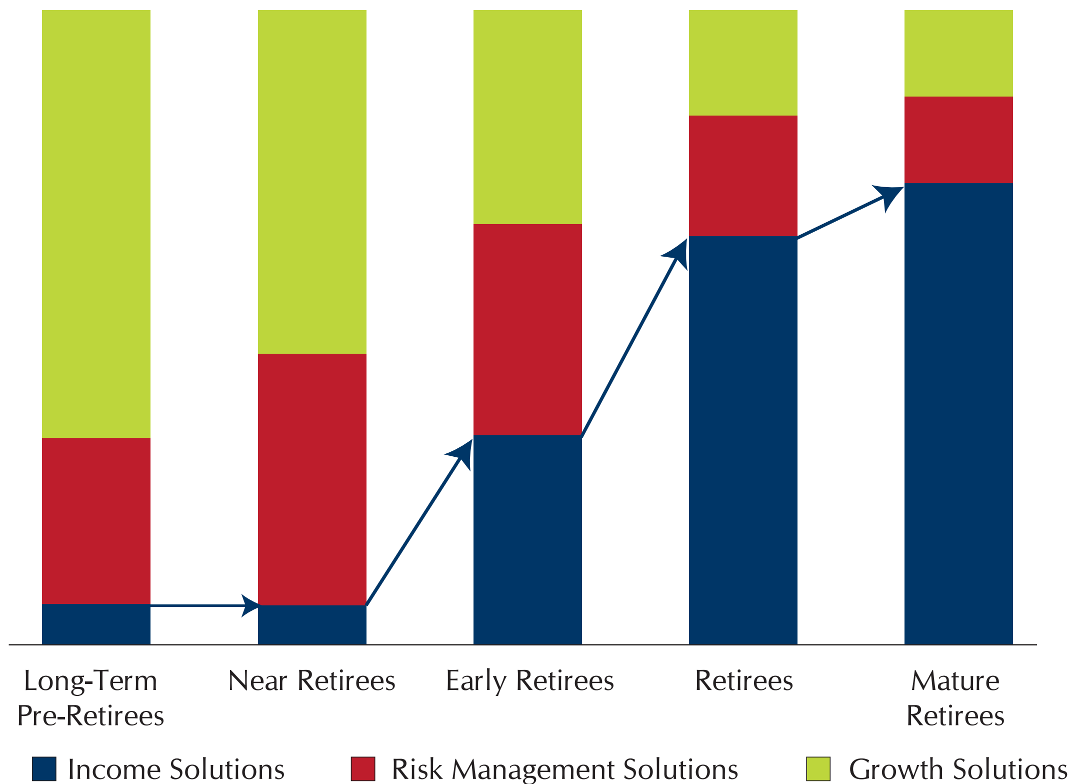

Figure 25 - An Example of the Evolving Use of Sustainable Income Solutions™ Over Time

Income Solutions

Income solutions are those that focus on providing income-oriented outcomes with a high degree of certainty. These solutions include cash-flow-matching bond strategies, lifetime annuitization strategies and short-term cash reserves. Allocations to these solutions typically increase as individuals move into retirement, and correlate directly with the increased need for certainty as time passes. In exchange for certainty, clients swap the potential for significant growth of assets, liquidity or both. Income solutions are the backbone of a retiree's Sustainable Income Solutions™ plan, providing the greatest chance for the highest level of certainty that individuals will be able to achieve a retirement that offers them choice.

Cash-Flow-Matching Bond Strategies

In keeping with the most important function of income solutions, cash-flow-matching bond strategies provide the chance for the certainty of outcome that retirees are demanding. Certainty is achieved best by utilizing government-backed fixed income securities, as even the highest-rated corporate debt can run into solvency issues from time to time, the U.S. government is assumed to always be able to meet its liabilities. U.S. government securities are generally considered the safest of all fixed income securities since they are backed by the full faith and credit of the U.S. government as to timely payment of principal and interest. However, yield and share price are not guaranteed and will vary with market conditions.

The use of cash-flow-matching bond strategies to address essential and subsequently discretionary expenses works best when a withdrawal rate is less than 5 percent (income needed as a percentage of invested assets). In most situations, a withdrawal rate equal to or less than 3 percent can be addressed by owning U.S. government-backed fixed income securities. However, depending on the forward-looking interest rate environment, the use of only U.S. government-backed fixed income securities may tie up too much of an individual's investable wealth. Tying up too much wealth in low-yielding solutions increases an individual's chance of inflation risk exposure. While inflation risk may not immediately affect one's retirement lifestyle, at some point in the future it is almost certain to. While U.S. government-backed fixed income securities provide a high level of certainty in that the likelihood of the U.S. government defaulting is minuscule, there remains the possibility of exhausting assets held exclusively in U.S. government securities depending on the time frame in question, the yields paid by the U.S. government securities and the level of inflation over time. For individuals searching for the security and certainty provided by solutions like U.S. government securities but want greater assurance of not outliving their retirement assets, the use of an immediate annuity solution may make sense.

Lifetime Annuitization Strategies

Immediate annuity solutions, or single premium immediate annuities (SPIAs), provide two very important features that are essential to the income solutions segment. SPIAs provide clients with a high chance of outcome certainty and generally offer higher payout rates than U.S. government-backed fixed income securities. A SPIA is an irrevocable contract with an insurance company who, in exchange for an initial up-front payment, will provide an individual with a predetermined income payment on a regular basis for the rest of that individual's life. The benefit to this solution is that it provides a "guaranteed" stream of income that can never be outlived. (Guarantees are based on the claims-paying ability of the underlying insurance company.) Because of this, in most cases, SPIAs provide the best example of an income solution. However, considering certain drawbacks that SPIAs carry is important.

Since SPIAs are irrevocable contracts, they are not redeemable like some other annuity options. Individuals must take this lack of liquidity into consideration when determining the level of assets that should be placed into a SPIA. Cash flows from SPIAs are also subject to inflationary pressures over time, since the cash flow amounts are fixed and do not adjust with inflation. While there are certain features individuals can purchase that incorporate an inflation adjustment in the income payments, these features tend to be very expensive. These extra costs often tie up too many additional assets so utilizing other solutions that will meet or exceed inflation over time is often more efficient. Individuals may use these other solutions to supplement the SPIA in order to ensure that, over time, the income received keeps up with the rising cost of inflation.

SPIAs are not always reasonable solutions for all age bands. Generally, the younger the individual (pre-retirement), the less likely a SPIA will be used in implementation due to the decreased need for current income. The biggest risk that a young investor faces with a SPIA is the high cost of inflation over a long period of time, say 30 years. For this reason, individuals moving toward retirement should focus their wealth allocations to solutions that provide equity or equity-like returns in an effort to amass inflation-adjusted wealth for the purpose of future inflation-adjusted consumption.

While liquidity and inflation risk are two significant drawbacks to using SPIAs, 1st Global still believes that single premium immediate annuities are the most efficient vehicle for providing guaranteed income with certainty during retirement.

Short-Term Cash Reserves

Basic financial planning states that one should maintain six to 12 months worth of living expenses in highly liquid cash equivalents to hedge against unexpected events, such as the loss of employment. While six to 12 months worth of cash may make sense as an "emergency fund" during the accumulation phase, as individuals move closer to retirement, the need for highly liquid reserves that protect principal increases in importance. For the purposes of 1st Global's Sustainable Income Solutions™ framework, short-term cash reserves include any liquid cash/cash-equivalent solutions such as money market funds and bank deposits. The amount of wealth dedicated to these solutions should represent between one and three years worth of total expenses, both essential and discretionary. An investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Yields will fluctuate, and although it is designed to preserve the value of your investment as $1 per share, it is possible to lose money by investing in a money market fund.

Allocations to short-term cash reserves are dependent on two factors: feelings about volatility and age. Individuals who are willing to accept higher levels of uncertainty and volatility will hold smaller allocations to short-term cash reserves, while those who are unable to accept uncertainty and volatility will require larger allocations to this solution. As individuals age, the need for a larger allocation to short-term cash reserves is necessary to account for rising medical expense risks. As individuals age and the risk of a "health shock" increases, the need for readily available liquid assets becomes greater. While a number of other solutions help to address this risk, it is always important to remember that the uncertainty of "health shocks," both expense and timing, makes planning for this risk very difficult. Short-term cash reserves provide a hedge against that uncertainty.

Income Solutions Conclusion

As a percentage of overall wealth, allocations to income solutions increase as individuals move into retirement. This directly correlates with an increasing desire for certainty as individuals age. In exchange for this increased sense of certainty, clients give up the return potential of riskier solutions, and in some cases, may give up control of a portion of their assets. Income solutions are the backbone of a retiree's solution set, providing the necessary certainty that individuals will be able to have the income they need to make the choices that matter to them in life.

Risk Management Solutions

Risk management solutions are those that help insure individuals against unforeseen events that would otherwise hinder their ability to achieve a retirement defined by dignity and choice. These solutions include insurance solutions and non-correlating solutions.

Insurance Solutions

Insurance solutions include life insurance and long-term care insurance. Both of these tools serve to ensure an individual can keep their important promises in the event of an unforeseen event affecting their life or health. The role life insurance plays in a Sustainable Income Solutions™ plan depends on where an individual is in the retirement life cycle.

For younger individuals, life insurance serves as income protection in the event of a sudden death, ensuring their hopes and dreams for their loved ones will live on. For maturing individuals, life insurance serves as a form of income replacement and as an estate maximization tool. Life insurance helps ensure the achievement of an individual's hopes and dreams for those left behind.

As illustrated earlier, "health shocks" can dramatically erode wealth and pose a significant risk of derailing a well-planned retirement lifestyle. While the need for long-term care insurance when one is younger may not make sense, there is a point where potential benefits outweigh the costs. Individuals must be aware of the risks involved in "self-insuring" and plan accordingly before premium costs become prohibitive.

Non-Correlating Solutions

As individuals increasingly become responsible for creating and maintaining a long-term plan that makes them look more like a private pension plan than an individual preparing for retirement, ongoing exposure to capital markets becomes an increasingly larger issue. Implementing solutions whose returns are not tied directly to the movements of the stock market can help to control short-term fluctuations in wealth. Non-correlating solutions include principal-protected investments, alternative investments and variable annuities with living benefit riders. Each of these solutions is designed to help control the variability of account values as well as individual behavior. Oftentimes, investor behavior, rather than market behavior, becomes an obstacle to long-term investment success. Psychological causes, known as behavior finance flaws, drive imprudent and often emotional investor actions. We have learned that volatility in capital markets leads to uncertainty, which in turn leads to short-term decision making based on emotions rather than logic. Unfortunately, these short-term, emotionally driven decisions often negatively influence long-term results. Incorporating the use of non-correlating solutions will not only help to minimize account value volatility, but also minimize the propensity for short-term, emotionally driven decisions.

Principal-Protected Investments

Focusing on long-term financial goals during periods of extreme market volatility is often emotionally challenging for investors. For an individual, finding the optimal balance between risk and reward through investment portfolio construction and having the fortitude to hold fast to one's investment program

over the long haul is no easy task. A principal-protected investment (PPI) strategy helps investors stay focused on their long-term financial goals by removing an emotion that often drives them off-course: the fear of losing principal. PPIs that are not issued using a certificate of deposit are not deposits insured or guaranteed by the Federal Deposit Insurance Corporation or any other government authority.

Principal-protected investments are typically buy-and-hold investments. The notes/CDs generally have a capped maximum return at maturity. These investments are not appropriate for all investors. Investors should fully understand their important legal and tax consequences, as well as investment risks, and discuss them with their tax and financial advisors after reading the applicable prospectus, offering memorandum, offering circular or disclosure statement that relates to the investment, and before deciding to purchase any principal-protected investment. Investors should be aware that the laws of certain jurisdictions (including laws that require brokers to ensure that investments are suitable for their customers) may limit the availability of principal-protected notes/CDs in those jurisdictions. Specific risks include:

1. Market risk: Return on principal-protected notes/CDs is linked to the performance of the underlying, and will depend on whether, and the extent to which, the change in value of the underlying is positive over the term of the notes (as measured on the applicable measurement dates for the notes).
2. The notes/CDs may not pay more than the principal amount: Investors may receive a lower payment at maturity than they would have received if they had invested in the underlying or the component stocks of the underlying.
3. Any investment in the notes/CDs is limited to the maximum potential return.
4. No interest or dividend payments or voting rights: As a holder of the notes/CDs, investors will not receive interest payments, and will not have voting rights or rights to receive cash dividends or other distributions or other rights that holders of securities composing the index (or other underlying) would have.
5. Lack of liquidity: The notes/CDs are designed to be held to maturity and may not be listed on any securities exchange. The price at which you will be able to sell your notes/CDs prior to maturity, if at all, may be at a substantial discount from the principal amount of the notes/CDs.
6. Tax treatment: The notes/CDs will be treated as "contingent payment debt instruments" for U.S. federal income tax purposes if the term of the note is more than one year. As a result, you will generally be required to recognize interest income in each at a "comparable yield," even though you may not receive any payments on the notes/CDs until maturity.

Principal-Protected Notes

7. The notes differ from conventional debt securities: The terms of the notes differ from those of conventional debt securities in that interest may not be paid on the notes, or if any is paid, a significant portion of the total payment at maturity may be based on the performance of the underlying asset rather than the interest rate paid.
8. The participation rate and the cap of the notes could limit returns: Participation in appreciation of the underlying is capped and participation in any such appreciation is limited to the applicable participation rate for the particular notes.

9. Notes are not FDIC-insured: A principal-protected note is backed by the firm that issued the note. In the case of a bankruptcy of the issuer, the note holder would be repaid at a rate equivalent to other senior unsecured debt holders of the firm. The notes are not deposits insured or guaranteed by the Federal Deposit Insurance Corporation or any other government authority.
10. References to principal protection or a guarantee of principal is dependent upon the claims-paying ability of the issuer of the notes. Special attention should be given to the creditworthiness of the issuer of the note.

Principal-Protected CDs

11. The CDs differ from conventional bank deposits: The terms of the CDs differ from those of conventional bank deposits in that they will not pay regular interest. The return on your investment in the CDs may be less than the amount that would be paid on an ordinary bank deposit. The return at maturity of only the principal amount of each CD will not compensate you for any loss in value due to inflation and other factors relating to the value of money over time.
12. The appreciation potential of the CDs will be limited by the fixed payment or maximum return, if applicable: If the CDs have a fixed payment, the appreciation potential of the CDs is limited to the appreciation represented by the fixed payment, even if the appreciation in the Index would, but for the fixed payment, result in the payment of a greater additional amount at maturity. If the CDs have a maximum return, the appreciation potential of the CDs is limited to the fixed dollar amount per $1,000 CD specified in the applicable term sheet as the maximum return. The additional amount will equal no more than the maximum return.
13. CD limitations on FDIC insurance: As a general matter, holders who purchase CDs in a principal amount greater than the applicable limits set by federal law and regulation will not be insured by the FDIC for the principal amount exceeding such limit. Deposits at FDIC-insured institutions are now insured up to at least $250,000 per depositor through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $100,000 per depositor for all account categories except for IRAs and other certain retirement accounts which will remain at $250,000 per depositor. This change will occur before the maturity date of the CDs.
14. The CDs may be subject to the credit risk of the issuer: A depositor purchasing a principal amount of CDs in excess of FDIC insurance limits will be subject to the credit risk of the issuer and its credit ratings and credit spreads may adversely affect the market value of the CDs.
15. Early call at the issuer's option: If a CD is designated as a callable CD in the applicable term sheet, the callable CD generally will be callable at the issuer's option during the periods or on the specific dates specified in the applicable term sheet, on written notice given as provided in the applicable term sheet. Unless otherwise provided in the applicable term sheet, any such call will be effected in increments of $1,000 per callable CD, at the call price or prices specified in the applicable term sheet. If any callable CDs are called by the issuer prior to the stated maturity date, you will be entitled to receive only the relevant call price and you will not receive any interest payment. If the issuer does not call a callable CD prior to the stated maturity date, the principal amount plus the interest payment, if any, that you receive on the stated maturity date may be less than any of the call prices.

Please review the "Selected Risk Considerations" section of the term sheet for additional information.

