

Investing^{for} Retirement

Six experts discuss the challenges clients close to retirement face in today's uncertain economic environment.
By Donna Mitchell

Investors planning for retirement are in uncharted territory. Baby boomers are starting to leave the workforce. Americans don't save enough. And the continuing housing slump, lingering high unemployment, a "fat-fingered" Flash Crash and a precarious public debt situation have tempered clients' appetite for risk. Despite the uncertainty, the equity markets closed out 2010 with reason for optimism: the Dow was up 11%, the S&P 500 gained 15.1% and the Nasdaq climbed 17%.

So how do financial planners advise their clients on retirement? On Jan. 5, *Financial Planning* convened a roundtable discussion with six industry experts to glean some of the best ideas on how to help clients maximize opportunities during their peak working years and lay sound plans for the next phase. To structure the conversation, we divided older clients into two groups based on their retirement



Fidelity is in the early stages of developing mobility aps for advisors, says Ron DePoalo, CIO at Fidelity Institutional.

consumers and advisors into the lab and performs usability tests to see how they interact with Fidelity products.

Many of the findings are proprietary, but the company did share a few nuggets of wisdom:

- When using financial websites, some customers like to receive financial information by video, but many do not. So Fidelity also makes transcripts available for those who prefer to read. Even those who are receptive to video want to have the choice of turning the video on. Auto play video does not work well, Fidelity found.

- Most web traffic on Fidelity sites occurs during the day. Presumably, many of these customers are at work, so they do not have access to sound on their computer.

- There are subtle differences between the way consumers and advisors interact with their software tools. Consumers are willing to put up with more clicks to make sure the task is done correctly. Advisors want as few clicks as possible, putting a premium on streamlined workflow and usability.

THE FUTURE

By now it should be clear that FCAT has been instrumental in many of Fidelity's technological innovations over

the last 10 years. Looking ahead to the future, it is likely that FCAT's role with regard to advisor technology will continue to expand.

"I believe that we have the best technology platform in the business," DePoalo says. "We have delivered an integrated solution, and we have the resources to leverage Fidelity's \$2 billion per year technology budget in order to continue to provide the technology solutions that Fidelity Institutional clients require."

As technology continues to play an increasingly important role in the success of advisors, and as custodians and broker-dealers compete on the quality of their technologies, the ability to anticipate advisors' future needs and to innovate rapidly will become ever more important. None of Fidelity's competitors appear to have a facility similar to FCAT. If that is in fact the case, FCAT may give Fidelity an edge as it seeks to anticipate and satisfy the needs of its advisors in the coming years.

FP

Joel P. Bruckenstein, CFP, is an international expert in applied technology and co-producer of the annual T3 Technology Conference for financial advisors. For more, visit www.technologytoolsfortoday.com/.

time frame: those hoping to retire over the next three to five years, and those planning for retirement 10 or more years out.

RETIRING SOONER

FP: Looking at this three- to five-year group, have clients fully recovered from the market crash of 2007-2008, and is their retirement readiness where they want it to be?

ED SLOTT: Our own clients just barely recovered. I think at this point from 2008, if you were pretty broad based over the market, you probably got a lot of that back, but you are probably gun-shy going forward because it could all just happen again. So retirement, at least for my clients and myself, seems to be something that's up in the air now.

CATHY WEATHERFORD: Investors' feet are firmly planted on the ground. They're not looking for sky-high returns anymore, they're looking for safety and security, and there is pessimism, as Ed mentioned, about their future. Our research tells us they're looking for more ways to derive steady returns, even if it's at a lower rate than in the past.

PENG CHEN: Let's look at the three areas where investors have their wealth. One is their defined-contribution plans, and they probably lost quite a bit in 2008-2009. Even with the rebound in 2009-2010, they are probably not back to where they were.

The second piece is housing. If you look at the average household net worth, the biggest piece is home equity; it's not financial assets. And that hasn't recovered for the most part.

The third piece is really their jobs. Many people lost their jobs, and those who haven't lost their jobs probably are getting paid less, and a lot of them have reduced their retirement contributions.

For many people close to retirement, the downturn significantly impacted their retirement readiness. They are questioning their ability to finance how they think they can live in comfortable retirement.

DEENA KATZ: In the 1990s, what moved investors was the fear of lost opportunities. Today, it's the fear of the loss of principal. Protect me, give me an income stream I can depend on.

JONATHAN GUYTON: Right now, folks who are soon to retire are worried about one type of risk—the fluctuations that come in a balanced portfolio. I worry that by

MEET THE PANELISTS:

· **PENG CHEN**, president of the Global Investment Management Division at Morningstar.

