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## Rescue your retirement

**W**hen it comes to retirement, there are some things that we can control, and many more that we can't. We can choose how much to save and how to invest those savings. We can choose our retirement start date. We can choose whether to keep working in retirement, and there may be some discretion in our spending.

We can't control the economic environment that will exist at retirement. Those who are planning to retire in the near term know all too well how financial market reversals can sabotage even the best of plans. Although the stock market is well above its 2009 lows, many 401(k) account balances haven't fully recovered. Those who were using their homes as a piggy bank for retirement are also facing disappointment, as residential real estate prices remain very weak in many parts of the country.

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## Better news

Last year, on March 9, 2009, the S&P 500 index closed at a gut-wrenching 676.53. That was the bottom of the bear market. One year later, March 8, 2010, the S&P 500 closed at 1138.50, a rise of 68% from the bottom.

That's welcome news. Still, stock market indices are well off their historic highs, and many families have experienced a significant decline in net worth during this recession. What impact will that have on retirement planning? That's the subject of this issue of *QuarterNotes*.

Also, see page 3 if you are considering a conversion to a Roth IRA this year. As always, we are here to help with your financial management questions.

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## Back to basics

Unless you have won the lottery, there are no magic formulas for creating a secure retirement. Begin with a five-step process:

*Review all income sources.* Inventory all the predictable income streams that you expect to receive—Social Security, traditional pension, lifetime annuities, rent from real estate, and portfolio income. Compile a list of

all financial and real assets, including stocks, bonds, mutual funds, certificates of deposit, IRAs, 401(k) accounts and real property.

*Project your expenses.* Estimate your monthly and annual expenses in retirement. Divide the expenses into the essential—food, clothing, housing, transportation, insurance and taxes—and the discretionary—travel, entertainment, gifts and so on.

*Compare income to essential expenses.* This will reveal whether there will be an income gap that will have to be filled by touching principal.

*Identify assets for essential and discretionary expenses.* If you have a gap for meeting essential expenses, you may want to segregate the assets that will be liquidated as needed to fill the hole. Alternatively, you can consider a guaranteed income product, such as an immediate annuity, to take care of the shortfall. Once the essential expenses are fully funded, remaining assets may be tapped for the discretionary expenses.

*Monitor the plan annually.* Each year you should review your plan with your financial professional, making adjustments as needed, as your retirement circumstances change.

### How long will your retirement capital last?



The table below will allow you to make a rough estimate of the life of your retirement resources, given different assumptions about your initial withdrawal rate and the rate of return on your investments. The withdrawals are increased by 3% each year after they begin, to account for inflation. Rates of return are assumed to be constant, but in reality they will vary from year to year. Also important: Taxes and transaction costs are not included in the table. That's why the estimate is "rough."

For example, assume that you start with \$200,000. If you begin with a 7% withdrawal, or \$14,000, your capital will last for 15 years if your rate of return is 4%. If the return could be boosted to 8%, you would get seven more years of payments, each increased by the 3% inflation factor. The table shows just how difficult it is to fund a 30-year retirement.

*This example is for illustration only and does not represent any particular investment.*

Percentage of capital withdrawn in the first year:	If your withdrawals increase by 3% annually, your capital might last this many years, invested at the following rates of return:					
	4%	5%	6%	7%	8%	9%
4%	28	30+	30+	30+	30+	30+
5%	22	24	29	30+	30+	30+
6%	18	19	22	25	30+	30+
7%	15	16	18	20	22	27
8%	13	14	15	16	18	20
9%	11	12	13	14	15	16

Source: Merrill Anderson Co.

### How much will you need?

The alternative to dipping into capital to meet essential income needs is to delay retirement, extending the accumulation period for retirement capital. How long a retirement should you plan for? That depends upon your age at retirement and your health, of course, but more and more people are expecting a 30-year retirement.