A principal-protected investment combines a key feature of a fixed income security, the return of principal at maturity, with the potential for capital appreciation available through equities. Typically, PPIs combine a zero-coupon bond or certificate of deposit (for principal protection) with an equity call option on an equity index or basket of indexes.

Depending on their structure, PPIs may offer full participation in up markets or an amount greater or less than the full positive return. Because of these participation rates, PPIs may underperform during market advances, but they will always outperform an equity index during periods of market decline. Like fixed income securities, PPIs often carry maturities of between one and seven years, and individuals must hold them to maturity to ensure a full principal return. In return for principal protection, investors forfeit all dividend income from any equity indexes and may forgo a portion of gains in the equity index.

Allocations to PPIs are largely dependent on an individual's ability to accept uncertainty and volatility. The low-correlating benefits of PPIs can accrue to all types of clients, including those approaching retirement as well as those in retirement. However, prior to investing, individuals must understand certain drawbacks that PPIs carry with them. PPIs are time-specific investments, and as such, have liquidity constraints. The only way to ensure the outcome matches expectations is to hold the note to maturity. While there may be liquidity made available by the issuer prior to the maturity of the note, via secondary markets, this liquidity is never guaranteed and investors are almost certain to pay a penalty for the early redemption of the note. This penalty, coupled with the uncertainty of the value of the note, will likely lead to an outcome that does not match initial expectations.

As with traditional fixed income securities, the ability to return principal is only as good as the paying capability of the institution that issues the PPI. This risk can be mitigated through the use of a PPI backed by a certificate of deposit rather than one backed by a note, which is "a short-term debt security, usually with a maturity of five years or less,"[64] although some of the ability to participate in market increases may be limited (the cost of safety). If the institution who issues a note goes bankrupt, it is important to understand that there is an unknown chance of a return of full principal, and the possibility exists that no recovery of principal will be available at all. The FDIC protection offered to certificates of deposit mitigates "issuer" risk for those PPIs issued using a certificate of deposit. Individuals with the ability to accept uncertainty, even with low likelihood, are better candidates for PPIs.

Variable Annuities with Guaranteed Withdrawal Benefits

In 2009, the near retiree faces new challenges that previous generations have not had to deal with. The decrease in pension income has generated a void in the amount of guaranteed income that individuals can expect in retirement. Variable annuities with guaranteed withdrawal benefits (GWBs) play an important role in supplementing income solutions by providing guarantees on future income. While SPIAs are the most efficient vehicle for generating guaranteed income immediately, variable annuities with guaranteed withdrawal benefits may be the best solution for the near retiree who will need guaranteed income later.

64 *InvestorWords.com*. Retrieved April 29, 2009, from InvestorWords.com Web site: http://www.investorwords.com/3351/note.html

Near retirees face market uncertainty, which influences the decisions they make as they approach retirement. Variable annuities with guaranteed withdrawal benefits can aid in controlling these emotions by providing a guaranteed amount of income at a future date regardless of market performance. The features, cost and characteristics of the variable annuity solution will vary based on the insurance company that offers the solution, but the example below illustrates how this solution works as part of risk management solutions. This is an income-based solution that guarantees a future amount of income. (Guarantees based on the claims-paying ability of the underlying insurance company.) These guarantees are associated with future income amounts and do not represent the actual value of the account. For the examples in this section, we will refer to these future guaranteed income amounts as the withdrawal balance. However, do not confuse the withdrawal balance with the contract value, the amount a client would receive if they wanted to surrender the contract. The withdrawal balance is the amount from which an individual can withdraw a specified percentage of income, such as 5 percent. The guaranteed withdrawal benefit on the variable annuity provides a guaranteed increase in the amount available for withdrawal in each year that no income is taken. If you are familiar with variable annuities, you may know that guaranteed withdrawal benefits often allow you to "lock in" higher withdrawal benefits if equities outperform the guaranteed amounts. In this example, we will focus only on the guaranteed amounts. It is important to note that these guarantees have no effect on the value of the subaccounts of the variable annuity policy, but provide an opportunity to take a guaranteed amount of income from the withdrawal balance in the future.

EXAMPLE: A 55-year-old places $100,000 in a variable annuity that has a 5 percent guaranteed withdrawal benefit and chooses equity investment vehicles. In this case, in each year that an individual does not withdraw income, the withdrawal benefit will increase at a guaranteed rate of 10 percent. If 10 years pass with no withdrawals, the withdrawal balance would have a minimum value of $200,000. If in this 10th year the contract value was only $75,000, the guaranteed withdrawal benefit still provides this individual with the opportunity to withdraw $10,000 per year for the rest of his life because the guarantee has moved the withdrawal value to $200,000 (5 percent of $200,000 is $10,000).

This rider provides value by ensuring that guaranteed income can be generated in the future, and that this income may rise even in cases where the capital markets decline, depending on the actual account value. Note that by making deferrals to the annuity, the investor provides a hedge against inflation risk in those years; however, there is not a guaranteed inflation hedge once the client starts taking distributions. If instead of a loss in the account value, from the above example, the withdrawal value *and* account value were *both* $200,000, an analysis of the individual's Sustainable Income Solutions™ plan would occur. This analysis would require that an individual consider whether their plan needs modification based on changes in income needs, inflation, certainty or a combination of these factors. If the withdrawal balance and account value were the same and more certainty of income was required, a transfer into a single premium immediate annuity would be utilized as this is a solution that provides the most efficient source of guaranteed income (see figure 26). If the withdrawal balance and account value were the same, but there was not a need for additional income, a discussion of the variable annuity's role would occur. A re-evaluation of each of the eight risks, future income needs and feelings about certainty will help determine if these assets should remain part of risk management solutions or move to a different solution, either income solutions or growth solutions, and be implemented there using different tools. The variable

annuity solution is most commonly suited for near retirees as a hedge against market risk, one of the biggest risks that near retirees face.

To provide these guarantees, the variable annuity comes with an expense that will typically result in higher costs than alternative solutions. Variable annuities are subject to insurance related charges including mortality and expense charges, administrative fees, and the expenses associated with the underlying funds. Moreover, the guarantee withdrawal benefits are optional, available for an additional fee, and are subject to restrictions and limitations. Please keep in mind that variable annuities are designed for long-term retirement investing. While the benefits of the future guaranteed income amounts provide value to a sustainable income plan, it is important for an individual to maintain liquidity in their investments outside of the variable annuity. The fact that guaranteed withdrawal benefits only allow for taking a specific amount of income at a future date creates the need for liquidity. This solution also requires a disciplined approach to future distributions, since withdrawals in excess of the specified amounts can significantly reduce future income amounts. The taxable portion of each annuity distribution is subject to income taxation. Withdrawals of taxable amounts are subject to ordinary income tax and, if taken prior to age 59½, a 10 percent federal tax penalty may apply. Early withdrawals may be subject to withdrawal charges. Variable annuities involve risk, including the possible loss of principal. The contract, when redeemed, may be worth more or less than the total amount invested. More complete information on the investment objectives, risks, charges, and expenses of the variable annuity contract and the underlying investment options is included in the prospectus which should be read and considered carefully before investing. Your financial advisor will provide you with a prospectus.

Single premium immediate annuities (covered earlier in this paper) and the variable annuities with guaranteed income riders are two solutions that can provide guaranteed income, but the most efficient solution to guarantee income is the SPIA. Figure 26 shows that the older the client is, the higher the drawdown rate will be on the SPIA. If we use age 65 as an example, we could provide $8,023 in guaranteed income with a $100,000 SPIA, as compared to placing $160,460 in a variable annuity to guarantee the same amount. While increases in income are available on variable annuity contracts, the potential to have increases is less likely when the client is taking a 5 percent distribution and paying 3 percent in expenses.

Age	SPIA (Life with Refund) $100,000/Male	Drawdown %	Variable Annuity Premium Required at 5%
60	$7,472	8.0%	$149,440
65	$8,023	8.2%	$160,460
70	$8,700	8.7%	$174,000
75	$9,581	9.6%	$191,620
80	$10,627	10.6%	$212,540
85	$11,853	11.9%	$237,060

Figure 26 - Comparison between SPIA and VA Investment by Drawdown

While the similarities between single premium immediate annuities and variable annuities with guaranteed income riders are evident, the role of each is distinct within the Sustainable Income Solutions™ framework. Single premium immediate annuities are considered the most efficient means of

generating *current* guaranteed income, while the value of variable annuities with guaranteed income riders is the *future* guaranteed income provided.

Alternative Investments

Reducing the frequency and severity of negative returns in a portfolio lowers the volatility of investment returns, which can serve to improve the compounding power of a portfolio's returns over time. Historically, individuals utilize diversification amongst traditional asset classes to reduce the severity of investment downturns. For more information on traditional diversification, ask for a copy of 1st Global's white paper, *"Asset Allocation: Your Critical Investment Decision."* However, by diversifying only amongst traditional asset classes, investors run the risk that all of their asset classes will similarly perform during traumatic market periods, thus eliminating much of the expected value of diversification efforts.

Investment allocations to alternative investment strategies, like hedging strategies, in addition to traditional diversification vehicles like fixed income, may benefit investors in varying market conditions because these investments behave differently from traditional investments and may serve to narrow the variation of portfolio returns. By achieving greater diversification, an investor increases the opportunity to minimize the severity of portfolio losses, thereby improving the positive compounding power of their investment returns over time.

Investors who include these alternative investment strategies in their portfolios benefit because of the expected low correlations in their various holdings. Broad diversification, careful asset manager selection and disciplined due diligence help minimize the risk of the investment manager failures that are often highlighted in popular media.

Some of the largest institutions and endowments use alternative investments for their diversification benefits. While these strategies do carry a number of advantages, they also carry with them drawbacks that clients must understand prior to use.

The most significant drawbacks of alternative investment strategies are liquidity and the risk involved in the various strategies used by alternative investment managers. Alternative investments typically carry "lock-up" periods where an individual's investment is unavailable for redemption without a significant penalty. Even after the "lock-up" period is over, redemptions are typically limited to once a quarter with prior notification of up to 90 days. It is because of these liquidity constraints that individuals must make allocations to alternative investment strategies in a prudent manner, considering all cash flow needs and any other liquidity constraints prior to investment.

Growth Solutions

Illustrated earlier, income solutions provide individuals with the opportunity for the certainty of outcome that they demand during retirement. Risk management solutions help clients hedge their wealth against unforeseen events like traumatic market downturns, unexpected "health shocks" or sudden death. While the comfort that income solutions provides to clients is powerful, it is important to remember that this comfort has a cost. With income solutions, individuals exchange lower return levels, and in some cases liquidity, for increased certainty. With risk management solutions, individuals use a hedging technique, which typically involves protecting downside in exchange for upside. Limiting upside growth potential is the typical cost of downside protection. It is important for clients to maintain sufficient growth of their wealth to help control inflation risk, longevity risk and market risk by expecting these costs to be less than the benefit received. It is only through the continued growth of assets that exposure to these risks can be controlled.

Growth solutions include diversified multi-asset-class investment portfolios and private investment opportunities like non-publicly traded real estate solutions. By design, growth solutions help minimize longevity risk, market risk and inflation risk. As retirement life spans continue to increase, the need for growth of assets in excess of inflation will continue to be an imperative. While individuals receive comfort from income solutions, they must augment these solutions with a plan for long-term growth of some assets. Income solutions in isolation are unlikely to keep up with inflation over time. Asset allocation within growth solutions should correspond with the overall goals of the individual and their ability to accept volatility.

Diversified Multi-Asset-Class Investment Portfolios

Despite what you might read or hear from the media, choosing the "best-performing" investments is not the key to achieving long-term success. Unfortunately, too many individuals rely on shortcuts such as star ratings or past performance rankings when developing their plans for investing, only to find themselves disappointed in their choice and chasing the next "best-performing" investment. The most important decision you can make with growth solutions is to define clearly, in writing, your feelings about volatility in these specific assets and work with a trusted retirement advisor to match these feelings to an appropriate portfolio of investments diversified across a mix of asset classes. The allocation of investments among various asset classes is the first step to achieving long-term objectives, which are the foundation for growth solutions in all age bands. By adopting an asset allocation model that matches the unique objectives for these assets, a blueprint is created for future investment decisions, guided by objective criteria that can counter emotional factors like fear and greed.

In 1991, a landmark study of pension plans by Brinson, Singer & Beebower reached a monumental conclusion that asset allocation, not security selection or market timing, was the primary determinant of the variation in portfolio returns. This study reinforces the assertion that asset allocation is far more meaningful to long-term success than either the selection of individual securities or the timing of buys and sells.

All too often during difficult market environments, individuals lose sight of their long-term goals and objectives because of short-term movements in their account value. This issue is even more prevalent among those close to and in retirement. The fear of watching your retirement nest egg dwindle down to nothing, resulting in the inability to ever achieve the retirement lifestyle you and your loved ones have dreamt about for so long, is so overwhelming that it causes emotional decision making. While this decision is likely to give great

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comfort in the short term, the comfort often comes at the expense of a long-term goal or objective. Studies show that individual investors who let emotions drive their decisions generate significantly lower investment returns than the market.

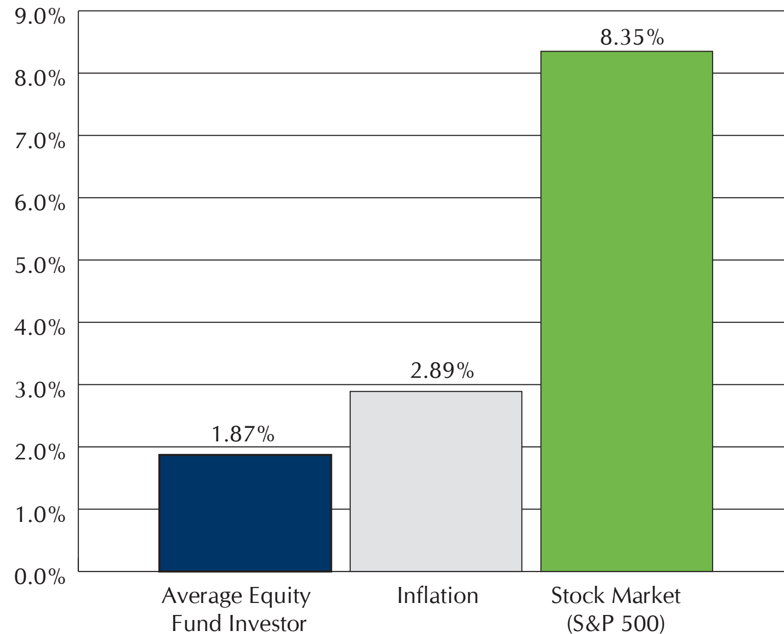

Figure 27 - 20-Year Average Annual Investor Returns as of December 31, 2008[65]

Non-Publicly Traded Real Estate Solutions

Additional growth opportunities exist in the non-publicly traded market with solutions like non-publicly traded real estate solutions. These solutions provide volatility-adjusted growth over time and a predictable ongoing stream of income. This income-producing characteristic makes the solution a great complement to the income solutions previously discussed. Diversified multi-asset-class investment portfolios often incorporate real estate assets, specifically *publicly* traded equity real estate investment trust (REIT) assets. These assets are subject to the volatility of the equity markets, while also providing an exposure to real estate. By using non-publicly traded real estate solutions, clients receive exposure to direct real estate properties in a more concentrated form. These concentrated forms are typically sector-specific (i.e., office, industrial and retail), although some take a "multi-sector" approach which provides for greater diversification. The concentrated nature of these investments carries greater upside potential but also greater risk of loss of principal invested.

65 Source: DALBAR Quantitative Analysis of Investor Behavior 2009. The DALBAR study examined real investor returns from equity and mutual funds from January 1989 through December 2008. DALBAR calculates the returns for the "average equity investor" based on a quantitative analysis of two factors: equity mutual fund flows (the amount of money going into and coming out of mutual funds) and the corresponding equity market performance over similar periods. Inflation is measured by the Consumer Price Index. The stock market is measured by the S&P 500 Index. The S&P 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. An investment cannot be made directly into an index. This chart is shown for illustrative purposes only and is not intended to predict or depict the returns of any particular investment. Past performance does not guarantee future results.