· **JONATHAN GUYTON**, principal of Cornerstone Wealth Advisors, a fee-only financial planning and wealth management firm based in Edina, Minn.

· **DEENA KATZ**, chairman and co-founder of Evensky & Katz Wealth Management in Coral Gables, Fla. Katz also leads the financial planning program at Texas Tech University.

· **DONNA MITCHELL**, senior editor at *Financial Planning* and roundtable moderator.

· **ED SLOTT**, a CPA in Rockville Centre, N.Y., an IRA distribution expert, a professional speaker and author of several IRA books.

· **THOMAS STREIFF**, executive vice president and retirement product manager at Pacific Investment Management Co. (Pimco).

· **CATHY WEATHERFORD**, president and chief executive officer of the Insured Retirement Institute, trade group for annuities and other insured retirement products.

doing the things that will eliminate or mitigate that risk, they unwittingly open themselves up to some far more serious problems down the road.

FP: What sorts of problems?

SLOTT: Inflation is a big one. There are a lot of products being developed that are designed either to guarantee principal or guarantee an income stream. When you look at the volatility that is likely to come and you play those scenarios out, it doesn't bode well for clients being able either to stay flexible or to retain the ability for their incomes to appreciate with inflation.

FP: I think the challenge is that the retirement planning puzzle has so many more pieces now than it did perhaps 10 years ago.

CHEN: Most important, retirement funding has shifted away from something being given to people—predominantly Social Security and defined-benefit pension plans. Now most clients have to rely on themselves to finance



Thomas Streiff:
"Clients are looking
at retirement as a
process, not an event."

PHOTOGRAPH BY MICHAEL WEBSTER

way anymore. They're looking at this as a process. Their ability to earn doesn't stop one day. It may go up or down at a later time in their life, but it doesn't go to zero.

GUYTON: Having survived the recent market downturn, they are asking more pointed and informed questions. They're asking, 'Okay, so how is income generated when a scenario like this occurs? How will we be able to make decisions about when I'm in trouble, when I might need to make some adjustments?'

STREIFF: I don't think they are intimidated by the lifestyle issues, but I do think they are still intimidated by some of the economics. The statistics indicate they haven't fully recovered yet. They are worried about the economic conditions and having the right plan in place for them to move forward.

STAYING HEALTHY

FP: What specific issues around healthcare and longevity are clients facing now?

GUYTON: We have access to a growing body of knowledge that talks about withdrawal rates and withdrawal strategies that are tied to inflation that are good for 30 or 40 years. So when I look at giving up something to purchase some additional longevity protection, I need to

look at what I'm really gaining at the margin.

We've got a pretty basic structure in place; we've got Medicare, we've got Medicare supplements, we've got some out-of-pocket costs, and then we advise a lot of clients to purchase long-term-care insurance.

For a person to spend about \$500 a month on his or her healthcare and assume that the inflation rate will be double the general inflation rate, which has generally held up pretty well over the last 10 years. Of course, that doesn't cover long-term care, but it does cover the healthcare piece.

KATZ: The other issue we have now is the current healthcare reform law, the new one as it's been written. I don't even know if it's going to stay in place. We need to make sure that if this is a priority, that we're dealing with it today and not waiting while we see what Washington decides is important for us. The American public is not happy with the healthcare plan, and Congress is revisiting that.

WEATHERFORD: We all know that an important piece of healthcare reform was designed to help control Medicare costs in the long term. Growing the number of insured Americans helps to do that, and some of the reforms around Medicare going forward in this bill will



Ed Slott: "Taxes will be the single biggest factor that separates people from their retirement dreams."

PHOTOGRAPH BY ERICA BERGER

the retirement, which means they have to manage their 401(k)s and IRAs, and tap into their home equity. It is definitely more complicated.

Also, the longer clients live, the more money they need to finance retirement. In the new regime, if you don't save by actively contributing to your 401(k) or IRA, at the end of the day you're not going to be where you want to be. It's not just a market risk. You can have a great strategy, protect your downside, participate in the upside, but it's not going to matter if you don't save.

NARROWING PRIORITIES

FP: Will people have to change their priorities in retirement? Will they have to work longer and perhaps give less to charity or pass less on to their heirs? Are planners talking about those issues with their clients right now?

WEATHERFORD: Almost everything is on the table when it comes to how people will change priorities. We've had so many things happen so rapidly, as this baby boomer population marches toward retirement.

