THE ROAD TO *Financial Maturity*

Part II: The Distribution Phase - Achieving Financial Independence

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During the first half of your financial life, what I have identified as "the accumulation period," you will make many choices that will affect your overall retirement plan.

You will choose when and how to save for retirement, how much to save and where to save and invest. While these choices may be difficult, the good news is that if you make a mistake during the accumulation period, you still have time to learn from these mistakes and correct them (or at least adjust your plans).

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Financial choices to consider as you reach retirement

As you near, and then enter retirement, time will appear to narrow. It may even seem to work against you.

You will have a variety of important choices to make, choices that will affect your finances and your lifestyle in retirement. Among the ones to consider are:

What adjustments, if any, should you make to your investments as you approach retirement age?

When should you start taking Social Security, and how will it affect your other income sources?

What pension option should you choose? A survivor option or a maximum pension?

Obviously, there are numerous other decisions to make – but they all have the same quality.

As retirement grows closer, you have less time to correct any decision-making errors you make. There will be certain crucial decisions you will undertake that can be catastrophic if done incorrectly. And, once incurred, they cannot be undone. That's why retirement planning with an advisor who specializes in this area is so crucial.

The Road to Financial Maturity: Part II

Retirement Income Planning

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The crucial aspect of retirement planning is to recognize that the strategies you employ and the investment choices that you make while you are saving for retirement are often very different than the strategies you use and choices you make while preparing to live in retirement.

One critical area of planning where this difference is most pronounced in what is known as Retirement Income Planning.

Generally, the question is this: will your income plan guarantee that your nest egg won't run out during your retirement years? Realizing that pensions and Social Security are an ever-shrinking part of a retiree's income, effective management of personal assets will increasingly be the single most important component that determines the quality (and quantity) of your retirement income.

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Serious Planning for Retirement: The Basics

In your retirement, you can hope to have three types of income:

Your essential income - the money that allows you to live at a baseline, comfortable level. It is the "must have" income each month

Your fun income - the extra income that allows you to really enjoy life: playing golf, vacationing, traveling, etc.

Your bonus or legacy income - the money that will provide your heirs and your favorite charities with the lifeblood they will need to flourish in the future.

For most people, there is a corresponding list of four income sources to meet these needs:

1. **Social Security**
2. **Employer pension**
3. **Income from personal assets**
4. **Continued work**

Because you have little or no control over Social Security and pension payments, we consider these relatively fixed income streams. There is some small inflation protection in the Social Security stream, but rarely is there an inflation hedge in the employer pension you may receive. Thus, it should come as no surprise that the sheer amount and year-by-year persistency of your annual retirement income will be based on the income you can generate from continuing to work and from your own investment portfolio.

Income from Personal Assets

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The quality of your retirement will most likely be determined by the success of your investment strategy and your portfolio's ability to generate income above and beyond any pension and Social Security payments.

The longer you want to live, the more you want to do; and the higher you want your lifestyle to be, the more dependent you will be on how well you handle your investment portfolio before and during your retirement.

The risks are substantial; investment risk, interest rate risk, investment performance sequence risk, inflation risk, and longevity risk are all very real and potentially very damaging to your financial well-being. You must understand them, and you must address them in your investment strategy.

The Game Has Changed

Interestingly, the products and strategies you used in the Accumulation Phase of your life - the very methods that got you to this point - may now no longer be relevant. In several cases, they may be downright damaging to your future success. The game has changed, and the rules are different. Even the finish line is different. From here on, we measure success not by how much wealth you have, but by how much income you can generate in an unending, annual succession of ever higher amounts during your retirement.

The principle financial products in your toolkit will shift from wealth accumulation instruments to the kinds of products that generate the three types of income we mentioned earlier. Guaranteed income products, like annuities, will supply the bulk of the essential income needs. Bonds and equities, in the form of individual securities, mutual funds and exchange traded funds, should be the major component of your discretionary income needs. Protection products, like long term care insurance and single premium variable life insurance, will provide the risk management necessary to manage the bonus/legacy income need.