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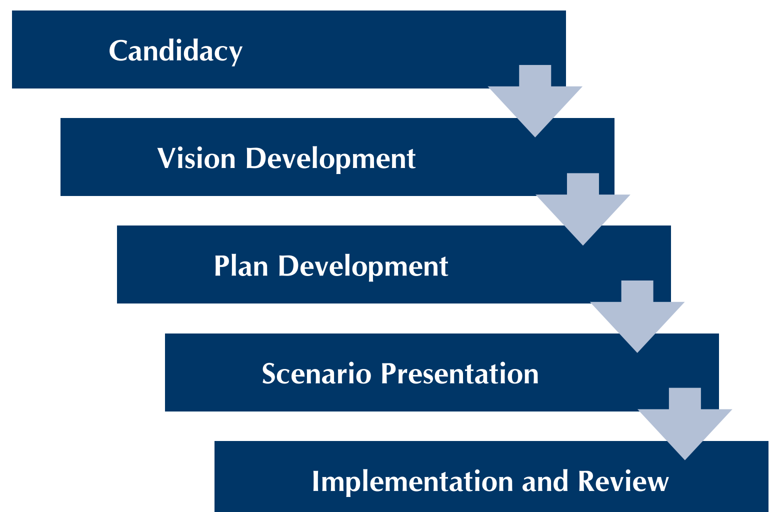
Based on this increased risk factor, it is important to maintain diversification across multiple providers, real estate sectors and programs. Specific providers will offer "programs" or "funds" in which the provider will pool investment capital to acquire properties. Programs and funds offered in different years may do better or worse than those offered in other years. Because of this uncertainty, program or fund diversification is an important consideration. Additional risks include the risk that cash used for operations may cause cash distributions to be deferred or decrease permanently. Also, there is risk that the affiliates of the REIT may be involved in the management of other partnerships with similar investment objectives and may have conflicts of interest in allocating their time in the selection of properties between this REIT and other partnerships with similar objectives that they manage. Finally, REIT investments may be affected by adverse economic and regulatory changes in the real estate market.

Allocations to non-publicly traded real estate strategies are limited based on liquidity constraints and an individual's willingness and ability to accept uncertainty and volatility. Non-publicly traded real estate strategies are illiquid investments and carry significant penalties for redemption prior to the end of the program, which is likely to dramatically alter the expected outcome of the investment. Due to the concentrated nature of many of these programs and the level of uncertainty that brings, individuals with a lower risk tolerance may want to limit their exposure to these strategies. Even those with the ability to accept risk must be aware of the risks carried by these types of investments and adhere to any usage limitations when allocating to non-publicly traded real estate strategies.

1st Global believes that through proper allocation to income solutions and risk management solutions, individuals will have enough comfort and understanding to look past the short-term fluctuations in growth solutions and instead focus on enjoying a retirement with choice.

Putting Sustainable Income Solutions™ to Work

Creating sustainable income is as much about an integrated implementation process as it is about the product solutions used with the plan. As outlined earlier, there are a number of solutions available to create retirement income, but to create sustainable retirement income, one must incorporate an advice-based process. As such, Sustainable Income Solutions™ requires extensive interaction and conversation between an individual and his retirement advisor. This process is deliberately flexible, yet nevertheless provides individuals with the knowledge that they have put plans in place to help ensure that they will be okay in the future. The process of Sustainable Income Solutions™ involves an advice-based framework that includes five broad steps:



While each individual discussion and plan will be different, your individual result will take a series of meetings to complete — typically three to six in-person meetings. On average, this five-step process will take eight to 15 hours to complete, making it critically important that both the individual and his advisor understand their specific role in the Sustainable Income Solutions™ process. Each party must be committed to this course of action to ensure the plan captures what choice means to you in retirement.

Step	Time
Candidacy	1 - 2 Hours
Vision Development	2 - 4 Hours
Plan Development	3 - 5 Hours
Scenario Presentation	1 - 2 Hours
Implementation and Review	1 - 2 Hours
Total Time	**8 - 15 Hours**

Candidacy

Before making a commitment to the Sustainable Income Solutions™ process, you should answer the following questions:

- *"How confident are you today that your income plan will provide adequate income that will allow you and your family to have the choices you envisioned in retirement?"*
- *"Does your income plan incorporate the most current solutions available in tax efficiency, risk management and sustainable income?"*
- *"Do you have a plan to turn your accumulated investments into sustainable income?"*
- *"What does 'cash flow' mean to you?"*

While many individuals feel the anxiety of uncertainty as they approach retirement, not every individual recognizes that the retirement income crisis described in the first half of this paper may affect their lifestyle. To be committed to this five-step process, you must acknowledge the need for guidance, through professional advice, in a direction that will help provide the outcome you desire.

Sustainable Income Solutions™ will not only provide a process for getting the right plan in place, but will also identify the solutions and implementation tools that are needed. Each implementation tool will have a role in creating a complete sustainable income plan. Some tools will fit into income solutions, while others will fit into risk management solutions and growth solutions.

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As an example, every baseball team has three outfielders, four infielders, a catcher and a pitcher. Each player has a specific role. Think what the team's results would be if all of the infielders moved to the outfield. With nearly the entire team out of their role, the outcome would be subject to several risks that would likely lead to the team's losing. The implementation tools of Sustainable Income Solutions™ are no different as each tool plays a specific role.

One critical factor for consideration when implementing a Sustainable Income Solutions™ plan is the use of professional resources for advice. While it is common for individuals to have their wealth divided amongst multiple institutions, providers and even advisors, for many people entering retirement, this begins to change. In fact, a successful Sustainable Income Solutions™ plan requires consolidation of wealth to efficiently administer the coordinated plan. Using multiple advisors to manage your plan increases the likelihood for one advisor, using an overly narrow view, to enact changes that may cause the Sustainable Income Solutions™ plan to be out of tolerance with your original or modified objectives. It is for this reason that the retirement advisor providing the Sustainable Income Solutions™ plan must have influence over all assets that combine to deliver the viable solutions.

Furthermore, acknowledging that a successful Sustainable Income Solutions™ plan requires a particular amount of investable wealth to be able to help ensure that individuals hedge all relevant risks and put in place a comprehensive plan is a necessity. The rule of thumb for realistically implementing a Sustainable Income Solutions™ plan is a $500,000 minimum requirement of investable assets. This is not a hard rule, rather it should serve as a guideline for determining the ability to implement a comprehensive plan which can address two or more risks using two out of the three broad solutions. This does not mean that those with less than $500,000 in investable assets cannot afford to retire; however, at these asset levels, it may mean that the plan looks much narrower in form and may rely more heavily on entitlement programs than Sustainable Income Solutions™ would prescribe.

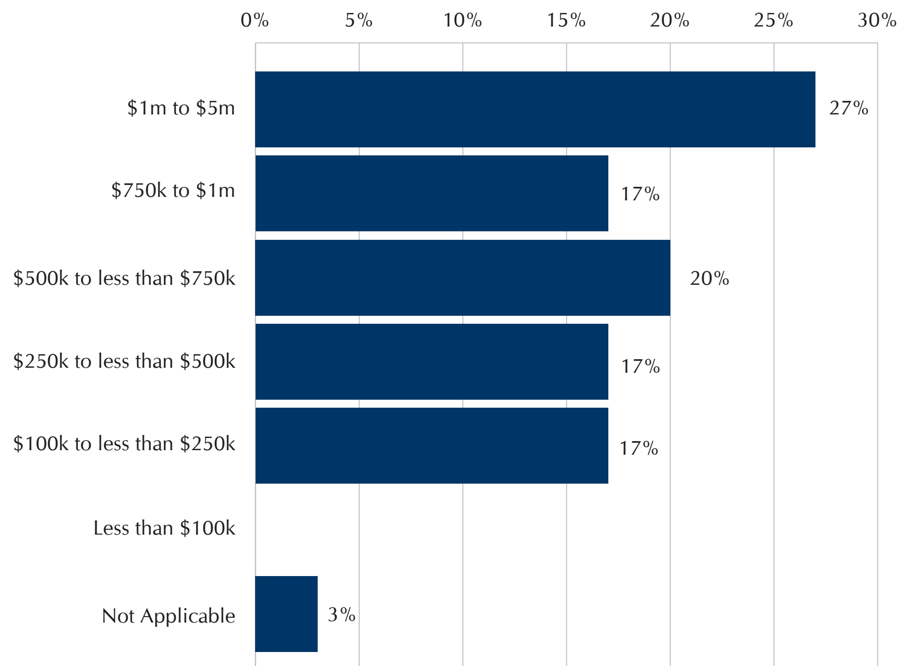

Figure 28 - Best Practitioners: Average Client Investable Assets[66]

66 Advisor Best Practices: Retirement Income & Transition Support by GDC Research & Practical Perspectives

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The risks in this paper affect most of the U.S. population; however, Sustainable Income Solutions™ is an exceptionally engaging process designed for individuals that primarily desire to go through a course of action that will make sure they are "okay." This retirement income problem affects a majority of America, but not every individual wants to commit to communicating his vision of retirement or take the time required to quantify that vision in a budget. Commitment and successful outcomes are inexorably linked. Individuals that are driven to be prepared for the promises they have made to themselves and others are the target of this comprehensive process.

Vision Development

If you were to ask 10 different people what retirement means to them, you would likely receive 10 different answers: continuing to work part-time, starting a second career, going back to school, starting a small business, donating time to charity, traveling the world, enjoying one's hobbies and leisure activities every day, spoiling the grandkids, or sitting on the porch for the next 25 years. Because the goal of Sustainable Income Solutions™ is to provide individuals with choice after the end of their traditional wage-earning years, there cannot be a "one size fits all" retirement income solution. In order to create a meaningful plan for choice throughout retirement, it is imperative to establish a vision of what choice means. This vision is developed when you visualize the positive results of choice and associate them with the powerful feelings of joy, satisfaction and pride. Examples of questions that will help you create a vision of that utopia/ideal retirement include:

- *"What choices will you make with the income you receive in retirement?"*
- *"What would you choose to do on a daily, weekly, monthly and annual basis? How will this change over time?"*
- *"What would it mean to you to have a plan in place that would give you the confidence that you could accomplish all of this?"*

One of the critical considerations in the vision development process is to develop a comprehensive understanding of the eight risks, including how each risk affects you today or could affect you in the future. However, understanding that these risks exist is not enough. While working with a retirement advisor, it is imperative to understand what these risks mean to you, your family and your ability to make choices in life. Without understanding what these risks mean to you, it is impossible to move forward and reasonably implement a Sustainable Income Solutions™ plan. One of the risks that is most likely to be missed, but may be the most critical to discuss, is relationship risk. As discussed earlier, relationship risk is unique in its binary impact, and planning for this risk most often represents an acknowledgement and understanding of its impact should this risk be encountered. While certain legal arrangements with spouses, children or business partners may alleviate some of these risks, both their occurrence and impact remain binary in nature. If you do not discuss relationship risk with your retirement advisor and understand its impact in the vision development process, it is highly probable that you will not discuss it again until it affects your plan for sustainable income.

Once both you and your retirement advisor understand your vision of a utopian retirement, the next step is to begin a plan to turn this vision into action. As challenging as it may be to visualize a utopian retirement, it can be even more challenging to create a spending budget that corresponds with this vision. Merely being told, "You can take 5 percent from your lump sum in retirement," is not an income plan.

The budgeting process of a Sustainable Income Solutions™ plan goes beyond the conversation of a lump sum by creating a process that provides predictability in gauging what an individual will spend in retirement. While obtaining the highest level of predictability is the goal of the budget, individually tailoring the approach ensures reaching this outcome.

Individuals that find an extensive evaluation of their expenses and spending patterns important will use the Sustainable Income Solutions™ Cash Flow Worksheet. This "Bottom→Up" approach gathers detailed information ranging from paid taxes and household-essential expenses to gym membership dues and one-time future expenses, such as a wedding, graduation or second home purchase.

However, not every individual needs this level of detailed budgeting to know that they will have choices in their later years. For this individual, the "Top→Down" budgeting process may be a better fit. This approach is a less exhaustive, high-level approach that uses estimates from the previous year's (or from a number of years) earnings and expenses to determine the necessary amount that should be used for the lifestyle of choice in retirement. Note that regardless of the method chosen, not all expenses are equal. Each individual should answer poignant questions that will help quantify his budget and begin to understand how this budget will change over time. This will not only define where you want to be in five years, but where you want to be in 30 years.

- *"Do you plan on moving or downsizing your primary residence?"*
- *"How will your health insurance premiums change once you retire?"*
- *"Will you spend more on travel and hobbies once you have more time to devote to them?"*

The accuracy of the budgeting process weighs heavily on the success of a Sustainable Income Solutions™ plan, so creating three budgets is an imperative part of the process.

1. "*Must have" budget:* Essential expenses only;
2. "*Important to me/us" budget:* Essential expenses plus income to make the very important discretionary choices envisioned later in life; and
3. "*Would love to" budget:* Essential expenses plus income to make the important discretionary choices as well as some or all of the imagined and hoped-for choices.

An individual and his retirement advisor must discuss the difference between choices in a utopian lifestyle and choices in a minimal lifestyle. The "must have" budget represents the bare minimum to maintain basic choices regarding food, clothing and shelter. It is the foundation of the three budgets since it essentially represents what it will take a client to "be okay" and what income must always be sustainable. While this budget may be far removed from one that represents the "ideal" lifestyle, the "important to me/us" and "would love to" budgets represent the income needed to make important choices that match the picture of a utopian retirement. Sustainable Income Solutions™ is about the power of choice. Often, the second "important to me/us" budget is where important discretionary choices are the only ones made. It is within this budget that the client determines which of their discretionary expenses are the most and least important to their lifestyle. The dream of achieving all of these goals will represent the utopian "would love to" budget and the "important to me/us" budget will reflect the lifestyle that can be achievable.

In addition to creating these budgets, all investment statements, insurance policies, Social Security statements, pension benefits information and future inheritances must be gathered. For this process to function effectively, individuals must provide their retirement advisor with access to all of their invested financial assets and allow this advisor to have influence on these accounts to ensure they fit into Sustainable Income Solutions™.

Unique Considerations for Budgeting Expenses over Time

What worked for previous generations in retirement will not work for an individual today due to changing spending patterns associated with increasing longevity. Understanding that these annual budgets do not increase or decrease in a linear fashion is an important part of the process that leads to the desired results of an income plan. In figure 29, the S-curve of expenses represents the typical retirement today.

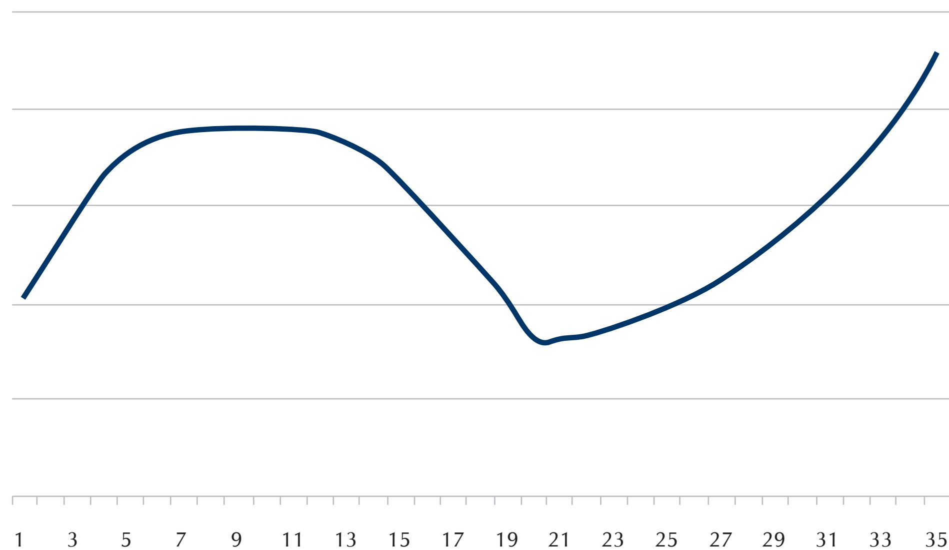

Figure 29 - Hypothetical Chart of the Change in Expenses (Years from Retirement)

Individuals will typically spend more of their funds in the early years of retirement while they have peak health, excitement and activity. As individuals begin to experience their vision of retirement, their spending will level off and slowly decline to a normalized or consistent level. After a number of years, however, this spending will rise again as the share of expenditures devoted to health care costs increases for mature retirees.

