Wealth Management Update

Retirement Minefield: Grab a Map!

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Planning for retirement today can feel a bit like navigating a minefield. The hazards of underfunding, coupled with inflation risk and the rising cost of health care, represent just a few of the potential pitfalls. Retirees run a similar gauntlet in managing retirement assets with concerns ranging from managing cash flow to effectively planning for taxes.

While strategies exist to help mitigate some of these concerns, there are some less obvious factors that, if left unaddressed, can have just as big an impact on your ability to enjoy retirement. Identifying and proactively addressing these factors early is the key.

Timing is everything

Average investment returns are often used in projecting retirement balances into the future. But did you know the sequence of those returns can have a large impact on your results? Consistency of returns is what matters for retirement. Consider the following hypothetical example below which shows three different investors each investing $1 million over a 20-year period. All three investors each have the same average rate of return of eight percent: one investor faces challenges early on, one investor faces challenges later in the market, and one investor has steady annual returns of eight percent. Despite the same average return and time horizon, however, the sequence of returns causes the ending values to differ.

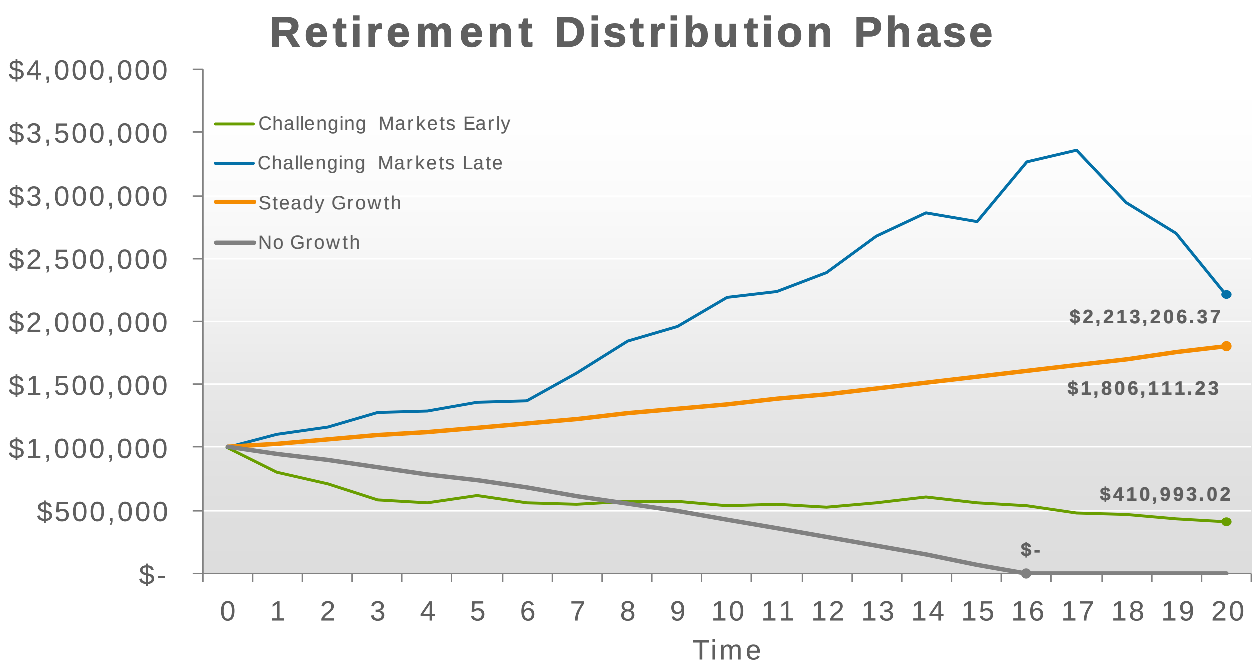
Retirement Accumulation Phase

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	Average	Ending Values
Challenging Markets Early	-15	-5	-10	5	20	0	10	15	10	5	15	10	20	20	5	10	5	15	10	15	8%	$ 4,299,726
Challenging Markets Late	15	10	15	5	10	5	20	20	10	15	5	10	15	10	0	20	5	-10	-5	-15	8%	$ 4,299,726
Steady 8% Annual Return	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8%	$ 4,660,957

Source: Wells Fargo Wealth Management, 02/13

This hypothetical example is for illustrative purposes only, does not represent actual transactions, and is not indicative of any specific investments.

Consistency of returns becomes even more important once these investors enter retirement and begin taking withdrawals. As you can see, poor returns experienced in the early years of investing can wreak havoc on long-term results.



Assumes five percent withdrawals annually and a three percent increase in withdrawal amount per year to account for inflation. Source: Wells Fargo Wealth Management, 02/13

Because of the importance of consistent returns, we suggest you exercise caution when selecting investments within retirement accounts. Concentrated or speculative investments can introduce significant volatility and risk. You can take additional steps to help achieve portfolio consistency by maintaining adequate short-term liquidity, implementing appropriate asset allocation for longer-term goals, and rebalancing regularly to control portfolio risk.

Sustainability is key

While the global economy and its impact on financial markets may be unpredictable, taking proactive steps can help you manage assets effectively through difficult market cycles. Since these downturns are inevitable, working to minimize their impact becomes paramount.

One best practice involves setting aside an emergency fund for use during those negative market cycles. By keeping up to 18 months of living expenses available in cash, you may be able to use these assets to finance living expenses and avoid having to “sell at the bottom.” Appropriate liquidity management and asset allocation rebalancing will also help to provide cash when needed, as opposed to having too much money earning little return in money market accounts. Investors should also consider creating two budgets and adhering to them based on current market conditions; a normal budget, which funds your lifestyle as you would ideally see fit, and a budget for Plan B which could be utilized during down markets.

An additional economic risk that can wreak havoc is inflation. Inflation erodes the buying power of the money you worked so hard to save. To protect that buying power, you may want to consider investing a portion of your savings in assets that have historically had a positive relationship with inflation. Some examples include allocations to real estate, commodities, Treasury Inflation-Protected Securities (TIPS), and even stocks.

Paying Uncle Sam on your own terms

Sometimes investors forget that a tax-deferred individual retirement account (IRA) doesn't belong solely to the individual; Uncle Sam (aka the government) actually owns a portion of these accounts as well. While you may not be able to avoid paying taxes on the assets within these accounts, you do have some flexibility in how and when you pay. For instance, by naming a young beneficiary to these accounts and implementing a strategy known as a Stretch IRA, you may be able to defer taxes for a longer period of time. This allows future generations to benefit from the continued tax-deferred growth of the assets over their own life expectancy. It also might make sense to consider converting part or all of your assets in a traditional IRA into a Roth IRA, especially if you think you will be in a higher tax bracket down the line.

The next stage

Retirement can offer retirees the freedom to focus on what is really important. Family, travel, and philanthropic interests can lead to new adventures in the next chapter of your life. Regardless of your age, the decisions you make now can have a profound impact on what your retirement looks like. Your relationship manager and team of experienced financial specialists can help you define retirement on your terms. In order to determine what you want your retirement to look like, we consider a detailed conversation about your retirement goals and aspirations as a good starting point. This conversation can form the basis of a customized financial plan to help make your retirement dreams a reality. If you haven't yet discussed developing such a plan, we suggest talking with your relationship manager today—the first step in avoiding the minefield and taking control of your retirement.