In many cases, these products will be new to you, or at least, they will be used in different ways than you used them in the Accumulation Phase. You may be using the Guaranteed Withdrawal Benefit from an annuity, or you may re-allocate your portfolio from growth to value-oriented, dividend paying stocks, or you may need to divert the insurance premium you had used for disability insurance toward long term care insurance. Regardless, some of the "rules of the road" have changed and you'd better recognize that.

The all-important questions to raise here are these:

1. How much of your essential income should you insure?
2. Can you afford not to guarantee some significant part of your retirement income?
3. Do you want to be able to guarantee the income necessary for your independence?
4. Does your current portfolio protect you from the risks of retirement income planning or does it actually expose you to them?

The Road to Financial Maturity: Part II

Your best chance of success with a financial planner

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The long road through a modern-day retirement is filled with uncertainties. Few people have real experience with handling money over a thirty-year period without a paycheck.

Creating a sustainable income stream that can withstand the risks of longevity, investment markets, and inflation is no easy task. With the assistance of an experienced financial planner, however, you will have access to the financial products and strategies that give you the best chance of success.

The income strategy best suited to you will be determined by your own financial situation and your own attitudes toward money. Regardless of which strategies you use, one thing is clear: retirees managing their finances in the 21st century will endure challenges unlike any that previous generations have faced. A crucial part of their success will be a well-designed and executed retirement income plan.

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The Distribution Phase: Getting Started with Estate Planning

Thorough estate planning begins with the careful consideration of the four possible life outcomes.

When you really think about it, these are the only four possible scenarios in your economic life: you are healthy and you cruise into retirement living to normal life expectancy, you are really healthy and you live a long time (longer than life expectancy), you are not healthy and you become incapacitated at some point, or you are really unhealthy and you die tomorrow. I admit this is a little over exaggerated, but the idea is right.

The major questions to consider in estate planning are:

1. What if I live for a while?
2. What if I live too long?
3. What if I become incapacitated?
4. What if I die?

Assembling your estate planning team

There is no specific formula for determining your estate planning team. Clearly, the more complex your situation, the more team members you may need. At the very least, there should be three essential players: a CPA, an experienced attorney, and a financial planner who each specialize in estate planning.

For attorneys, an advertisement of “doing wills and trusts” is not a sufficient level of sophistication to do real estate planning. One needs to seek out a true estate attorney who works primarily (maybe only exclusively) with estate planning clients. In the financial planning world, there are several professional designations that advisors earn through continuing education and accredited study programs.

An Accredited Estate Planner (AEP@) and a Certified Financial Planner (CFP@) are two such designations that are reflective of significant knowledge and experience in estate planning. Seek out candidates who have these credentials. Further information and background can also be found by communicating with your local chapter of the National Association of Estate Planners and Councils (naepc.org).

The Road to Financial Maturity: Part II

The Basics of Wealth Transfer: Why You Need a Will

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Let me be blunt on the topic of wills; you need one. You must have one! In fact, whether you know it or not, you already have one.

Your state of residence has a written will sitting on the shelves for every person who dies without having written a will for themselves. It's called the "intestate will" and you do not want this will.

First of all, the state-written will does not often make a lot of sense. In some states, it gives money to your parents when most likely you would like it to go to your children. Second, by allowing the state to dictate the distribution of your estate, you have lost most of the important tax savings mechanisms available to planned estates.

The bottom line is that you should have a will drawn up and notarized. A competent attorney can draft a personalized, simple will at a reasonable price.

This official act tells the world that you have made an affirmative action toward the disposing of your assets upon your death. If for no other reason, please make a will to name a guardian for your minor children. Without this provision, your children may end up in orphan's court, even if there is an obvious, ready-and-willing and loving family member to step into the void that your untimely death would create. Without a definitive statement from you in a will, the courts will decide who cares for your children - not you.

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Have no fear and *trust* the process

I have found that "probate," where a will is to be proven valid in court, is one of the most feared terms in estate planning.