Because expenses change dynamically over time, individuals must closely examine their long-term spending plans. Specifically, individuals must work to determine and subsequently monitor an appropriate drawdown rate that will meet their needs and avoid risk. Drawdown rates are typically measured as an annual percentage rate and are calculated as the annual income need divided by total available assets. As outlined earlier, the drawdown rate plays a major role in determining how susceptible your plan is to longevity risk. While the initial determination of a drawdown rate is important, monitoring that rate and making adjustments over time, as needed, will be necessary to ensure the longevity of the plan.

Drawdown rates are commonly expressed in one of three forms:

1. Fixed dollar
2. Annual percentage
3. Annual percentage with a smoothing factor

Fixed-dollar drawdown rates are just as the name implies, a fixed dollar amount is planned for (usually expressed on an annual basis like a salary) and withdrawn from the portfolio on a regular basis (like a paycheck). While this method is simple to understand and implement, it can be harmful to the longevity of income depending on the amount of growth that occurs within the total account. While taking $50,000 per year from a $1 million account seems realistic, taking that same $50,000 from an account that has just decreased in value to $600,000 is very different when measured in relative terms (5 percent withdrawal versus an 8.3 percent withdrawal). To address the need to maintain a drawdown rate that adjusts with the fluctuation in market value, the annual percentage method is often used.

Under an annual percentage method, an initial drawdown percentage is set, for example at 5 percent. In this example, a portfolio valued at $1 million would offer a $50,000 drawdown. However, when we assume the same 40 percent decrease in market value ($600,000 value), this 5 percent drawdown rate would only provide $30,000 in income. Individuals often utilize an annual upward adjustment to their annual drawdown rate to ensure income drawn keeps up with inflation over time. This method acts like a dynamic budget, providing less when account values are down and providing more when account values are up. While providing more when values are up and providing less when values are down seems to make sense, it may result in large fluctuations in income from year to year depending on the swings in account value due to market movements.

Large educational endowments, who strive to provide stable, inflation-adjusted income, incorporate a smoothing factor to the annual percentage method. The annual percentage with a smoothing factor method is broken into two calculations. First, an initial annual percentage drawdown rate, as in the method above, is established. Again we will use 5 percent as an example. In the first year, the account provides $50,000. To calculate income for the next year, take 80 percent of the previous year's income (adjusted for inflation), in this case 80 percent times $50,000 (inflated income), and add to it 20 percent of the previous year-end's portfolio value multiplied by the initial drawdown rate (prior year-end value * .05 * .20). By only adjusting the income offered each period by 20 percent of the prior account value (rather than 100 percent as per the annual percentage method) and taking 80 percent of the prior year's income as the rest, income is not subject to the large changes that may occur by only using the annual percentage method. The smoothing factor results in more stable income over time. This can also provide for more efficient compounding of returns and result in greater ending wealth.

Figure 30, on the next page, illustrates the difference in the volatility of income between the annual percentage method and the annual percentage with smoothing factor method over a 25-year period from 1984 to 2008.

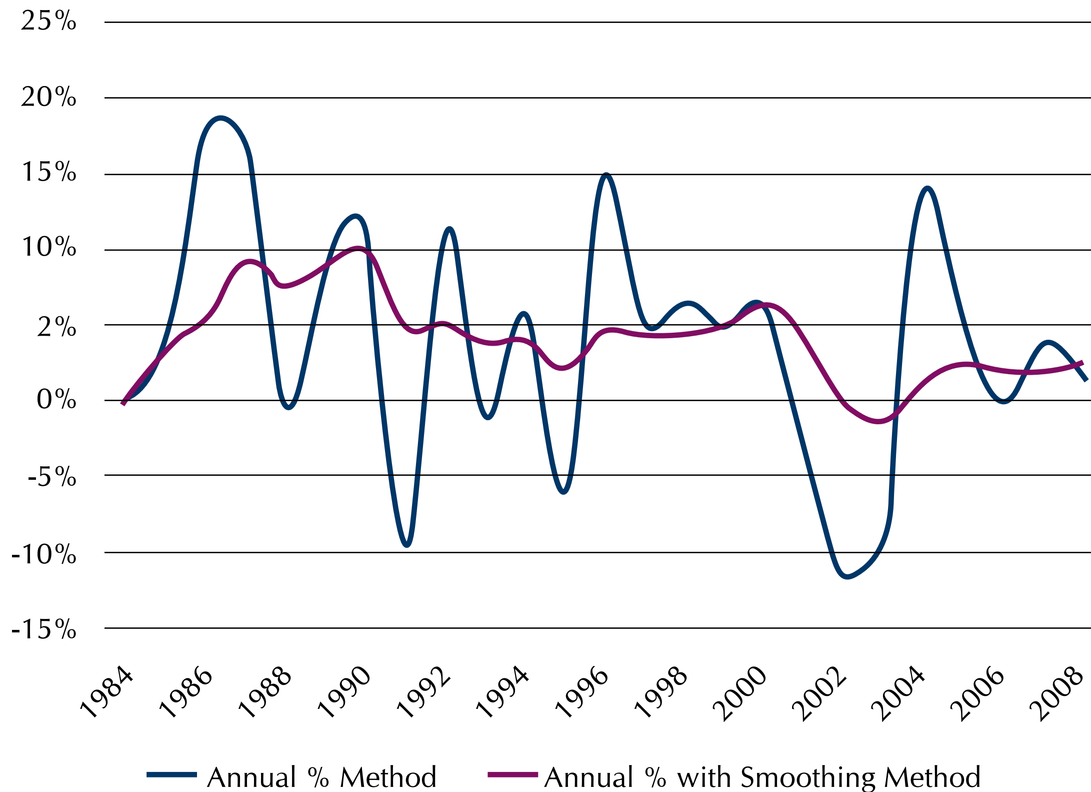

Figure 30 - Hypothetical Change in Annual Income: Annual Percentage Method vs. Annual Percentage Method with Smoothing Factor

"There is nothing wrong with change, if it is in the right direction."

-- Winston Churchill

By design, Sustainable Income Solutions™ endeavors to provide income for 30 years or more. It will provide solutions to hedge the risks that would have had the greatest impact on an individual's plan, but during this process, it is appropriate to expect the unexpected and to accept that necessary changes will need to occur. While an individual cannot control the capital markets, he does have the choice to control his retirement plan. The implementation/review process will address the choices that individuals must consider when large market declines or increases affect their Sustainable Income Solutions™ plan. For example, take the 30 percent capital markets decline that was experienced at the end of 2008. Your retirement advisor would test the sustainability of your plan and may provide the following choices:

- Modifying spending goals
- Reducing drawdown rate
- Consider working longer or the need for a part-time job
- Changes in the allocation of your Sustainable Income Solutions™ plan
- Staying the course

While each choice comes with a discussion of trade-off, the power of choice will always be the backbone of Sustainable Income Solutions™.

Identifying Risks

The first step towards solving the retirement income crisis is identifying the problem. As we discussed in chapter three, all individuals are subject to risks, such as longevity risk, inflation risk, market risk and confiscation risk, and it is essential to recognize how these specific risks can affect each person's Sustainable Income Solutions™ plan. Sustainable Income Solutions™ cannot be a rigid and pre-defined process, as each individual faces different levels of these risks. 1st Global's Sustainable Income Solutions™ will help determine which risks impact individuals and subsequently address the risks that have the largest impact on sustaining income for life. The accuracy of a completed expense budget is crucial, since the information gathered will play a significant role in determining the risks that an individual must address, as well as the solutions, strategies and implementation tools that may help hedge those risks.

Plan Development

As previously stated, 1st Global believes Sustainable Income Solutions™ plans must be built based on three guiding principles:

1. Individuals want a safe, stable and certain flow of income in retirement;
2. Retirement life spans are increasing; therefore, inflation will eventually erode the purchasing power of any income. Individuals must continue to grow a portion of their wealth to ensure their income keeps up with inflation; and
3. Individuals make emotional decisions that are not rational. Emotions often challenge the fortitude of individuals and cause improper alterations to long-term plans, which increase the probability of damage.

These three principles address the combination of *outcome-based* solutions, a combination of income solutions, risk management solutions and growth solutions that will help individuals address three basic ongoing needs:

- Short-term needs
- Intermediate-term needs
- Long-term needs

Short-Term Needs

Short-term needs include the ongoing generation of income. The income solutions category, comprised of cash-flow-matching bond strategies, single premium immediate annuities (SPIAs) and cash reserves, facilitates the generation of income.

The basis for combining these three solutions is an individual's drawdown rate, age and ability to accept uncertainty or volatility. Establishing a realistic drawdown rate is a critical exercise because it is a major factor

in avoiding longevity risk. Realistic drawdown rates are imperative to Sustainable Income Solutions™. You must establish a realistic drawdown rate after accounting for income received from entitlement assets, like Social Security and pension benefits, *to the degree that you expect them to be available to you*. While there is no "right" answer regarding a sustainable drawdown rate, consensus opinions indicate that a maximum drawdown should be between 4 and 5 percent. Anything more than a 5 percent drawdown rate will increase the uncertainty of having enough income for life. Formulating the right drawdown rate for an individual will help determine the mix between cash-flow-matching bond strategies and other income solutions. For example, it is best to address a drawdown rate greater than 5 percent with a SPIA due to the higher guaranteed income amounts, while a cash–flow-matching bond strategy may be more appropriate for a drawdown rate of 3 percent or less.

An individual's age will provide a realistic estimate of where he falls in the retirement life cycle. A 45-year old individual will fall into the long-term pre-retiree age band and have very different needs and circumstances than a 68-year-old individual who falls into the retiree age band. Where an individual falls within the five age bands provides an initial look at the retirement risks to which individuals are generally subject. For younger individuals, the emphasis is still very much on growing their assets in preparation for retirement; however, as they move closer to retirement, issues such as sequence of returns risk have the potential to disrupt a significant amount of the progress made over the years. Instead of bearing this risk, an individual can incorporate risk management solutions as part of their personalized plan. As we age, income solutions become our highest priority. Allocations to growth and risk management solutions continue to decrease in favor of providing ongoing sustainable sources of income. Regardless of age, there will rarely be a case where one of the three solutions will not be necessary. This complete framework provides the flexibility to address the needs of individuals of all ages to ensure no one has to compromise their need for choice in retirement.

The ability to accept uncertainty and volatility is also an important factor in determining the use of strategies within income solutions, specifically cash reserves. Even though there is a high degree of certainty and safety associated with cash-flow-matching bond strategies and SPIAs, they still hold an element of uncertainty. Holding up to three years of income in cash reserves can provide an added measure of certainty for individuals that are more conservative. For individuals that are more aggressive, holding too much in cash reserves means that less wealth is at work in risk management solutions, growth solutions or both. These individuals may choose to maximize risk management solutions, growth solutions or both at the expense of cash reserves.

Intermediate-Term Needs

Intermediate-term needs are those that bridge the gap between income generation and growth of assets. By design, intermediate-term needs mitigate the risks that cause individuals to alter their long-term plans. Growth solutions are necessary to increase enough wealth to provide income that keeps up with rising inflation. Risk management solutions, which are comprised of life insurance, long-term care insurance, principal-protected investments, variable annuities with guaranteed withdrawal benefits and alternative investments facilitate intermediate-term needs. Individuals allocate to strategies within risk management solutions based on their age, ability to afford risk management and feelings about uncertainty.

In broad terms, risk management solutions help ensure that unexpected events do not irreparably erode wealth, resulting in a forced alteration of a planned retirement. If individuals do not plan for and hedge against these risks,

events like unexpected health shocks, dramatic market downturns and sudden death can all result in a devastating depletion in retirement assets.

For younger individuals, risk management is often about ensuring that loved ones will not have to compromise their plans due to a sudden death. Replacing lost income is an important consideration that individuals address through life insurance solutions. As individuals get closer to retirement, risk factors, like sequence of returns risk, become more impactful. Uses of low-correlating solutions, such as principal-protected investments, alternative investments and variable annuities with guaranteed withdrawal benefits, help to ensure an unforeseen market downturn does not dramatically alter comprehensive planning. As we age, the need for long-term care insurance rises. For individuals in their 50s to early 60s, long-term care consideration is critical, as the cost of insurance begins to rise for these age groups. In order to hedge this risk, now is the time to address the need for long-term care or life insurance solutions as waiting may raise the future costs of these plans to the point of prohibition. As we age, income solutions become even more important, and for this reason, liquid assets in risk management solutions may eventually move to income solutions.

The ability to accept uncertainty and volatility is also important in determining the allocation among strategies within risk management solutions. Those who are unable to accept uncertainty may not be appropriate candidates for certain risk management solutions strategies, specifically principal-protected investments and alternative investments, whose outcomes, while *expected*, are not *guaranteed.*

Long-Term Needs

The necessity to grow wealth at rates that exceed inflation characterizes long-term needs. Later in life, individuals will shift this wealth to income or risk management solutions to ensure they generate sufficient income in the "dollars of the day" (think back to the stamp example). Growth solutions, which utilize multi-asset-class diversified portfolios and non-publicly traded solutions like real estate strategies, address long-term needs. An individual's age and their willingness to accept uncertainty and volatility is generally the basis for the level of use of growth solutions strategies.

The purpose and object of growth solutions are to grow assets beyond inflation for the purpose of future inflation-adjusted income. To achieve this objective, the allocation between stocks and bonds should help ensure that growth over time occurs well in excess of inflation. It is important for individuals to think narrowly about the purpose of growth solutions, and incorporate this knowledge into a determination of the amount of uncertainty and volatility that they can accommodate, knowing that they also have income solutions and risk management solutions in place. The composition of multi-asset-class diversified portfolios will be determined largely by an individual's risk profile, *only as it pertains to growth solutions*. Allocations to non-traded strategies will depend on an individual's additional income needs and ability to accept liquidity constraints. While these solutions can provide supplemental income, this occurs at the cost of liquidity, as non-traded strategies are typically illiquid for a number of years.

While an allocation to growth solutions is appropriate for all client segments, the amount of assets dedicated to growth solutions transitions over time. For younger individuals, the use of growth solutions is very high. Once the need for income arises, the use of growth solutions decreases to help facilitate the increasing need for risk

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management solutions and income solutions. As time progresses, use of growth solutions continue to decline to further supplement income solutions with inflation-adjusted assets. This transition is performed in an effort to make sure that income levels will keep up with inflation over time, ensuring the availability of choice in retirement is never compromised.

Scenario Presentation

Sustainable Income Solutions™ is a process that reduces the uncertainty surrounding sustainable income. Retirement advisors deploy this process through customized solutions that provide income, growth and risk management. It is within this process that retirement advisors present and discuss an assessment of risk, including the solutions that are best able to hedge these risks. This presentation and conversation must also describe the trade-offs that are associated with deploying these solutions. When presented with this assessment of risk, it is important to note that not everyone will be concerned with the identified risks. However, it is reasonable to assume that individuals will want to understand how not addressing these risks will affect their income plan. Sustainable Income Solutions™ provides the flexibility to make adjustments to hedge the risks that are the most important to the individual *at that particular time*. Later in this paper, we will illustrate a simple case study of a 65-year-old client looking for the greatest amount of certainty, as well as two other objectives. In this example, the Sustainable Income Solutions™ process provides a solution to generate the amount of certainty that the client was looking for, but this certainty came with trade-offs, specifically limited growth and low liquidity. During the scenario presentation, retirement advisors must carefully explain the trade-offs inherent in all solutions, strategies and implementation tools used, and make any adjustments that are the most important to the client.

Implementation/Review

Any plan is only as good as the information and assumptions that go into it. Over time, the assumptions and information used to build a solid plan are bound to change. As such, the plan must be revisited and consideration given to adjustment. This process is not unique to Sustainable Income Solutions™. While the frequency of review should be set based on preferences agreed upon by individuals and their retirement advisors, we believe advisors and individuals must review Sustainable Income Solutions™ plans at least once a year, at a minimum. We also strongly suggest that periodic interactions take place throughout the year to ensure no significant developments have occurred that would result in cause for a change in the plan.

