



5 Keys to a Retirement Income Plan

Understand the risks and know your needs.

Am I ready for retirement? It's a question that Greg Doyle, a vice president on the Advanced Planning team at Fidelity Investments, hears over and over again when working with clients. It's a question that invites further questions, about not just one's financial situation, but about their long-term needs, wants, and desires. "Once we get into the weeds," says Doyle, "we often uncover things that clients may not have been thinking about."

If you're interested in developing a solid stream of retirement income that can serve you into your golden years, here are 5 things you should be thinking about as you develop your plan.

1. Understand the challenges that may lie ahead

Having a clear sense of the challenges you may face in retirement is essential to developing a retirement income plan that may be able to last as long as you need it. Here are a few of the most important.

Rising health care costs

"Health care costs should be top of mind when planning for retirement," says Doyle. One of the most difficult financial headwinds you might face is the prospect of rising health care costs, which can quickly eat away at your savings and endanger your retirement plans if you haven't taken it into account.

"Historically, we've seen health care expenses increase by about twice the rate of inflation," says Doyle.

Longevity

While previous generations may have only needed to plan for 10 or 15 years of retirement, today's retirees, thanks to both healthier, more active lifestyles, and improvements in medical science, could enjoy up to 30 or more years of retirement. Though this is certainly good news, it means that the risk of outliving your savings could potentially be much higher, especially if you require long-term care or specialized health care treatment.

Inflation

Inflation is a particular concern for retirees. As it pushes the cost of goods and services higher, it reduces the purchasing power of your savings, potentially making it more difficult to maintain the lifestyle you're accustomed to.

Asset allocation risk

Many retirees seek to reduce the effects of market volatility on their investments by moving to a less risky asset allocation. However, being too conservative may be as detrimental to one's retirement, subjecting retirees to the effects of inflation and passing up potential growth that could come during periods of strong market performance. Conversely, being too aggressive may leave retirees too exposed to big changes in the market, which might compel you to overreact and make a mistake that undermines your long-term plan. What's important is to settle on an allocation that factors in your risk tolerance, time horizon, and overall financial situation.

Spending

Not having a clear sense of your expenses and how you'll cover them can threaten the long-term sustainability of a retirement income plan. Without a clear sense of how much money is leaving your portfolio, you may find yourself in dire financial straits sooner than you realize. "It's important to be realistic about your needs," says Doyle. "Don't undersell how much you're spending today and how much you'd like to spend when you're in retirement. That way, we can determine whether there's a gap between what you're getting from your sources of retirement income and your projected cost of living and how best to address that."

2. Reconcile your income and expenses

Once you have a clear picture of your needs, you can determine what you'll need to satisfy them. "It's important to get a good grip on your cash flow," says Doyle. "What income sources do you have coming in now and potentially in the future? Typically, in retirement, you may have a few predictable sources of income, such as Social Security, or perhaps a pension."

When assessing expenses, start with your current level of spending, then think through how that might change over time. "What are you spending today on things like housing, property taxes, utilities, shopping, dining out?" says Doyle. "Some of these expenses will change when you transition into retirement, some will go up and some will go down. But this will provide you with a good starting point."

"You can compare your sources of income to the expenses you're anticipating and see if there's a gap. Once that foundation is set, we can really start to develop a plan," says Doyle.

Filling that gap can be accomplished in a number of different ways. Your first resource will be your investment and retirement accounts, such as taxable brokerage accounts, 401(k)s, traditional and/or rollover IRAs, and Roth IRAs. But there are other ways to help bolster your retirement income and help offset some of the most challenging expenses. "If eligible, you may want to consider a health savings account (HSA)," says Doyle. "An HSA allows you to contribute money every year for current and/or future qualified medical expenses. If invested, contributions grow tax-free and can be withdrawn tax-free, provided they are used for qualified medical expenses."

Guaranteed income, in the form of annuities, may also help alleviate the stress of having to cover expenses in retirement. For example, purchasing a fixed lifetime income annuity can create regular, predictable income payments for the remainder of your life. This can help you feel more confident about covering your critical living expenses and provide you with a solid foundation that can help you ride out

market volatility. There are tradeoffs, however, so it's important to understand all the details and work with your financial professional, who can help you navigate the various options, before making a decision.