FP: Deena, Jonathan, what are you seeing in terms of your clients' priorities right now? What are they willing to give up?

GUYTON: Clients are realizing that we've gone from an environment where they once felt like they could do everything in retirement to a scenario where they can do anything but not everything. Those who are having the hardest time are the people who are not clear about what really matters most to them in their lives. Those who are most frustrated are the people who manage their degree of meaningfulness by the size of their portfolio.

I am excited because I think that today's situation will force people to get clearer about the things that matter to them. Then the chance for them to have a fulfilling retirement that's always been in their image actually goes up, even if it has a little lower price tag to it.

KATZ: Yes. I think we need to see how people are changing. We have to look at that baby boomer cohort. These are the can-do folks, the ones who wanted to have it all, and they're changing what retirement means. Most boomers are saying, 'Isn't that great, I get to stay in the workforce. I'm going to be more engaged, I'm going to be more valuable.' They are not really looking at this as a negative.

THOMAS STREIFF: We can't look at retirement as an event any longer because retirees aren't looking at it that

RETIRING LATER

FP: Let's move to our other group of clients—those planning on retiring 10 or more years in the future. These clients are in a different situation; they are likely to spend their last decade of accumulating years in a time of slow growth and rising inflation. What strategies are available to help these clients plan for retirement?

STREIFF: A lot of the things that we've talked about already apply. There are risks to standing on the sidelines and there are risks to getting in the game. And if you look at the nature of investors, they tend to miss, especially, rises in the market that happen quickly, and according to the pundits, unexpectedly. Taking on more risk is certainly an appropriate thing to do when you have a longer time horizon.

The point I made earlier from an income standpoint is true from a stimulation standpoint. And you do need to structure things in your portfolio that directly enable you to protect against inflation risk over these longer

future. What is the best way for clients to take advantage of global growth without necessarily increasing the volatility of their portfolios?

CHEN: You are absolutely right. If you look longer term, the United States and for that matter, the rest of the developed world, are probably not going to be super growth economies. Certainly there will be a lot more ups and downs in emerging markets, which is where the volatility part comes in, but nonetheless, I think over time the growth will be better.

For clients who really don't want to invest directly into these emerging-market companies, a perfect place for them is a multinational company, either U.S.- or Europe-based. Just to give you a quick example, on the S&P 500, the amount of revenue derived outside of the United States from these companies is just short of 50%, I wouldn't necessarily shy away from investing in emerging markets, though, because I think a percentage of it would help round up your portfolio

Cathy Weatherford: "Healthcare reform will be debated politically for some years, but it will be hard to undo. We might see some tweaking, but this piece of legislation is already deep into implementation."

time horizons. Inflation is a bigger risk for these folks.

FP: Ed, is there anything you would add to that?

SLOTT: Everybody's been talking about risk, and taxes will be the single biggest factor that separates people from their retirement dreams. And that's why they have to be managed now.

Right now we have a two-year window of opportunity of relatively low rates, but that model is not sustainable. Our government is broke. At some point taxes have to go up, despite what the politicians say. You can have all these investments with all these returns, but if you're losing 40% or 50% a year to taxes, a lot of those models are not going to work out.

I thought low rates were going to end in 2010. But with the extension of the tax cuts, we've got a two-year reprieve to use some of those low rates and leverage taxable money into tax-free territory. Planners and their clients shouldn't miss this opportunity.

FP: We hear consistently that the United States will have a smaller role to play in the world economy in the

KATZ: If you do that, you might want to balance it off, because certainly you would increase your short-term volatility with an emerging-market investment. So you want to set up to plan around that volatility. If you need to take cash flow, set up a cash flow reserve so you are not selling out into a more volatile time when you need to take a withdrawal.

FP: Should investors be thinking seriously about frontier markets?

STREIFF: You know, I'm a baseball fan, and one of the things hitters need to remember is the easiest way to strike out is to try to hit a home run.

CHEN: I would definitely agree with that. These frontier markets sound very exotic and attractive, but the reality is that, first, the market is not well established, and second, it's not very transparent. There are a lot of hurdles, and the cost of investing is high, too, even tough. You can selectively invest in them as a diversification piece, but it shouldn't be a corner piece of your portfolio, and I would strongly encourage you to select

probably increase *some* out-of-pocket costs as some of the benefit levels change.

On the other hand, there are also some significant benefits. It will be an issue of political debate for a number of years. Many things are hard to undo when it comes to government. We might see some tweaking and some changing, but this bill is already deep into the implementation process.