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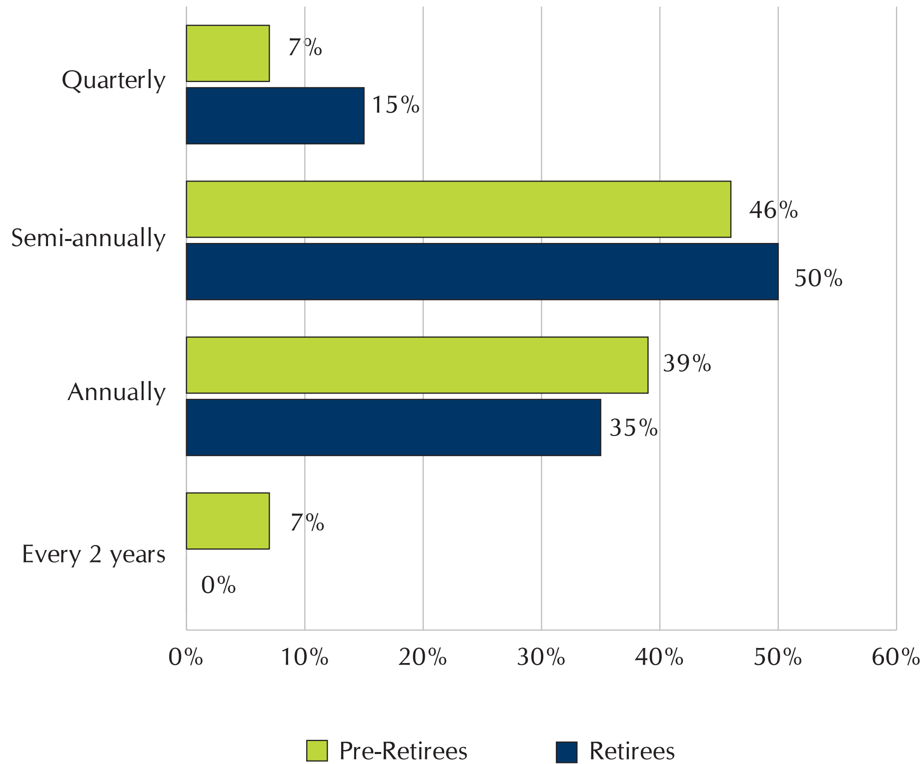

Figure 31 - Frequency of Meeting with Clients[67]

Each of the solutions utilizes strategies that are dependent on changes in the capital markets, and as such will increase and decrease in value over time. The increasing and decreasing value of these assets over time will cause the allocation between the various solutions and strategies to change. While being conscious of these changes is important, depending on the circumstances, it may not warrant immediate action. It is always important to revisit the role that each solution set plays within the overall Sustainable Income Solutions™ plan.

As Sustainable Income Solutions™ plans provide for an individual's ongoing income needs after the end of his traditional wage-earning years, and as the values of the individual solutions change, a question that must be continuously considered is, "Does the plan still provide the necessary income required?" If so, immediate action is not necessary. However, if not and the plan can no longer sustain the desired cash flow outcome, immediate action is necessary. Individuals can only solve the problem in two ways: move assets from risk management and growth solutions to income solutions, or reduce their budget to achieve the targeted cash flow. Income solutions are the highest priority of the three solution types in Sustainable Income Solutions™, specifically maintaining the integrity of income solutions put into place. While increasing income is one of the logical solutions, individuals must remain realistic about the size of the income distributions they desire. As mentioned earlier, a drawdown larger than 5 percent may be detrimental to the sustainability of income. Individuals who are looking for greater income may need to consider other means of securing it, by delaying retirement or working part-time for supplemental income in retirement.

67 Advisor Best Practices: Retirement Income & Transition Support by GDC Research & Practical Perspectives

The key questions that must be asked and answered in any review meeting are:

- *"Have your income needs changed?"*
- *"Has your ability to accept uncertainty or volatility changed?"*
- *"How do you feel about the choices you are able to make today? Would you like them to be different?"*

Ongoing review of a Sustainable Income Solutions™ plan plays a critical role in ensuring that an individual does not compromise the retirement lifestyle for which he originally planned.

One of the most significant benefits of 1st Global's Sustainable Income Solutions™ is the ability to formulate a different solution for individuals in all age bands, including those still working toward retirement. Sustainable Income Solutions™ allows an individual and his retirement advisor to transition his wealth as he ages toward and through retirement.

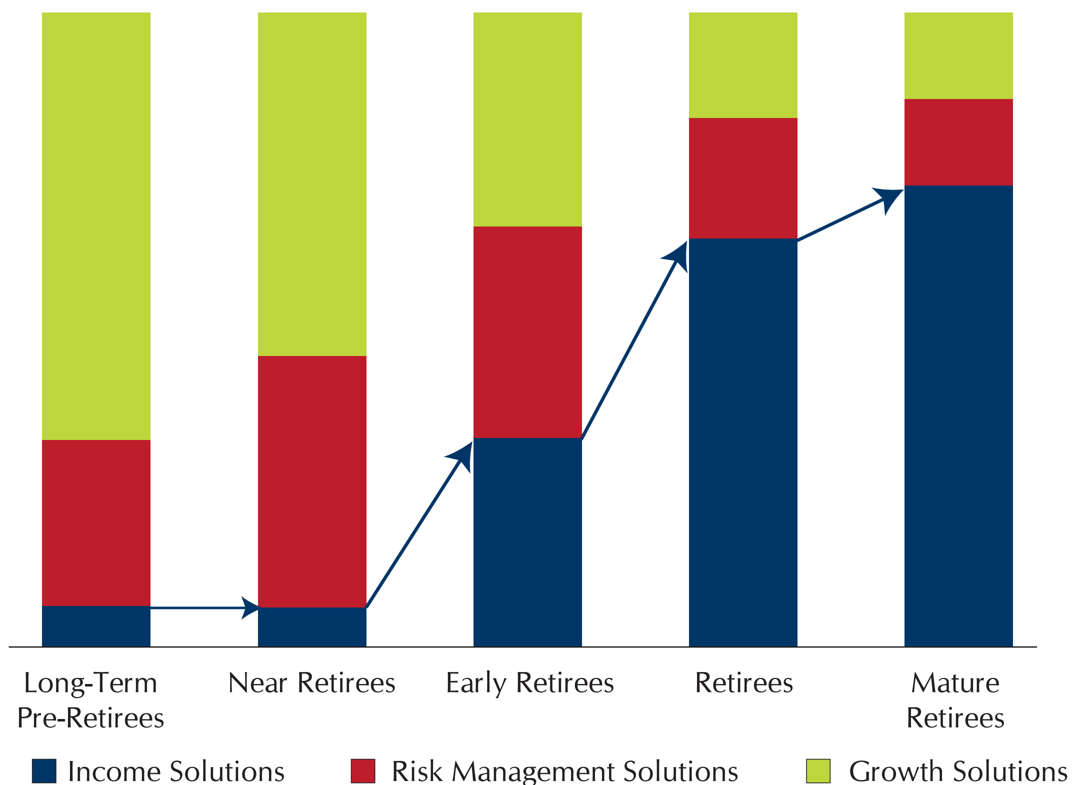

Figure 32 – An Example of the Evolving Use of Sustainable Income Solutions™ Over Time

As illustrated in figure 32, growth solutions, which are imperative to controlling longevity risk, market risk and inflation risk, are anticipated to make up a very large part of the allocations for long-term pre-retirees and near retirees, as these individuals are typically still in their wage earning years and do not yet have a sufficient need for income solutions. The wealth appreciation offered by growth solutions will help ensure progress toward a pool of retirement assets that will ensure the availability of choice in retirement. This allocation of solutions is not significantly different from what most individuals have done during the accumulation phase of their lives; however, the biggest difference is the emerging emphasis placed on risk management for both today and the future.

Of particular note for long-term pre-retirees is the importance placed on maintaining adequate exposure, to both growth and risk management solutions, to help ensure sufficient inflation-adjusted income over the long term as well as income replacement in the event of a sudden death.

As individuals move closer to retirement and enter the near and early retiree stages, risk management solutions become a larger portion of their allocation amongst the three solutions, accounting for the rise in sequence of returns risk and asset allocation risk. The increase in use of risk management solutions helps to not only protect against unforeseen market downturns but also provides the emotional reassurance necessary for proper asset allocation.

For early retirees, income solutions also increase in use as they help to address the "gap period" for those who retire prior to taking Social Security benefits. Income solutions also make up any short fall for those who take Social Security benefits before full retirement age and receive less in benefits. While increases in income solutions and risk management solutions are important and prudent, sufficient exposure to growth solutions remains important. Near retirees and early retirees are still young and need growth in excess of inflation to help control longevity risk and inflation risk. Risk management solutions will also evolve with an individual, as there is a shift to insurance-related solutions like long-term care and greater amounts of life insurance at the expense of non-correlating solutions. This increase in life insurance has more to do with early estate planning preparation than the need for income replacement in the event of a sudden death.

As individuals become retired and progress further into mature retirement, income solutions continue to increase in use and reduce both risk management solutions and growth solutions. The rationale for this shift is that, as an individual's time horizon continues to decrease, their susceptibility to risks like longevity risk, market risk and inflation risk begin to decrease. The need for growth solutions and risk management solutions never disappear completely, but the use of these solutions is anticipated to shift with an individual's movement through the retirement life cycle.

Figure 32 illustrates both the importance and migration of each of the three solutions groups. This chart does not prescribe specific allocations among solutions, as the individual solutions are much more personal and complex. The allocations to the various solutions groups, as well as to the strategies within the various solutions groups, are tailored to each client individually. A personal allocation to these solutions based on objective criteria is obtained through the vision development process that occurs at the beginning of putting each of these solutions to work and is refined through review meetings and guidance on a continual basis for life.

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Chapter VI: Case Studies

Case Studies in Implementation

This paper has continued to highlight that the process for creating income to allow choice in retirement is very personalized and individual. Because of the unique nature of each plan, Sustainable Income Solutions™ must be tailored to the needs of the individual. While customization is critical, it is important to understand how 1st Global's Sustainable Income Solutions™ translates into implementation.

Without a comprehensive vision development process, individuals and their retirement advisors cannot accurately put a Sustainable Income Solutions™ plan in place. To highlight further the importance of a comprehensive vision development process, we will display the challenging complexity of creating individualized solutions by the following simple question:

What is the right solution for a 65-year-old retired couple with $1 million in retirement assets, who need $40,000 per year after tax from their retirement assets, adjusted 5 percent for inflation, and will live for 30 years?

This question is kept as basic as possible to highlight the complexities that accompany even a simple scenario. The question assumes that the couple and their advisor have already assessed entitlement income and risk, and other decisions relevant to retirement. They have concluded that honoring their complete retirement vision will only be possible with the promise of the stated $40,000. Undoubtedly, each individual will have highly precise and complex needs that will dramatically affect the type and range of solutions, strategies and implementation tools used. Thus, tremendous accuracy is imperative when discovering what is important about the future, the state of existing plans and feelings surrounding the need for certainty.

While each of the three answers below will solve this couple's problem, there are dramatic differences in the certainty and liquidity of each. This exercise is designed to help individuals understand the trade-offs among the different options and choose which one makes them feel most comfortable.

To develop answers to the question posed in the case study above, we divided our solutions to address three individual feelings toward the need for certainty. The illustration of these options helps portray the difficulty in identifying a single solution that will solve all income planning needs. In reality, there are an infinite number of answers to the question above, but each answer carries certain trade-offs. To answer the stated question, we divided our solutions into three categories, each representing client feelings:

- High degree of certainty of the outcome
- Average degree of certainty of the outcome
- Lower degree of certainty of the outcome

Answer #1 – High Degree of Certainty of the Outcome

Without any point of comparison, it seems clear that individuals would prefer solutions with a high degree of certainty to those with a lower degree of certainty. However, the point of comparison is critically important, as individuals must consider the trade-offs associated with obtaining higher levels of certainty. Certainty comes at a price, and clients who believe they need a high degree of certainty must weigh that need against the inevitable costs associated with achieving it.

The best way to provide certainty of an income stream is to find an individual or provider who will guarantee the payment of that income stream. As discussed earlier, the most *efficient* means of generating guaranteed income is with a single premium immediate annuity (SPIA). Operating under the assumption that our 65-year-old couple wants $40,000 a year, guaranteed for the rest of their lives, and that they seek certainty at any cost, they would use 64.5 percent of their assets to purchase a SPIA based on real terms available in April 2009. As $645,000 is allocated to income solutions through the SPIA, the remaining $355,000 is allocated to growth solutions in order to offset rising inflation, which we cannot account for in the income generated by the SPIA. The growth solutions segment uses a "moderate" risk profile, which is likely riskier than a typical 65-year-old might choose if they looked at their wealth holistically, but is a reasonable risk level when the guaranteed income from the SPIA is taken into consideration. In conjunction with the income solutions segment, this growth solutions portfolio resulted in the following allocation:

Higher Income Certainty				
Income Solution (64.5%)	Risk Management Solution (0%)	Growth Solution (35.5%)		
SPIA 64.5%	0%	Fixed Income 14.2%	Small Cap 3.5%	Real Estate 1.8%
		Large Cap 8.9%	International 5.3%	Commodities 1.8%

The fixed income allocation is represented by the BarCap Aggregate Bond Treasury Total Return Index (USD), the large cap allocation is represented by the S&P 500 Total Return Index (USD), the small cap allocation is represented by the Russell 2000 Total Return Index (USD), the International allocation is represented by the MSCI EAFE Total Return Index (USD), the real estate allocation is represented by the DJ Wilshire REIT Total Return Index (USD) and the commodities allocation is represented by the S&P GSCI Total Return Index (USD). These are unmanaged indexes of stocks and bonds with dividends reinvested. An investment cannot be made directly in an index. Past performance is no guarantee of future results.
International investing presents certain risks not associated with investing solely in the United States. These include, for instance, risks relating to fluctuations in the value of the U.S. dollar relative to the values of other currencies, custody arrangements made for foreign holdings, political risks, differences in accounting procedures and the lesser degree of public information required to be provided by non-U.S. companies. Investing in a single-region or single-sector fund involves greater risk than investing in a more diversified fund. Investing in micro, small or mid-sized companies involves risks not associated with investing in more established companies. Since equity securities of small companies may not be traded as often as equity securities of larger, more established companies, it may be difficult or impossible for the fund to sell.

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Assuming a starting point of January 1, 1979 (to obtain real data on inflation and returns over 30 years), the growth solutions segment would grow from $355,000 to just over $616,840 by the end of February 2009.

The appreciation of the growth solutions segment assumes an individual is paying 1.5 percent annually for investment advice. To supplement the income from the SPIA, this solution uses a 3 percent annual drawdown rate from the growth solutions segment that is adjusted for inflation each year at 3 percent. Over the 30-year period ending December 2008, this solution, when combined with the $40,126.50 annual income from the SPIA, was able to meet or exceed the required, inflation-adjusted income need of the couple every year except for the last seven years. While there was sufficient principal available to make up the shortfall in all of these years, it would have resulted in a decision by the couple to either dip into other available assets or alter their cash flow need.

Figure 33 illustrates annual income generation by solution, relative to the income benchmark of $40,000 after tax, adjusted for inflation along with total liquid asset growth over the 30-year period. The $40,162.50 in the income solutions column represents real SPIA terms for a joint-life SPIA for a 65-year-old couple in April 2009. Furthermore, this income is after-tax, as the pre-tax annual income from this SPIA was $45,000 and is presented based on a 57 percent exclusion ratio.