3. Be thoughtful about how you withdraw from your retirement accounts

When it comes time to take withdrawals from your retirement accounts, you'll need to be sensitive to how such withdrawals will affect your taxes. Reducing how much you pay in taxes at this point in your life can potentially help to extend your retirement savings and help you better achieve your wealth-transfer goals. There are a number of strategies available that can assist in reducing your exposure to taxes, which will become particularly important once you must start taking required minimum distributions (RMDs) at age 73 (or age 75 if born in 1960 or later).

"Traditionally, the standard approach was leaving assets in accounts that offer tax-deferred or tax-free growth, such as 401(k)s, IRAs, and Roth IRAs, as long as possible so you can make the most of those benefits and allow the assets to compound," says Doyle. "That means one would start withdrawing from taxable accounts first, then tap into your tax-deferred 401(k) or IRAs next, and save the tax-free Roth IRA withdrawals till the end."

However, there is another approach that may be advantageous if you haven't hit RMD age yet. "It may be helpful to withdraw some funds from a tax-deferred account, possibly filling up your income tax bracket for the current year," says Doyle. "By paying some taxes on those withdrawals now, you may reduce the amount of assets you need to withdraw to satisfy RMD requirements down the road. This could potentially reduce your exposure to income taxes in the future, and help smooth out income taxes owed in one's retirement."

4. Don't let the financial overshadow the personal

While the money is important, it isn't everything. Before you determine what it is you may need in retirement financially, be sure you're really taking everything into account. If you have a spouse or partner, you'll want to be sure to include them as you develop a vision for your retirement years. Together, you can sort through your preferences, manage your disagreements, and create a shared point of view that may be more resilient than if you'd done it alone.

You'll want to think about where exactly you want to live in retirement. Will you be in your current home or are you looking to downsize? Will you stay in your current region, or will you relocate? Will you be near family, or will you need to figure out what a support system might look like as you age? How will you spend your free time? What hobbies or interests do you want to pursue, and do your intentions align or conflict with those of your spouse or partner? Do you see yourself traveling a lot, or would you prefer to stay close to family, such as children or grandchildren?

Whatever personal vision you settle on for your retirement years will help you make better decisions about your financial needs and help to ensure the plan you develop will be set up to fulfill your expectations.

5. Stick to your plan

When markets decline, it's not uncommon for investors to get spooked. Often, investors will want to pull their money out of the market or switch to a more conservative asset allocation in an effort to protect their hard-earned wealth. However, these moves may in fact be counterproductive. Switching things up when the going gets tough by selling off investments or changing your plan could lead you to miss out on an eventual recovery in the market, undermining the long-term growth potential of your portfolio.

"When folks see markets falling and their account balances going down, that can be really scary," says Doyle. "Especially in those early years of retirement when you're depending on those accounts for your income. I've seen a lot of folks get in trouble during times of volatility—they may decide to sell out of the market or move assets into a more conservative allocation thinking they will wait until things stabilize. But usually that means waiting until prices are higher again. As a result, they've missed out on that period of growth which might be crucial to ensure their retirement savings last for their entire lifetime."

Thankfully, there are a few steps you can take to help prepare yourself for the strain of market volatility and hopefully reduce the chance that you make a mistake by deviating from your plan, such as recognizing and planning around the emotions that arise during down markets, complimenting your investment portfolio with a steady stream of income that doesn't come from market-based sources, and engaging an investment professional who can help you navigate challenging conditions.

Stay focused but flexible

There are always going to be risks and there are always going to be bumps in the road. As you age, you may want to engage the help of an advisor (if you haven't already). They may be able to help reduce the stress and time-consuming effort that comes with figuring out all the tricky nuances of building a retirement income plan. They can also help you keep your plan up to date and modify should your circumstances or needs change. It won't always be easy. But with proper planning, you're more likely to stay the course and enjoy the kind of retirement lifestyle you've envisioned.