How much money will you need for a comfortable retirement? That depends upon how well your investments perform, as well as how deeply you have to dip into your savings each year. See "How long will your retirement capital last?" for more details.

### We can help with your investment choices

Some retirees enjoy managing their investments. Many prefer to enjoy their retirement, so investment management is a necessary chore. If you would like a professional opinion about your portfolio management decisions, please bring your questions to us. We will be pleased to help you on the road to financial independence.



## Roth rollover ideas

**T**axable conversions of traditional IRAs to Roth IRAs have been allowed for some time, but only this year has the opportunity been extended to those with adjusted taxable income above \$100,000. That's why the strategy is so much in the news.

The decision to convert to a Roth IRA is not a simple one. The prospect of tax-free income must be weighed against the certainty of an enhanced income tax liability. Federal income tax due on a 2010 conversion may be reported and paid with the 2010 tax return, or it may be split between the 2011 and 2012 tax returns. Normally, one would prefer to delay tax payments—it amounts to an interest-free loan, after all—but there is the very real prospect that tax rates could be higher in future years.

### Converting to multiple accounts

Another fear that some taxpayers have is that they will choose the wrong date for their conversion. The optimal date would be the day when the IRA is at its lowest value during the year. In today's volatile markets, picking that date is an impossible task.

Imagine, for example, Ted Taxpayer, who has an IRA worth \$100,000 when he converts it to a Roth IRA. Now let's assume that the value of the IRA falls to \$80,000 by year-end. That collapse won't change the tax bill on the conversion.

Ted does have an escape hatch. He can reverse his decision to convert to the Roth IRA, and he has that option until the due date, including extensions, for his 2010 tax return.

Ted could increase his flexibility in this regard by converting to multiple Roth IRAs instead of just one. For the sake of a simple illustration, assume that Ted's IRA is half invested in stocks and half in bonds. Ted might consider one Roth IRA for the bonds, a separate Roth IRA for the stocks. Assume that at year-end the market



**The conversion decision can be revisited after 30 days or in the next tax year, whichever is later.**

losses are attributable to the stocks, not the bonds. The Roth IRA invested in bonds would be worth \$50,000; the Roth IRA in stocks, \$30,000. Ted could choose to reverse his rollover as to the stocks, leaving the Roth IRA in bonds alone. That would cut his tax bill on the conversion in half.

The conversion decision can be revisited after 30 days or in the next tax year, whichever is later. Thus, if stock prices remain low, Ted could decide in 2011 to convert the remaining IRA to Roth IRA status.

### Beneficiary designations

One of the major estate planning benefits of converting to a Roth IRA is that a tax-free income stream may be provided to heirs. However, to maximize this benefit, it is important that the Roth IRA name the beneficiary who will be the surviving owner. If there is no named beneficiary, or if the Roth IRA is payable to the estate, the account must be emptied within five years after the death of the owner. Don't assume that the named beneficiary for the traditional IRA automatically will become the named beneficiary for the Roth IRA. Each account must have its own beneficiary designation.

## JUST ASK US

### **I'm not rich; do I need to worry about death taxes?**

Maybe. As of this writing, there is no federal estate tax. Under a law enacted a decade ago, this year the federal estate tax is suspended for one year. In its place, however, is a new income tax rule imposing potentially larger capital gains taxes on inherited assets. That rule is known as "carryover basis."

If the amount exempt from federal estate tax had been held at \$3.5 million, as it was in 2009, some 5,500 estates would have owed this tax, according to published estimates. In contrast, an estimated 70,000 estates will be affected by carryover basis.

"Death taxes" also include state inheritance taxes, imposed in a minority of states. If you are a resident in or own property in one of those states, you should consult with your estate planning advisors about your exposure.

### **What happens next year?**

Better to ask, what will happen this year. Prominent Congressmen have called for the restoration of the estate tax for 2010, perhaps retroactive to January 1. Should Congress take no action, next year the federal estate tax returns with a \$1 million exemption and sharply higher tax rates.

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