Year	Income Solutions Income	Growth Solutions Income	Total Income	Growth Solutions Year End Value	Inflation Adjusted Cash Flow Need	Total Liquid Assets
Start						$1,000,000
1979	$40,163	$11,184	$51,347	$377,522	$40,000	$377,522
1980	$40,163	$12,767	$52,930	$431,651	$42,000	$431,651
1981	$40,163	$14,836	$54,999	$419,233	$44,100	$419,233
1982	$40,163	$15,215	$55,378	$478,390	$46,305	$478,390
1983	$40,163	$19,671	$59,834	$532,930	$48,620	$532,930
1984	$40,163	$20,686	$60,849	$548,951	$51,051	$548,951
1985	$40,163	$25,466	$65,629	$666,686	$53,604	$666,686
1986	$40,163	$32,724	$72,887	$773,657	$56,284	$773,657
1987	$40,163	$40,268	$80,431	$769,388	$59,098	$769,388
1988	$40,163	$43,317	$83,480	$833,542	$62,053	$833,542
1989	$40,163	$45,168	$85,331	$927,461	$65,156	$927,461
1990	$40,163	$47,198	$87,361	$844,093	$68,414	$844,093
1991	$40,163	$49,278	$89,441	$952,291	$71,834	$952,291
1992	$40,163	$54,079	$94,242	$935,283	$75,426	$935,283
1993	$40,163	$58,479	$98,642	$986,753	$79,197	$986,753
1994	$40,163	$56,726	$96,889	$918,398	$83,157	$918,398
1995	$40,163	$60,476	$100,639	$1,045,022	$87,315	$1,045,022
1996	$40,163	$64,613	$104,776	$1,093,162	$91,681	$1,093,162
1997	$40,163	$74,071	$114,234	$1,158,714	$96,265	$1,158,714
1998	$40,163	$81,736	$121,899	$1,186,311	$101,078	$1,186,311
1999	$40,163	$85,988	$126,151	$1,220,853	$106,132	$1,220,853
2000	$40,163	$88,650	$128,813	$1,170,272	$111,439	$1,170,272
2001	$40,163	$83,242	$123,405	$1,022,605	$117,010	$1,022,605
2002	$40,163	$76,031	$116,194	$899,200	$122,861	$899,200
2003	$40,163	$73,894	$114,057	$992,313	$129,004	$992,313
2004	$40,163	$79,239	$119,402	$1,004,990	$135,454	$1,004,990
2005	$40,163	$81,282	$121,445	$972,187	$142,227	$972,187
2006	$40,163	$77,752	$117,915	$989,246	$149,338	$989,246
2007	$40,163	$80,523	$120,686	$962,996	$156,805	$962,996
2008	$40,163	$78,476	$118,639	$713,039	$164,645	$713,039
2009				$616,840		$616,840

Figure 33 – High Degree of Certainty: After-Tax Income by Solution Source Including Growth Solutions Year-End Account Values and Total Liquid Assets

All data illustrated above is after taxes, based on a 25 percent ordinary income tax rate and a 15 percent long-term capital gain tax rate. Past performance is no guarantee of future results.

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As previously mentioned, tax liabilities can dramatically affect the viability of a Sustainable Income Solutions™ plan. To illustrate this point in the context of this case, figure 34 illustrates the percentage of liquid wealth lost each year to taxes. While the individual annual percentages may seem small, the total wealth lost to taxes over the 30-year period is $473,063.

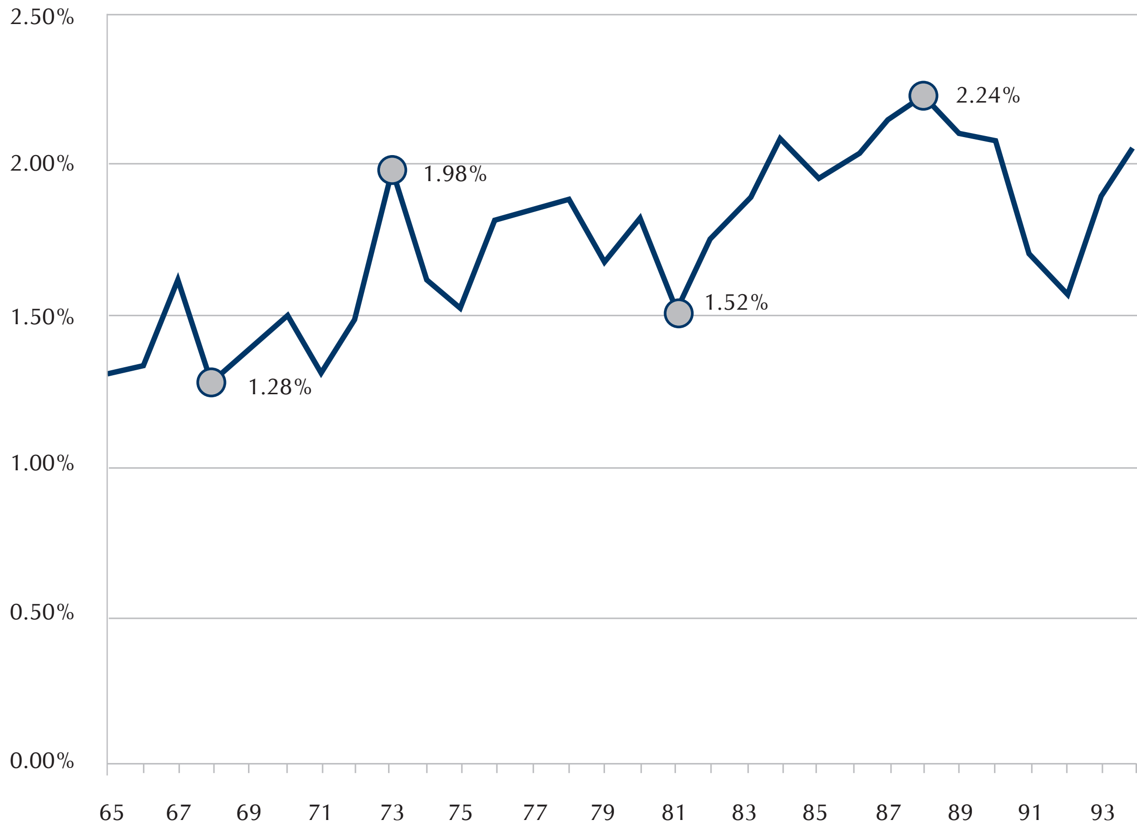

Figure 34 - Wealth Lost to Taxes each Year: Answer #1

The significant tax impact in this scenario attributes to the allocation of wealth between assets subject to ordinary income tax and assets subject to capital gain tax. Because 64.5 percent of the initial implementation is in a SPIA, it is subject to ordinary income tax rates (net of the exclusion ratio) and contributes to the low tax efficiency (relative to the other answers) of a high need for certainty.

Figure 35 demonstrates the temporary impact in the loss of liquidity for Answer #1. This chart shows the value of liquid assets (growth solutions only) compared with the theoretical value of all assets calculated as growth solutions plus the amount paid into the SPIA, minus the amount paid out of the SPIA, until the SPIA is paid out in its entirety. Note that this theoretical account value is not the "marketable" value of the SPIA as the SPIA is an irrevocable contract and has no market value and cannot be sold or given back to the issuer in return for payment.

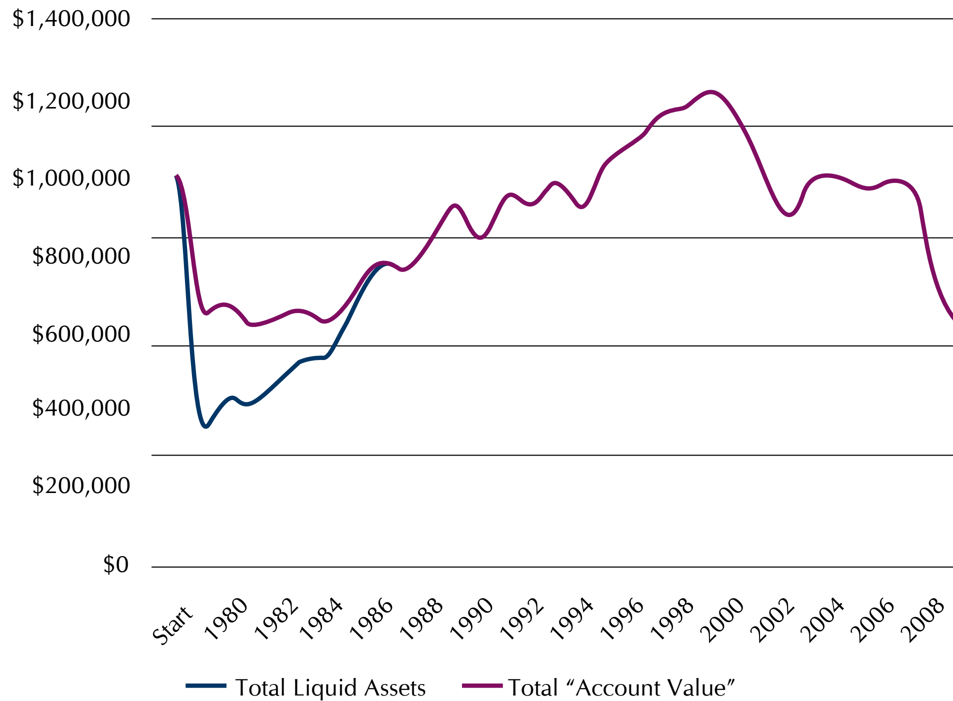

Figure 35 - Liquid Assets: Answer #1 (High Degree of Certainty)

Trade-Offs

Despite the success of this scenario, it does have its price, specifically losing control of over 64.5 percent of investable assets by placing them into an irrevocable contract (SPIA). Would the couple be willing to give up control of 64.5 percent of their investable assets in exchange for a high degree of certainty? By losing this control over liquid assets, the couple may be exposed to significant risks if an unexpected drawdown, like a "health shock," was to occur and they are not insured (as in this scenario). Additionally, by design, the SPIA does not provide any kind of growth over time; its purpose is only to pay a fixed amount of income over time. In this scenario, tying up 64.5 percent of the couple's money in a depleting asset limits the overall growth of their investable assets. This limiting factor undoubtedly played a role in the income shortfalls of the last seven years in this scenario.

Answer #2 – Average Degree of Certainty of the Outcome

Individuals who need comfort in the form of a guarantee, but seek to maintain greater control over their assets and achieve greater potential for asset growth, may still choose to use a SPIA as an income solution in smaller measure.

Our second case assumes that the same 65-year-old couple is looking for $40,000 per year after tax, adjusted for inflation. In this case, we pare back the amount of income generated by the SPIA by half to $19,293, which costs only $325,000 to guarantee for life. This method provides 50 percent of the stated income need *before inflation*. Allocating the remaining $675,000 in assets to the other two solutions will help offset the impact of inflation by providing for sustainable income by drawing down on these assets over time. Because of the couple's age and their potential exposure to sequence of returns risk in an all-growth-solutions strategy, we allocated 13.5 percent of their total wealth to risk management solutions using a hedged equity solution (although we can also use a principal-protected investment or a variable annuity with guaranteed withdrawal benefit). We allocated the remaining 54 percent (as opposed to 67.5

percent in Answer #1) to the growth solutions segment. The growth solutions segment is comprised of multiple asset classes and a more aggressive growth risk profile is used. We based the change in risk tolerance (as compared to the moderate "risk" tolerance used in Answer #1) for the growth solutions segment on the couple's decreased need for certainty. The overall allocation is as follows:

Average Income Certainty				
Income Solution (32.5%)	Risk Management Solution (13.5%)	Growth Solution (54%)		
SPIA 32.5%	Hedged Equity 13.5%	Fixed Income 11%	Small Cap 8%	Real Estate 5.4%
		Large Cap 16%	International 11%	Commodities 2.6%

Assuming an investment starting point in 1979, the growth solutions and risk management solutions portion would have grown from $700,000 to just over $959,324 at the end of February 2009.

The appreciation of the growth solutions segment assumes an individual is paying 1.5 percent annually for advice. To supplement the income from the SPIA, this solution uses a 4 percent annual drawdown rate from the growth solutions segment, adjusted for inflation each year at 3 percent. Note that this is a larger drawdown rate than the 3 percent drawdown rate used in Answer #1. Over the stated 30-year time period (1979 through the end of 2008), there was only one year where the inflation-adjusted cash flow need could not be met, although there were plenty of liquid assets available to make up for the shortfall.

Figure 36 illustrates annual income generation by each solution, relative to the income "benchmark" of $40,000 after tax, adjusted for inflation, along with total liquid asset growth over the 30-year period. The $19,294 in the income solutions column also represents real SPIA terms available by generating this quote for a joint-life SPIA for a 65-year-old couple in April 2009. Furthermore, this income is net of taxes, as the pre-tax annual income from this SPIA was $22,500 and is presented net of taxes paid based on a 57 percent exclusion ratio. All data illustrated below is net of taxes, based on a 25 percent ordinary income tax rate and a 15 percent long-term capital gain tax rate.

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Year	Income Solutions Income	Growth Solutions Income	Total Income	Growth Solutions Year End Value	Inflation Adjusted Cash Flow Need	Total Liquid Assets
Start						$1,000,000
1979	$19,294	$23,062	$42,356	$739,254	$40,000	$739,254
1980	$19,294	$29,406	$48,700	$864,137	$42,000	$864,137
1981	$19,294	$35,440	$54,734	$830,341	$44,100	$830,341
1982	$19,294	$34,857	$54,151	$908,509	$46,305	$908,509
1983	$19,294	$43,975	$63,269	$1,029,034	$48,620	$1,029,034
1984	$19,294	$46,969	$66,263	$1,031,183	$51,051	$1,031,183
1985	$19,294	$53,784	$73,078	$1,236,286	$53,604	$1,236,286
1986	$19,294	$70,019	$89,313	$1,424,784	$56,284	$1,424,784
1987	$19,294	$86,854	$106,148	$1,379,490	$59,098	$1,379,490
1988	$19,294	$91,736	$111,030	$1,521,642	$62,053	$1,521,642
1989	$19,294	$89,085	$108,379	$1,689,312	$65,156	$1,689,312
1990	$19,294	$91,251	$110,545	$1,509,424	$68,414	$1,509,424
1991	$19,294	$105,195	$124,489	$1,705,587	$71,834	$1,705,587
1992	$19,294	$100,621	$119,915	$1,668,682	$75,426	$1,668,682
1993	$19,294	$110,818	$130,112	$1,754,892	$79,197	$1,754,892
1994	$19,294	$108,785	$128,079	$1,659,066	$83,157	$1,659,066
1995	$19,294	$118,429	$137,723	$1,848,746	$87,315	$1,848,746
1996	$19,294	$121,612	$140,906	$1,968,045	$91,681	$1,968,045
1997	$19,294	$142,396	$161,690	$2,096,463	$96,265	$2,096,463
1998	$19,294	$158,130	$177,424	$2,132,778	$101,078	$2,132,778
1999	$19,294	$159,810	$179,104	$2,254,191	$106,132	$2,254,191
2000	$19,294	$168,691	$187,985	$2,123,272	$111,439	$2,123,272
2001	$19,294	$158,106	$177,400	$1,815,544	$117,010	$1,815,544
2002	$19,294	$137,733	$157,027	$1,521,470	$122,861	$1,521,470
2003	$19,294	$132,295	$151,589	$1,721,062	$129,004	$1,721,062
2004	$19,294	$140,193	$159,487	$1,768,181	$135,454	$1,768,181
2005	$19,294	$144,104	$163,398	$1,717,555	$142,227	$1,717,555
2006	$19,294	$147,143	$166,437	$1,785,178	$149,338	$1,785,178
2007	$19,294	$156,047	$175,341	$1,705,959	$156,805	$1,705,959
2008	$19,294	$143,763	$163,057	$1,144,809	$164,645	$1,144,809
2009				$959,324		$959,324

Figure 36 - Average Degree of Certainty: After-Tax Income by Solution Source Including Growth Solutions Year-End Account Values and Total Liquid Assets

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The allocation of wealth between assets subject to ordinary income tax and assets subject to capital gain tax decreases in this answer. Because of this decrease, the average annual wealth lost to taxes decreases from 1.7 to 1.52 percent. Compared to Answer #1, by allocating half as much of the starting wealth to the SPIA, an ordinary income tax asset, a larger percentage of wealth was instead subject to capital gain tax (assumed at 15 percent). Figure 37 illustrates the annual percentage of wealth lost to taxes over the 30-year period.

