ROOF ADVISORY GROUP, INC.™
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

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Advisory News Brief

Part of Roof Advisory Group's ongoing series of updates designed to keep investors informed about news & events impacting the financial marketplace.

Retirement Planning vs. Income Planning

When 'retirement planning' is mentioned, most people think of building wealth and accumulating investments. However, as baby boomers begin to reach whatever they have personally chosen to define as their 'retirement' age, preparation needs to shift toward something more appropriately called 'income planning.' What's the difference?

Simply put, retirement planning's focus is on amassing assets, while income planning's emphasis is on how to effectively and efficiently convert those assets into an ongoing income stream. Income planning requires a detailed determination of cash-flow requirements based on retirement income goals and develops specific strategies and tactics to optimally meet this need.

Questions that at one point related to some distant and future change now carry much more weight when referencing an event that will occur within the next five to ten years. How much income is truly required? Have I accumulated enough to sustain my needs? How do I offset the impact of inflation? How do I convert actual investments into predictable cash flow? And do it in the most tax-efficient manner? How do I control portfolio volatility?

Clearly Outline Needs

As with any type of planning, having clearly defined goals and objectives is essential. But it is even more critical when doing income planning because there are not as many opportunities to make adjustments for miscalculations or incorrect assumptions once you've sold your business, left your profession, or retired from your job.

The multitude of possible scenarios that were explored in the retirement planning phase of your life is now focused into one reality. It becomes time to truly 'sharpen the pencil' when calculating actual monthly cash-flow expectations, estimating larger periodic expenditures, and outlining possible financial contingency needs.

What is the amount needed for day-to-day expenses? Is there a lump-sum required to pay annual property taxes? What time of year are trips typically taken and at what cost? Will there be large future needs; vehicle replacements, home improvements, gifting, etc? How do I create a monthly "paycheck" from my investment portfolio?

The Transition

The proposition of coordinating all of your accumulated assets in a way that will adequately support you for the rest of your life can be a daunting task. In order to create this income stream, your portfolio will generally need to be transitioned from an asset accumulation orientation to one that also includes the generation of income.

This modification does not occur instantaneously and should be the result of a disciplined portfolio transition that evolves over several years prior to retirement. The lead time provides the flexibility to phase into an appropriate portfolio structure while also controlling tax consequences and still optimizing overall returns.

The expected timing of estimated expenses should also influence your portfolio's restructuring. Why? Because the majority of your income needs should be able to be accommodated without requiring unexpected security liquidations or unplanned portfolio modifications; all changes could potentially have significant tax consequences, add unnecessary cost, and expose the portfolio to increased risk and volatility.

Similarly, evaluating the current mix of qualified versus non-qualified assets and developing a coordinated strategy for how these assets will best be converted into income is essential. The amount, timing, and blend of dollar distributions from qualified retirement plans/IRAs with other non-retirement plan assets will determine the ultimate tax liability of your income stream and can have a notable impact.

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Total Return vs. Income Only

Years ago, the standard approach to managing an income-generating portfolio was to focus only on fixed income yields and equity dividends when computing the potential cash-flow from the portfolio. This is no longer the case. The new standard is a 'total return' approach; one that represents the overall return on a portfolio including yield income from interest and dividends, as well as any appreciation/depreciation in price over time.

Through diligent management, diversification, and regular rebalancing; the total return approach can generate significant amounts of bottom-line value over time and ultimately enhance post-retirement income. Additionally, portfolio appreciation can be used to offset the impact of inflation and allow the cash-flow generated by the portfolio to maintain a comparable level of spending power throughout the years ahead.

Pulling It All Together

Like most other endeavors, planning without execution is pointless. While establishing plans, outlining goals and benchmarking objectives are important factors, fastidious execution is vital to successfully implementing your income planning. Comprehensive income planning necessitates disciplined and focused portfolio management at all levels.

For example, while discussions about fixed income investing rarely dominate cocktail conversation, skillful bond management is a key component to the successful implantation and ongoing maintenance of proper income planning. In our opinion, the use of individual bonds, as opposed to bond mutual funds, is crucial. A properly managed portfolio of individual bonds allows control of maturity, quality and income flow. Additionally, unlike a bond mutual fund, by actually owning the underlying securities and holding them until maturity, you are essentially insulated from the daily volatility of bond prices.

One initial decision regarding the fixed income portion of your portfolio is whether it is more advantageous to generate 'tax-free' or 'taxable' interest in your taxable accounts. While at first glance, this choice may appear to be a 'no-brainer', it is not. In many cases the use of taxable and semi-taxable bonds such as corporate, agencies, etc. creates a much higher net yield for your portfolio than triple tax-free municipal bond alternatives. An analysis of current tax rates, estimated future tax rates, relative yields from each type of bond, etc. is required.

Ongoing Diligence

It is important to note that these fundamental parameters change continually, so income planning is not a once and done proposition. For instance, dividends from your portfolio's stock holdings can be a dependable source of income. Additionally, the current Federal tax rate on stock dividends is capped at only 15% versus the interest earned on bonds, CDs, etc, which is taxed at your ordinary Federal income tax rate; up to a maximum of 35%. But this preferential tax treatment of stock dividends is scheduled to expire in 2008. What steps should you start taking now to properly position your portfolio's structure for this possible change? There are several.

Unfortunately, many firms in the financial services industry would lead every baby boomer to believe that all of their retirement income needs can be simply met through a single solution - the purchase of annuities. While annuities can have their place in certain situations, rigorous marketing has turned the annuity into the most oversold and improperly positioned product in the financial services industry. The reality is that high expenses and lack of flexibility often make annuities mere band-aids for the complex income planning issues faced by most boomers.

Serious concerns require serious planning and serious solutions. The decisions you make now can have life-long consequences. Let us put our talents and expertise to work for you.

The Roof Advisory Group Advantage

The focused and disciplined nature of Roof Advisory Group's portfolio management process is well suited to income planning. Our process is designed to control downside portfolio risk while optimizing overall investment return versus clearly identified benchmarks. Clients receive non-biased professional portfolio management they can trust, reflecting the firm's core concepts of integrity, expertise and service. Our independent structure and fee-only compensation assures clientele that their best interests are our primary concern.

Call us with any questions. The firm's expertise, experience and professional integrity continue to make Roof Advisory Group the place to go…

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