The Affluent Meeting Reality in These Uncertain Times

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SHE Ltd

The face of the affluent in 2008

Good News

- Recent survey states that:
  - A majority of advisors say their clients' portfolios have largely recovered
  - 10% are doing better than they were before the recession

…but they aren't sure their clients have recovered

Today’s Baby Boomer Sentiment

- A majority said the economic crisis has made them realize that a secure retirement is by no means guaranteed
- 61% say they are more afraid of outliving their money than they are of dying
- 69% said they prefer a product that is “guaranteed not to lose value” rather than a product whose goal is “providing a high return”
- 76% would rather have a 4% guaranteed return with no risk than an 8% return with risk
- 46% said protecting their assets has become more important to them

In other words…

- Retirees want:
  - Sustainability - low risk of outliving their assets
  - Predictability - consistent income
  - Liquidity - financial flexibility
- …clients expect their relationships with firms and advisers to create more sustained and broad value than before the global financial crisis (GFC).

The question that must be asked

Can the conversations between advisor and investing client stay the same?

Can the conversations stay the same?

- Two most common conversations:
  - Building income generating portfolios
  - Devising systematic withdrawal programs (SWP)

- Do these fill the need for a client's desire for:
  - Sustainability?
  - Predictability ?
  - Liquidity?

Income Producing Portfolios

- A portfolio focusing only on yield emphasizes the income characteristics of these assets over their investment characteristics
- “Chasing yield” can lead investors to buy questionable investments merely because they offer—at least temporarily—favorable income streams

Systematic Withdrawal Programs

- Almost 80% of advisors establish SWP to create retirement income for their clients
  - Concept: stated initial withdrawal percentage to be taken from assets in first year. Each year increase value with a pre-determined inflation rate
- Example:
  - $1,000,000 initial portfolio value, 5% initial withdrawal, 3% inflation adjustment
  - YR 1 Withdrawal: $50,000 (5% of $1,000,000)
  - YR 2 Withdrawal: $51, 501 ($50,000 increased by 3% for inflation)

SWP - Two Prominent “Problems”

- Client Spending
- Volatility

SWP - Spending

- Problem:
  - Studies show that a vast majority of pre-retirees (age 50-59) expect to spend **almost 10%** of their savings each year in retirement!

SWP- Spending

- Problem:
  - Depletion risk is very high for initial withdrawals greater than 5%

Initial Withdrawal rate	**Retirement Horizon (years)**						
	10	**15**	**20**	**25**	**30**	**35**	**40**
3%	0	0	0	0	1	3	4
4%	0	0	1	4	10	15	20
5%	0	0	6	17	28	37	44
6%	0	3	20	39	52	60	64
7%	0	14	43	62	74	80	84
8%	1	30	63	79	86	90	92
9%	5	52	80	89	94	96	97
10%	14	69	90	96	98	98	99

SWP- Spending

- Problem:
  - Many clients feel that the safe max…is uncomfortably limiting...and therefore tend to draw more than that amount (10%)
  - The longer an investor lives the more dramatic the risk of depletion…except for untenably low withdrawal rates
  - 40% of women today who are 50 will live till 100…35 years of retirement!!
  - Vulnerable to emotional withdrawals

SWP - Volatility

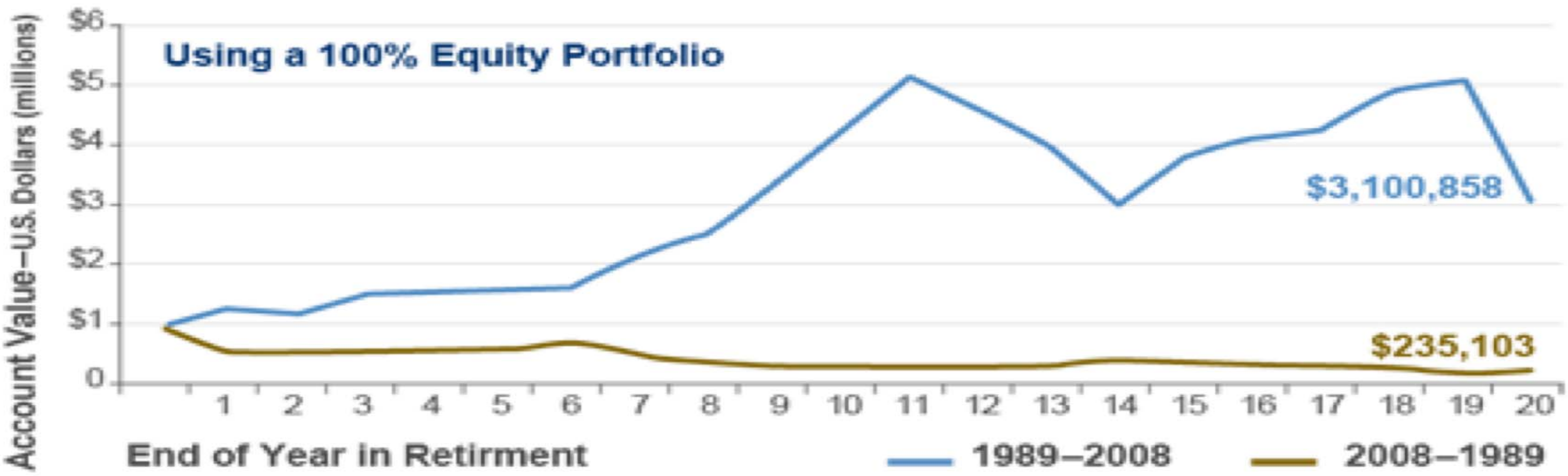
- Problem:
  - Highly vulnerable to a sequence of negative returns
  - During bear markets the “effective” withdrawal rate at the time of withdrawal can become extraordinary high and increase the probability of depletion

- Example:
  - Assumptions: $1,000,000 initial portfolio value, 5% initial withdrawal ($50,000)
  - YR 1: (45%) portfolio return; year end portfolio value $525,000
  - YR 2: 3% inflation adjustment, withdrawal $51,501
  - YR 2: Withdrawal is approximately 10% of portfolio value

SWP - Volatility

The order in which they realize their returns is crucial to the long-term sustainability of a retirement portfolio,

Figure 2.