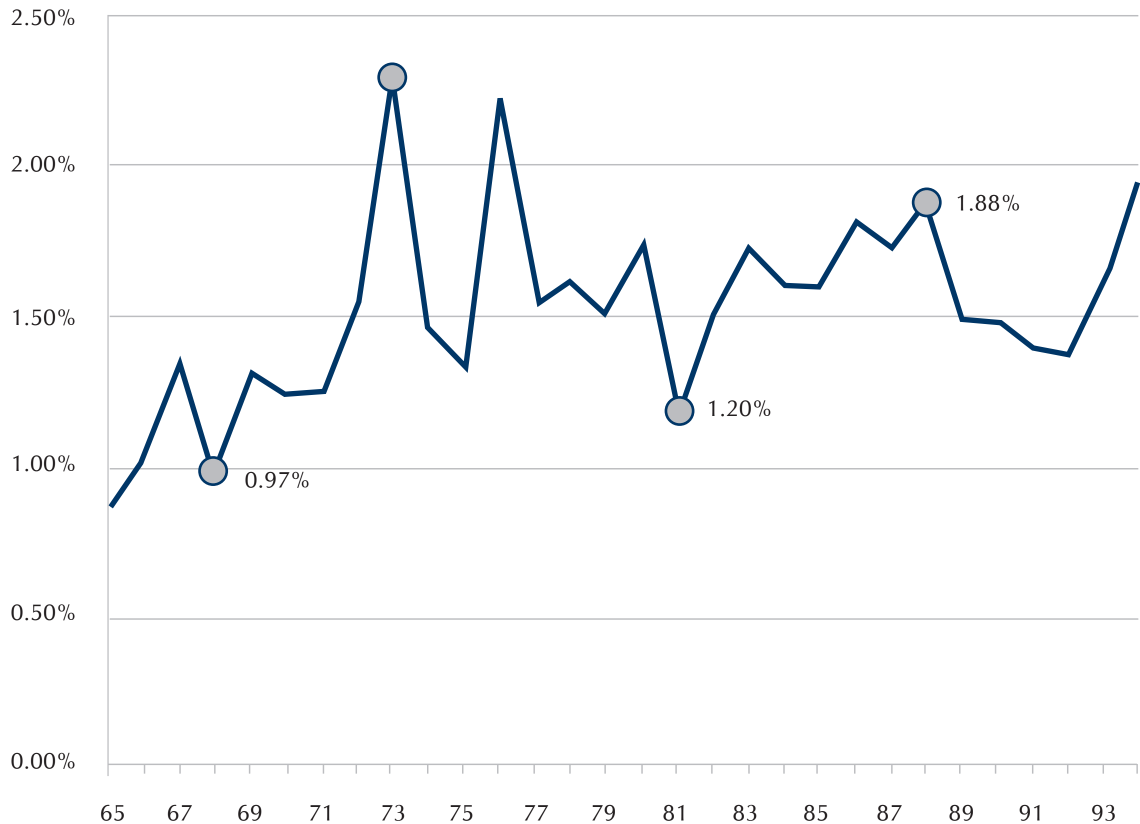

Figure 37 - Wealth Lost to Taxes each Year: Answer #2

Figure 38 demonstrates the temporary impact in the loss of liquidity for Answer #2. This chart shows the value of liquid assets (growth solutions only) compared with the theoretical value of all assets calculated as growth solutions, plus the amount paid into the SPIA, minus the amount paid out of the SPIA, until the SPIA pays out in entirety. Note that this theoretical account value is not the "marketable" value of the account as the SPIA is an irrevocable contract and has no market value and cannot be sold or given back to the issuer in return for payment.

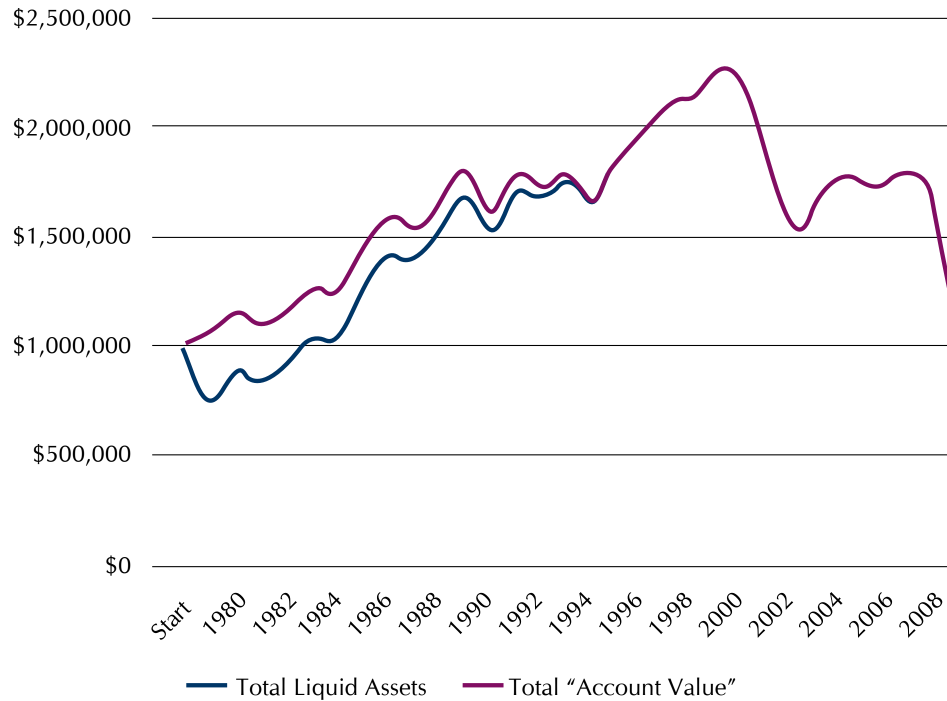

Figure 38 - Liquid Assets: Answer #2 (Average Degree of Certainty)

Trade-Offs

This scenario ties up less capital in an irrevocable annuity contract, which allows us to allocate more of the investable assets to equity assets in growth solutions relative to the high certainty option. Risk management solutions tend to be more expensive than the growth solutions, limiting the growth of this portfolio segment. The question then becomes, "how much growth is the couple willing to give up for certainty?" While growth solutions offer the potential benefit of greater asset values and liquidity, they also offer increased variability (less certainty) in their outcome. The year where there was a shortfall was when the growth solutions portion of the allocation lost almost 27 percent in value. While the *shortfall* for that year was minimal, looking back with the benefit of hindsight and an understanding of typical investor behavior, the volatility in the growth solutions portion of the allocation may cause individuals to make a short-term emotional decision and change their plan. Knowing the results, we understand that making changes based on our emotions would be a bad idea. As opposed to changing their investment plan, a better solution would be for the couple to cut back on their spending and reduce their budget until things improve, or take additional assets from growth solutions to supplement the deficit. While this solution achieved the goals of the couple, it did so with greater variability and an increased level of uncertainty, but with much greater liquidity and flexibility to address unforeseen future events.

Answer #3 – Lower Degree of Certainty

For some, the prospect of allocating any of their investable assets to something that will never appreciate and that they have no control over is too difficult to accept. For these individuals, relying on non-guaranteed methods of cash flow generation has advantages and disadvantages.

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For this 65-year-old couple looking for a guaranteed $40,000 per year after inflation, who want maximum liquidity, control and the potential for asset appreciation, maximizing growth solutions is imperative. Using a cash reserve to hold nearly four years of income (15 percent) will help provide a cushion in the case of unforeseen volatility while maximizing the amount of money working in the capital markets. We allocated the remaining 85 percent to growth solutions. Since this couple is even more comfortable with volatility than in our previous two answers, we implement the growth solutions segment using an aggressive growth risk profile. Based on these assumptions the allocation would be as follows:

Lower Income Certainty				
Income Solution (15%)	**Risk Management Solution (0%)**	**Growth Solution (85%)**		
Cash Reserves 15%	0%	Fixed Income 0%	Small Cap 30%	Real Estate 9%
		Large Cap 21%	International 21%	Commodities 4%

Assuming an investment starting point of 1979, the growth solutions portion would grow from $850,000 to just over $3,275,919 dollars at the end of 2009.

The appreciation of the growth solutions segment assumes an individual is paying 1.5 percent annually for investment advice. To generate income, this solution maintains just under four years worth of income need in cash through the income solution. Annually, this couple spends one year's worth of income and the *portfolio rebalances to replenish the income solution allocation.* We adjust annual cash flows from the income solution by 5 percent each year. Over the 30-year period of time (1979 through the end of 2008), there were no years where the inflation-adjusted cash flow need could not be met.

Figure 39 illustrates annual income generation by the solution, relative to the income "benchmark" of $40,000 after tax, adjusted for inflation, along with total liquid asset growth over the 30-year period. In this case, we maintain $150,000 in cash reserves in income solutions, which represents nearly four years worth of income. Each year, we remove $40,000, inflation-adjusted, from the account. Additionally, we rebalance the portfolio annually, which replenishes income solutions and returns it to the target of 15 percent.

Figure 39 shows income continually in each year even though only about four years of cash has been set aside. This is because the rebalancing process transmits assets annually from growth solutions to income solutions, rather than liquidating assets based on a predetermined drawdown rate. All data illustrated below is net of taxes based on a 25 percent ordinary income tax rate and a 15 percent long-term capital gain tax rate.

Year	Income Solutions Income	Growth Solutions Income	Total Income	Growth Solutions Year End Value	Inflation Adjusted Cash Flow Need	Total Liquid Assets
Start						$1,000,000
1979	$40,000	$0	$40,000	$1,120,092	$40,000	$1,120,092
1980	$42,909	$0	$42,909	$1,361,714	$42,000	$1,361,714
1981	$48,377	$0	$48,377	$1,295,948	$44,100	$1,295,948
1982	$53,569	$0	$53,569	$1,410,682	$46,305	$1,410,682
1983	$54,103	$0	$54,103	$1,649,112	$48,620	$1,649,112
1984	$61,156	$0	$61,156	$1,616,459	$51,051	$1,616,459
1985	$64,628	$0	$64,628	$2,000,259	$53,604	$2,000,259
1986	$66,030	$0	$66,030	$2,354,292	$56,284	$2,354,292
1987	$77,681	$0	$77,681	$2,347,844	$59,098	$2,347,844
1988	$90,471	$0	$90,471	$2,692,181	$62,053	$2,692,181
1989	$87,310	$0	$87,310	$2,998,210	$65,156	$2,998,210
1990	$91,050	$0	$91,050	$2,519,020	$68,414	$2,519,020
1991	$97,120	$0	$97,120	$3,009,721	$71,834	$3,009,721
1992	$94,294	$0	$94,294	$3,068,198	$75,426	$3,068,198
1993	$115,721	$0	$115,721	$3,393,103	$79,197	$3,393,103
1994	$114,400	$0	$114,400	$3,310,284	$83,157	$3,310,284
1995	$120,744	$0	$120,744	$3,839,865	$87,315	$3,839,865
1996	$112,049	$0	$112,049	$4,289,901	$91,681	$4,289,901
1997	$138,225	$0	$138,225	$4,758,375	$96,265	$4,758,375
1998	$141,344	$0	$141,344	$4,885,750	$101,078	$4,885,750
1999	$164,739	$0	$164,739	$5,553,174	$106,132	$5,553,174
2000	$177,813	$0	$177,813	$5,263,534	$111,439	$5,263,534
2001	$174,185	$0	$174,185	$4,698,493	$117,010	$4,698,493
2002	$167,043	$0	$167,043	$3,906,584	$122,861	$3,906,584
2003	$174,419	$0	$174,419	$4,950,085	$129,004	$4,950,085
2004	$153,160	$0	$153,160	$5,520,642	$135,454	$5,520,642
2005	$200,478	$0	$200,478	$5,683,875	$142,227	$5,683,875
2006	$194,320	$0	$194,320	$6,386,695	$149,338	$6,386,695
2007	$198,450	$0	$198,450	$6,317,159	$156,805	$6,317,159
2008	$227,995	$0	$227,995	$3,996,932	$164,645	$3,996,932
2009				$3,275,919		$3,275,919

Figure 39 - Low Degree of Certainty: After-Tax Income by Solution Source Including Growth Solutions Year-End Account Values and Total Liquid Assets

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Of the three answers, this one had the lowest exposure to assets subject to ordinary income tax rates, increasing the tax efficiency of this answer. Over the 30-year period, the average annual wealth lost to taxes was 0.81 percent, as compared to 1.52 percent for the average degree of certainty answer and 1.75 percent for the high degree of certainty answer. Certainly, the significant exposure to assets subject only to capital gain tax played a role in "keeping more of what you make" through minimizing ongoing tax liabilities.

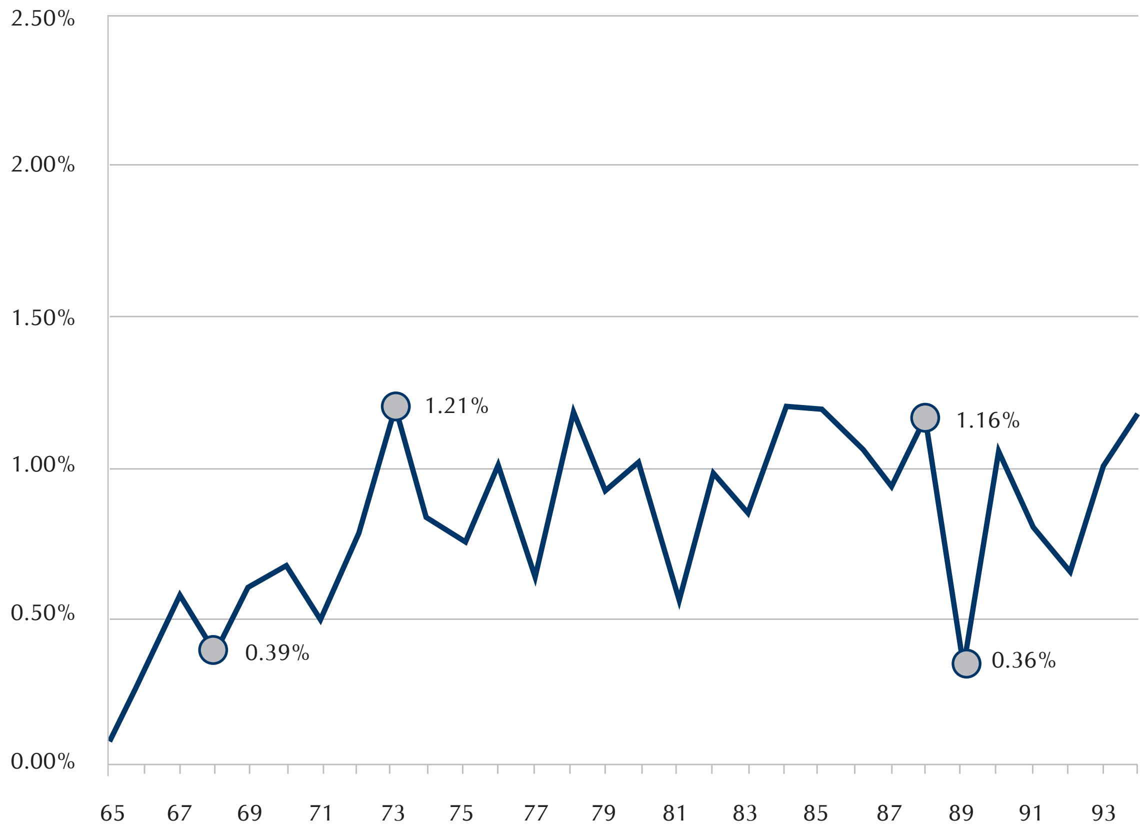

Figure 40 - Wealth Lost to Taxes each Year: Answer #3

Figure 41 illustrates the growth of liquid assets for Answer #3. Because there was no allocation to a SPIA in this answer, the entire initial investment amount of $1 million remains liquid. In the previous two answers, a "theoretical" value of the SPIA was included despite the illiquid nature of the asset. The previous two answers also provided the liquid assets as shown in figure 41.