Yes, there are some costs associated with probate, and yes, some attorneys draw out the process solely for their own financial reward. But ethical, competent attorneys can use it to your favor. At the very least, don't let the simple idea of "avoiding probate" be the reason you let yourself get stuck into doing the potentially phony estate planning hyped by "Living Trust" salespeople. Suffice to say: sometimes, you want probate.

Power of Attorney

There may come a time in your life when you will not be able to speak for yourself. There may be a medical situation, however temporary, that could prevent you from being able to transact financial business. Or you could simply be out of the country on vacation or on business. In any case, a Power of Attorney (POA) allows someone you have designated to act on your behalf in financial and legal matters.

If the situation is temporary, a basic POA will suffice; however, if you wish to cover a situation where your inability to act on your own behalf is more permanent (a major medical event for example), then you should consider a Durable POA. Such a document is "durable" in the event of your incapacity and would be recognized as a valid legal instrument, whereas a basic POA becomes null and void at your incapacity - exactly at the time you might need it the most!

Trusts

As in most planning concepts, a competent team of advisors, including an estate attorney, an accountant, and a financial advisor, is your best source of information on trusts. This article is only really intended to provide basic ideas and concepts. As such, there is no way I could possibly do justice to trusts here.

Not always, but in most cases, a trust is executed in estate planning to handle what I call the Four Horsemen of the Estate Planning Apocalypse: Creditors, Predators, Outlaws, and In-Laws. I am being a bit flippant here, but the idea is solid. Trusts are meant to protect against creditors who would take your assets against your wishes, against predators who could "dupe" and manipulate your heirs, against your former in-laws in the case of divorce or business disputes and against current in-laws in the case of future action against your heirs.

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Long Term Care

First, let's be very upfront: by the time you learn all you need to know about long term care, you might already need it.

So, hiding behind the veil of "I need to learn more about it before I do something" is probably not a good approach. Do some homework, educate yourself about long term care and then talk to your financial advisor. Make your best judgment at the time, decide on how to proceed and then enact a plan that gives you maximum flexibility to alter your course later, if and when you think you should.

For purposes of our discussion on Long Term Care (LTC), I mean a situation where you or a loved one requires ongoing, specialized care for an injury or chronic medical condition. The required care is beyond your family's ability to provide it and the cost is substantial.

I have been fortunate in the sense that I have much firsthand knowledge of this exact situation. In my family, I have had six nonagenarians who have required one form or another of care - assisted living, nursing home care, critical care, etc. While I will not comment on the quality of care in various facilities, I will say that the more money you have to deal with this issue, the better your chances are of having quality care in a nice environment. As with most things, money talks when it comes to long term care.

Among the many unnerving aspects of LTC is the sense of uncertainty. When someone you love is in long term care, you can easily feel like you are being held hostage to the situation because you never know when the care will end, or what the ultimate cost will be. This is in addition to the truly draining emotional and psychological toll that any LTC situation takes on a family.

Conclusion: The framework for your estate plan

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While the full scope of estate planning may appear to be overwhelming, I hope I have given you a framework by which you can examine the most important aspects of your estate plan.

A well-crafted and implemented retirement plan with the requisite retirement income plan should adequately cover the questions of "what if I live/what if I live a long time?" The appropriate documents like a Power of Attorney or a Revocable Living Trust can help you negotiate the case of a temporary or permanent incapacity. Well-planned wills, trusts, and beneficiary designations can cover the eventuality of your demise. In the end, the success of your estate plan is measured by only one thing: how well it carried out your wishes.

Estate planning is an ongoing process.

Tax laws change, new and improved trust arrangements may become available, and certainly the circumstances of your own life will change with time. At the very least, we ask our clients to review the fundamentals of their estate plan once a year. Absent any major legal or life changes, we undertake a more thorough review about every five years to make sure that the official documents like wills, trusts, and beneficiary designations are up to date and that they reflect your current wishes. You owe yourself the time to carefully consider how you will disburse your legacy; it is time well spent to reflect upon the good you have done and will do in your lifetime.

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