Hypothetical investment for both sequences consist of 100% equities, represented by the S&P 500 index. *Past performance does not guarantee future results.* **Source:** Thornburg Investment Management

The S&P 500 is an unmanaged index of 500 widely held stocks. An investment cannot be made directly in the index. Diversification does not guarantee a profit nor protect against loss.

Suggested Solutions

- Focused Spending Plans
  - Men or women?
  - Must haves, like to have, nice to have
  - Rent or own
    - assets for emotional purchases (i.e. 2^{nd} home)
  - Support for grown children
  - Support for charities
  - Balance between spending today and spending tomorrow
  - Annual review of spending (i.e. monitor at frequent intervals depending on patterns)

Suggested Solutions

- Avoid withdrawals during bear markets
- Cash flow reserve ladder
  - Cash account for living expenses as a rainy day fund
    - 6 month rainy day fund
    - Stop withdrawals during black swan events and give the portfolio breathing room to recover
  - Home Equity Conversion Mortgage (HECM Standard or lower cost version HECM Saver)

HECM

- Home Equity Conversion Mortgage (HECM Standard or lower cost version HECM Saver)
- The line is used for distributions in down years
  - HECM Saver has lower upfront mortgage insurance premium (MIP .01% vs 2%) but may receive 10-18% less money
  - Because the fees are lower, and no monthly payment is required, it may also prove to be a better option than obtaining a home equity line of credit
- The FHA provides a toll-free number to get a recommendation on an FHA-approved counselor: (800) 569-4287

Suggested Solutions

- Time-segmented asset allocation model
  - "Bucket" system
    - income, growth, and capital preservation
    - mirrored by a goals-based portfolio, in which separate pools of assets are aligned to each objective
  - Looks at income needs over the span of retirement and segments investments accordingly
    - Early segments have a conservative allocation often allocated to fixed-rate investments that are not subject to fluctuation of principle
    - Later segments are allocated more aggressively to allow for market appreciation
    - Asset/Liability scenarios being developed

Suggested Solutions

- Time-segmented asset allocation model (con’t)
  - Harvesting when account balance exceeds the goal
  - Challenging for advisors because it demands the management of multiple accounts
  - Harvesting can help ensure the strategy’s success, it can limit the opportunity for significant over performance
  - Moderate benefits for clients emotional behavior
  - Lots of chatter

Suggested Solutions

- Annuities –
  - Guaranteed Minimum Withdrawal Benefit (rider)
    - Guarantees based upon client not exceeding a pre-determined guaranteed withdrawal amount.
    - If exceeded, guarantee could be lost or recalculated
    - Do not, necessarily, provide inflation protection
  - Immediate Annuities (low interest rates)
  - Women are the largest consumers
  - Do not necessarily provide inflation protections

Suggested Solutions

- Some old strategies are “new” again
  - Pension Maximization using life insurance

Suggested Solutions

- Income tax planning prior to year end
- Income tax planning after 2012

Suggested Solutions

- Estate planning prior to year end
- Estate planning after 2012

Suggested Solutions

- There is no one silver bullet - Combination of solutions will be needed
- Solutions used will be dependent on a client’s:
  - Desired Lifestyle
  - Market Risk tolerance and behaviors
  - Risk tolerance for longevity risk
- Investment advisor. estate planning attorney, CPA insurance advisor, etc. must work together
- Client expectations must be managed in terms of sustainability, predictability and liquidity

Managing client expectations

- Communication….
  - Communication is more than talking
  - Communication …it is getting others to understand what you say

Talking vs Communicating

- Talking is like walking….we do it without stopping to question how we are doing it.
- Subtle differences can lead to great misinterpretation.
- Maximize your impact

" The problem with communication is the illusion that it has occurred"

George Bernard Shaw

Different styles of communication

- Men and women tend to have different styles of communication
- One is not better than the other – it is just different
- When we don't realize that other styles are different (and what those differences are) we often get frustrated in conversations
- Leads to misinterpretation of intensions, abilities and character
- Example : Husband and wife sleeping; connection vs. hierarchy

The importance of communication

- Boston Consulting Group study
  - women have identified the financial services industry (of all the industries that affect their daily lives) as the one that they are most dissatisfied with both on a service and a product level.
  - More than 70% report low or moderate satisfaction
  - The average number of years a woman stays with her advisor after becoming a widow is less than 1

*Women of Wealth – Russ Alan Prince and Hannah Shaw Grove

Satisfaction Factors

62.4%	Listening skills
54.5%	Helping solve problems as they come up
48.3%	Understanding client's goals
44.3%	Knowing how often to how seldom to be in touch
42.3%	Helping clients clarify values and goals
35.1%	Willingness to invest time in client education
06.3%	Ability to be a real friend to the client

Do your conversations need to change?

You are the only one that can answer that question!

Questions?

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