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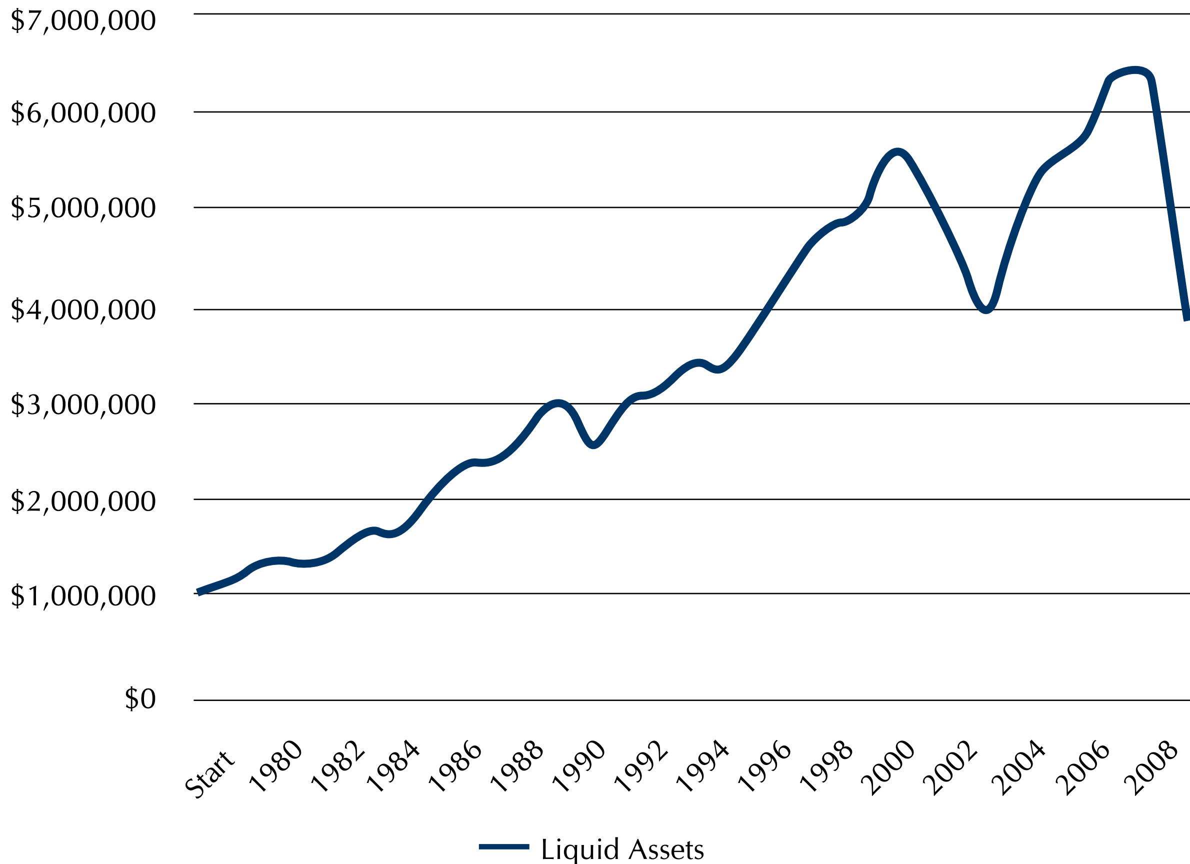

Figure 41 - Liquid Assets – Answer #3 (Low Degree of Certainty)

Trade-Offs

Relative to Answer #2, this couple accepts much greater uncertainty in exchange for higher growth potential. Over time, the allocation to assets exposed to the capital markets exposure should result in significant portfolio growth, as compared to more certain and conservative solutions. The trade-off for this scenario is high growth potential and high levels of liquidity in exchange for much higher levels of volatility, which equates to a higher level of risk of loss on the investments.

Over the 30-year period, this portfolio experienced seven years of negative performance, and in three of those seven years, the portfolio was down more than 10 percent for the year.

- *1981: down 1.84%*
- *1990: down 14.03%*
- *1994: down 0.06%*
- *2000: down 3.10%*
- *2001: down 8.43%*
- *2002: down 14.57%*
- *2008: down 34.64%*

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Through the end of February 2009, this scenario had lost an additional 18.24 percent for the year. At the end of 2006, this answer reached a high of $6,386,695, and then dropped to $3,996,932 two years later. The greatest risk in this answer is that the couple will not have the fortitude and emotional control to participate in this volatility, and forgo the plan for "safer" options that can dramatically affect the client's ability to maintain the retirement lifestyle for which they originally planned.

We show the impact of taxes below in figure 42 for each of the three answers. While there are some who may consider taxes to be the "cost of playing," it is important to illustrate the relationship between the need for certainty and tax liability. In our answers, there is a positive correlation between the need for certainty and a higher tax impact ("tax drag"). Figure 42 illustrates the impact of taxes across the three scenarios.

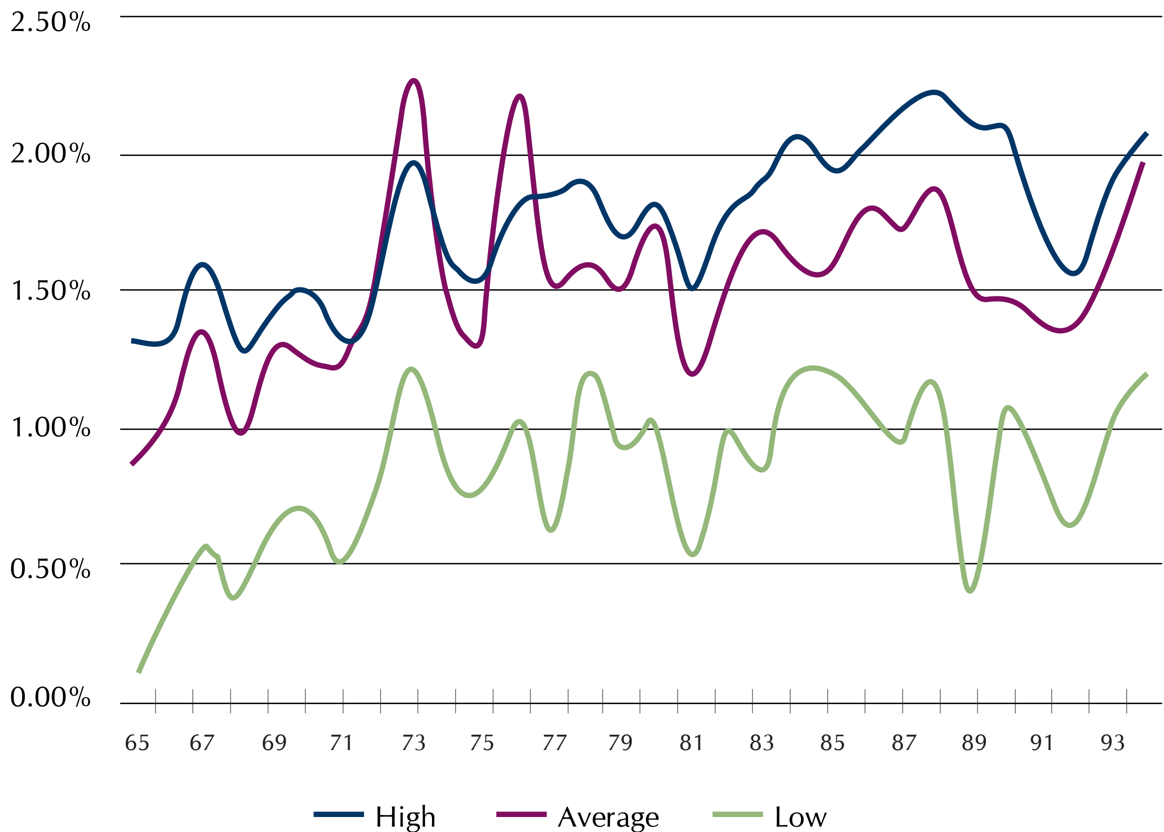

Figure 42 - Wealth Lost to Taxes each Year: All Answers

Figure 42 shows that with greater certainty comes increased tax liability, which in turn affects the overall long-term growth of the chosen answer. Not surprisingly, of the three answers to the initial question, the one with the highest degree of certainty is the one that ended the test period with the least amount of ending wealth.

Section Conclusion

Degree of Certainty	High	Average	Low
% Guaranteed Cash Flow	64.50%	32.50%	0%
Average Annualized Return	9.31%	9.34%	10.00%
Standard Deviation of Cash Flow	4.13%	8.16%	9.99%
Total Cash Flow	$2,837,910	$3,729,117	$3,543,783
Total Excess Cash Flow	180,356	1,071,563	886,229
Total Tax Liability	336,361	637,195	941,954
Ending Wealth	616,840	959,324	3,275,919

Figure 43 - Summary Statistics for Each Answer

The reality of Sustainable Income Solutions™ is that there is no single ideal solution. The right allocation of solutions, strategies and implementation tools is based heavily on the trade-offs an individual is willing to accept. Of the three answers provided, individuals are most likely to opt for Answer #2 – Average Degree of Certainty based on its combination of guaranteed income, liquidity, market growth potential and risk management. While few clients will be willing to tie up 64.5 percent of their investible assets in Answer #1 – High Degree of Certainty, some of the most conservative clients may take comfort in knowing they have guaranteed income even if the price paid is loss of liquidity growth. Conversely, few individuals may be willing to endure the volatility associated with Answer #3 - Lower Degree of Certainty, despite the high level of liquidity and high growth potential. However, for some, the high level of flexibility and potential for growth are worth the short-term and often dramatic fluctuations in value.

	Benefit	Trade-Off
High Degree of Certainty	Guaranteed Income	Liquidity / Growth Potential
Average Degree of Certainty	Some Guaranteed Income / Greater Liquidity	Growth Potential / Potential Cash Flow Deficits
Lower Degree of Certainty	High Growth Potential / High Liquidity	High Market Volatility / No Guaranteed Income

Figure 44 – Trade-Off Analysis for Each Answer

While generating income from a reasonable asset base is not difficult, generating it in a sustainable and certain manner is difficult and costly in either emotional or economic terms. The trade-offs between solutions, strategies and implementation tools are important for individuals to consider when working with a retirement advisor to identify the best solution to address their income needs for life.

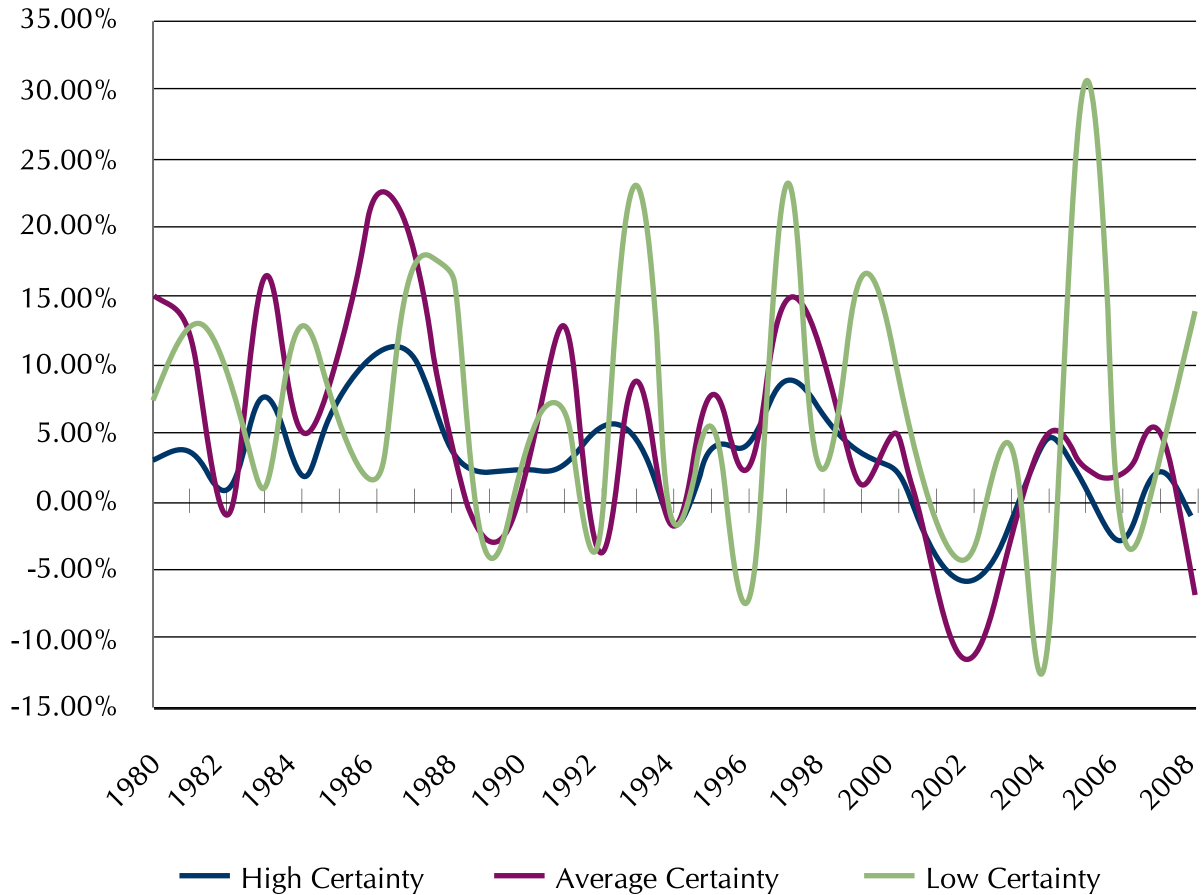

Figure 45 - Year-Over-Year Change in Annual Income: All Three Answers

Conclusion

Retirement, in its many forms, is not a certainty for the vast majority of individuals reaching the "normal" retirement age. To begin with, factors such as an aging population that is not being replaced by younger individuals and our ever-increasing longevity mean that social funding programs like Social Security or pension plans may not be available to us, a risk increasing for younger generations.

The economic downturn that began in 2007 caused tremendous damage to personal retirement planning done through traditional vehicles such as 401(k) and IRA accounts. This damage has caused changes in both spending and saving, and has left many individuals delaying their plans to retire.

So how does one work to create the most certainty of a retirement that looks like the one written out in the first few pages of this paper, rather than the "cold wind" described by Mr. Leacock? The fundamental difference between your vision and Mr. Leacock's cold wind is choice. While each one of our mental pictures of retirement is different, we are all joined by the common fact that our ideal picture of retirement is tied to the ability to make choices, rather than have our choices defined by circumstances we are powerless to control. We want the power to choose where to live, the friends and family we spend time with, the travel we take, the vocations we pursue, the charities and institutes of learning we support, and so on. The cold wind is felt when we are restricted in our freedom to choose.

The answer to this conundrum is Sustainable Income Solutions™. This process starts with an understanding of two factors, the eight critical risks you are subject to as you go through life and the unique attributes of your age band. By understanding these eight risks and how they affect you differently at different stages in your life, the necessary groundwork to begin the Sustainable Income Solutions™ process has begun. Without an understanding of these risks, you cannot make informed judgments about which of these risks you choose to bear and which you choose to share. Without an understanding of these risks, you dramatically affect the probability of damage to your plans for retirement and feeling the cold wind.

With an understanding of risk, including how risk affects you, the Sustainable Income Solutions™ process can start. This process requires the use of a dedicated retirement advisor who, along with you, exerts control over your entire retirement plan. A retirement advisor will take individuals through a multi-step process that will establish their unique Sustainable Income Solutions™ plan. Only after a thorough discovery process is completed and data is collected can individuals begin developing their personalized plan.

The development of the plan involves two significant decisions:

1. Which of the eight risks does the individual want to hedge, and how much certainty is required?
2. What control is an individual willing to give up to achieve this greater certainty?

With this understanding complete, the plan can be divided into income solutions, risk management solutions and growth solutions. Once the plan has been prepared and agreed to, individuals and their retirement advisor implement the plan through investment and insurance solutions. The critical step following implementation is to ensure a constant review of the plan to make sure it continues to represent an individual's feelings about the eight risks and the level of certainty required. It is nearly certain that the risks individuals are exposed to will change over time, as will their need for certainty.

While there is no practical way to offer solutions that provide the perfect certainty that most individuals would like, Sustainable Income Solutions™ represent the aggregation of realistic answers to the complex problems of generating enough income to provide adequate cash flow for life. Individuals have the personal ability to create a retirement that offers them the power of choice. Creating this outcome requires solid advice from a retirement advisor, a thorough understanding of risk, a clear understanding of the trade-off between certainty and control, and the discipline to create and adhere to a budget defined by choices. Sustainable Income Solutions™ provides the ability to deploy the myriad of financial innovations available today in a way that is personalized for a unique vision of retirement. Individuals must feel empowered to take personal responsibility for the ideal of choice and work with a retirement advisor to create income for life and avoid the "cold wind" of retirement. Sustainable Income Solutions™ provides the path to achieving this ideal.

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