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Retirement: A Balancing Act

Confidence in retirement requires more than a large nest egg, it necessitates a well-managed balancing act. A lifetime spent accumulating wealth does not prepare us for the complexities of managing these assets in retirement. As holdings increase, inventive planning strategies become as important as an investment policy statement and asset allocation. Some of the many factors and variables we must consider include the economy, personal cash flow needs, taxes, long-term financial care, family legacy and charitable giving.

The transition to retirement should be navigated with a comprehensive yet flexible plan, one that works to:

- Minimize income and estate taxes through asset selection and location.
- Balance investment opportunities and current lifestyle needs.
- Enhance legacy through strategic gifting and philanthropy.

To this end, we have found it is helpful to divide wealth objectives into three categories:

- Current cash flow
- Lifetime asset base
- Family legacy and philanthropy

Each category has its own management protocol and risk considerations, and will shift in importance over time. In preparation for the transition to retirement, a detailed cash-flow analysis must balance the need to generate income against the long-term capital appreciation necessary to preserve a lifetime asset base. This tension between income and growth is especially delicate for the new wave of retirees who enter this phase of life without a defined benefit pension plan.

Category One: Current Cash Flow

Due to the current low interest- rate environment, considerable capital may be necessary to fund current expenses. Investments in this category should be characterized as liquid and low-risk. In addition, we recommend holding six- to-12 months of cash in reserve in order to avoid ill-timed asset dispositions.

To begin the process of evaluating near-term cash-flow needs, income streams such as pensions, deferred compensation and Social Security must be inventoried. In these instances, the timing of payments can be adjusted to allow for beneficial tax planning and investment impact. For example, an executive with deferred compensation payouts that begin upon retirement can delay pension and Social Security payments in order to reduce current taxes owed and maximize future fixed-income streams. Healthy couples can maximize Social Security payments by suspending individual benefits until age 70, with the lower-earning spouse applying for spousal benefits at normal retirement age, to allow for increased growth of benefits. Conversely, for couples with little guaranteed income from pensions, an earlier Social Security payout may be desirable in order to keep the investment portfolio intact, for as long as possible.

Retirees over the age of 70 $^{1/2}$ should conduct special planning for required minimum distributions from qualified retirement accounts. Because distributions are subject to ordinary income tax rates, these accounts can fund near-term cash-flow needs, leaving a greater percentage of taxable investments for longer-term investing.

Category Two: Lifetime Asset Base

These are the investable assets required to fund the remainder of a retiree's life. In future years, many individuals will retire with large lump sums of investable assets through 401(k) or 403(b) qualified retirement plans. Recipients are left to allocate holdings across multiple asset classes while also managing liquidity for income needs. If markets decline dramatically in the first years following retirement, the lifetime asset base could be significantly eroded just as withdrawals begin.

The optimal timing for payouts is critical, and with many factors in flux during early retirement years, many retirees opt to start out with a more conservative investment approach than will be needed later in life. While it had been customary to realign portfolios away from equity to fixed-income securities with age, this approach has evolved in response to increased longevity and the probability we will spend more money in the earlier years of retirement. Recent studies suggest that the best way to achieve a short-term defensive posture without sacrificing long-term growth may be to trim equity exposure on day one of retirement, repositioning back to the asset class over time.

Qualified retirement plans can play an important role in creating an optimal planning structure by facilitating what is known as an "asset location strategy." This strategy matches the tax characteristics of an investment type with the tax benefits of an account type. For example, the tax-deferred nature of qualified retirement plan accounts provides a safe haven for tax-inefficient alternative investments and high-yield fixed income. Non-qualified accounts, on the other hand, can be used to house tax-efficient investments such as qualified dividend paying stocks and capital gain property.

Category Three: Family Legacy and Philanthropy

For retirees whose assets greatly exceed their anticipated needs, there is an additional bucket of wealth that requires a different analysis. These assets afford a much longer investment period and require strategies designed to limit and reduce future estate tax and generation-skipping tax liabilities. The use of an irrevocable trust where income is taxable to the grantor, for example, can be an integral part of the planning process. Passing the trust's income-tax liability back to the grantor provides the ultimate in wealth transfer through continued depletion of the grantor's personal taxable estate, while leaving the assets inside the irrevocable trust for future growth without causing additional transfer taxes.

In the case of philanthropic giving, there are many ways to optimize investment returns and realize tax efficiencies through gifts to charity. Understanding an individual's current and long-term tax situation will help determine the timing and type of the charitable transfer. If an outright transfer to charity is impractical, a more sophisticated vehicle such as a Charitable Remainder Trust allows an individual to retain current income from assets irrevocably set aside for charity. Conversely, a Charitable Lead Annuity Trust allows excess appreciation from a portfolio of assets to be diverted to heirs after the charity receives a steady income stream for a term of years.

For individuals who enter retirement due to a once-in- a-lifetime event, such as the sale of a business, the donation of a large gift can maximize tax-saving opportunities while also allowing the individual to retain control of future charitable distributions through private foundations or donor-advised funds.

Retirement should be a time to pursue our passions. For most people, this freedom comes as the result of thorough financial planning. At Glenmede, our role is to ensure you begin this chapter with a balanced cash-flow and asset plan in place that will allow you to realize your vision of the future.