STREIFF: One of the challenges is the unknowns, and even the experts don't yet know what parts of the legislation will survive and which won't. The uncertainty presents many challenges for retirees and those who plan with retirees.

GUYTON: There is broad agreement that what is promised under Medicare and what it will cost to fulfill those promises is a gap that is widening quickly. What you are going to receive for that Medicare premium—Part A and Part B—is in some way or another going to be less. We'll know more in a few years about what that looks like, but it probably means that the premiums for supplements

going to be between 7% and 8%. So equity will return less, but bonds are so undesirable right now that it doesn't matter.

FP: Is it a good idea to start implementing income-producing strategies now or can that wait until a client has retired?

KATZ: The future is so uncertain. So looking at retirement income strategies at this point is not inappropriate. Since there are so many good products out there now, and if you are not taking your whole portfolio and dumping it into one product, I think it's appropriate.

FP: Is there a certain portion or percentage that is worth targeting, or does that really differ depending on the client?

KATZ: This is totally individual. It really depends on your demand. Peng, didn't your group come out with some data a few years ago about putting 25% of your portfolio into an annuity and how that extends...

CHEN: Yeah, we did some analysis. What variable annuities provide that traditional stocks, bonds, mutual

Deena Katz: "In the 1990s, investors most feared loss of opportunities. Today, they most fear loss of principal. They want protection, they want an income stream that they can depend on in retirement. They don't want sleepless nights."

are going to be higher, and the out-of-pocket costs are going to go higher. But I don't think medical costs are going to be twice as high five years from now.

PRODUCTS AND TIME FRAMES

FP: Let's talk about some of the biggest issues facing high-net-worth investors. What types of products are driving the rally and are they appropriate for clients with this retirement time frame?

CHEN: The government has done a fairly decent job of stabilizing the financial system. Once risk was addressed, the markets reacted positively.

Going forward, equity is reasonably valued and the economy is recovering, even though very slowly. Secondly, fixed income is so undesirable right now. Looking out in the 10- to 20-year time frame, we actually think equity returns are going to be lower than the historical average, which is around 10%. We believe it's probably

funds and ETFs don't, is really two protections in the retirement phase.

One is an income to protect against market downturns. The other, which not a lot of people talk about, is a longevity guarantee, where the income will be paid for as long as the investor lives. And the longevity guarantee has a unique insurance aspect because it pools everybody together so that there is a benefit of a mortality credit to help enhance the retirement income for everybody in the annuity pool.

Of course, these protections are more or less important depending on certain factors impacting people. We looked at that. For example, can they manage the risk of market downturns? Can they adjust their spending if they have a market crash, or if they are going to live longer? If they can, then the benefit of this protection is less. Do they have other forms of protection in their portfolio already, such as a defined-benefit pension plan?



Jonathan Guyton: "Clients who aren't clear about what matters most to them are having the hardest time."

PHOTOGRAPH BY MICHAEL HAUG

the right way. That means finding the right managers and going into the right format.

ONE LAST PIECE OF ADVICE

FP: To close, I'd like to ask everyone this question: If you could give one recommendation to a 50- to 55-year-old client, with a decent portfolio to invest, what would that recommendation be?

CHEN: Look at protections on the longevity side. There are different ways to get that protection. Analyze your situation to see if you need that protection or not.

KATZ: I believe in passive investing. Most retirees should stay with index funds, ETFs or other investments that are fairly plain vanilla and that they can understand. I believe that they shouldn't own anything they don't know anything about because that only causes them sleepless nights.

WEATHERFORD: Work with a financial professional to have a strong holistic retirement plan. And to work with that professional, beyond the financial conversation, it has to be an in-depth conversation around your wants, needs and desires in retirement. That's my key recommendation for every investor in America.

GUYTON: Invest in your own health. I would put it really high on the list. It increases the amount of time you will be able to work, it increases your ability to do the things that are going to matter most to you. It tends to lead to other balanced decision-making.

STREIFF: While you are working, save as much as you can, because saving more can offset so many other things that crop up along the way. The biggest challenge to overcome in a retirement plan often is just the lack of savings. Save as much as you can while you do have the human capital on your side, and then work with a planner to understand the risks that you have.

SLOTT: Plan now. A lot of people think because the estate exemption is now \$5 million and \$10 million for couples, they don't have to do any estate planning. There is so much more you can do with these exemptions.

Finally, somebody probably said it before, but I've been saying it for years, too: It's a yo-yo economy—"you're on your own." There's not a lot of help out there from government or from businesses; even guaranteed pensions are not guaranteed anymore. Because you are really on your own, you need a financial advisor to help you through it.

FP