The Retirement Income Playbook

Solving The Income Equation:
A Comprehensive Guide to Funding Retirement

KINGSVIEW PARTNERS

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Introduction

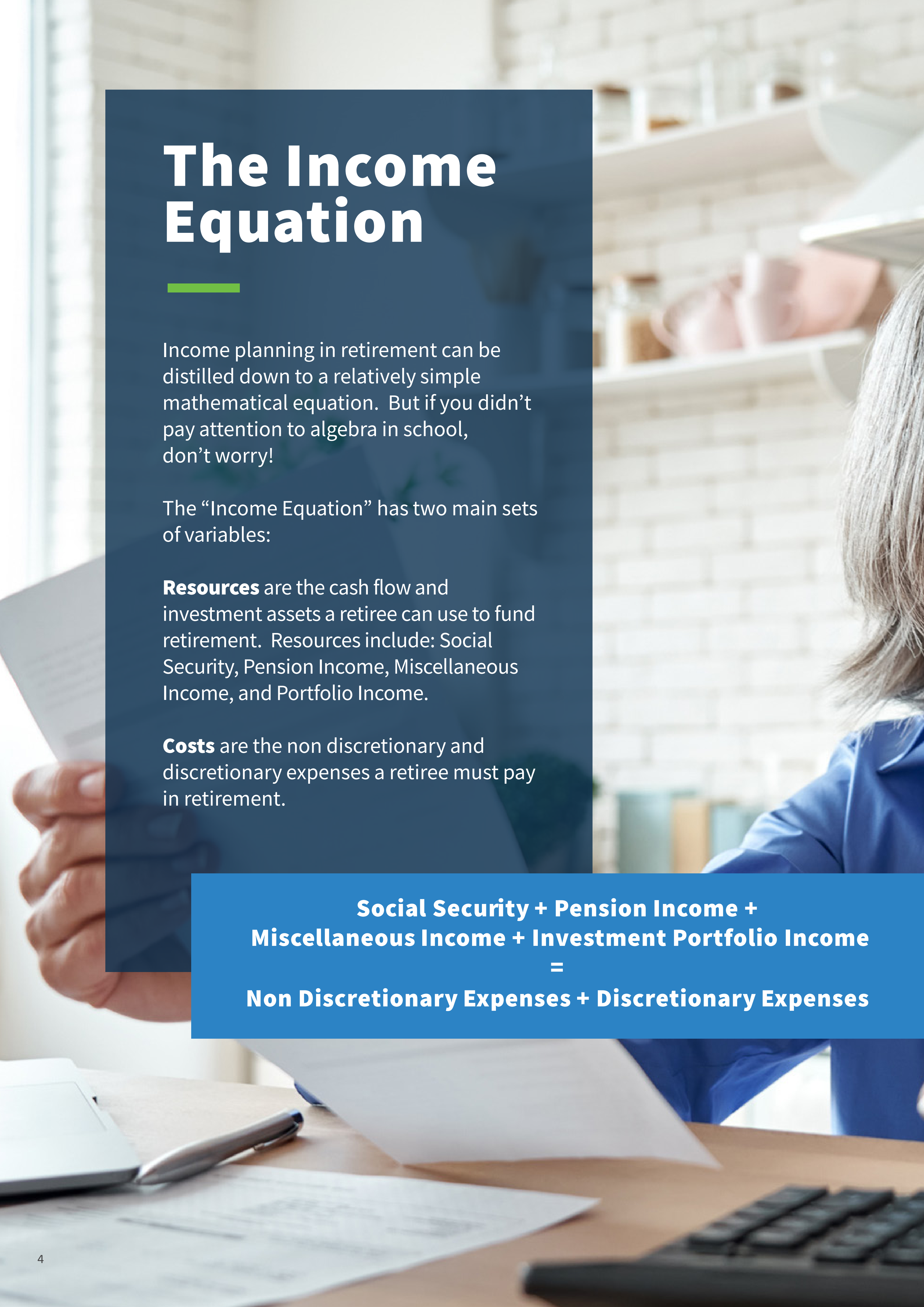
It's no secret that retirement can be expensive, and it's becoming more difficult for investors to prepare for it. Most retirees won't be able to survive on Social Security benefits alone, so that means you'll need a healthy nest egg and a robust retirement plan.

There is one simple question that everybody planning for retirement needs to ask. How much will retirement actually cost? If that question stops you in your tracks, you're not alone. Many Americans don't have a clue about how much they need to save for their future. That's alarming news considering pensions have dissipated and individuals are now expected to rely on themselves more than ever when it comes to saving for their future.

Understanding what it is going to cost you to live comfortably in retirement is not a simple question. One way to figure out what your retirement number is and how much you CAN spend… and how much you will NEED to spend in your golden years is to complete a full financial plan.

It is important to remember that planning for retirement is not something you do shortly before you stop working. Rather, it's a lifelong process and it is NEVER too early to start. Throughout your working years, your planning will undergo a series of stages. You'll evaluate your progress and targets and make decisions to ensure you reach them. You'll evaluate your progress and targets and make decisions to ensure you reach them.

Our team at Kingsview Partners put this guide together because informing investors allows us to help empower people financially. We sincerely hope this guide helps you on your road to retirement



The Income Equation

Income planning in retirement can be distilled down to a relatively simple mathematical equation. But if you didn't pay attention to algebra in school, don't worry!

The "Income Equation" has two main sets of variables:

Resources are the cash flow and investment assets a retiree can use to fund retirement. Resources include: Social Security, Pension Income, Miscellaneous Income, and Portfolio Income.

Costs are the non discretionary and discretionary expenses a retiree must pay in retirement.

Social Security + Pension Income +
Miscellaneous Income + Investment Portfolio Income
=
Non Discretionary Expenses + Discretionary Expenses

Completing your personal income equation can help you identify the costs of retirement as well as the cash flow and resources you have available to fund your life after you stop working. More importantly though, the equation allows an investor to see how additional expenses in retirement impact the need to draw income from an investment portfolio.

Ultimately, understanding your income needs in retirement can help you figure out exactly how much you need to save to comfortably fund your goals.

In order to retire successfully as an investor, the total income that you can produce from your resources must be greater than the combined total of both your discretionary and non discretionary expenses.

Ultimately investors that want to begin to understand their own income equation can start by segmenting potential costs in retirement and then prioritizing them based on their goals.

Understanding Costs in Retirement

It is no secret that retirement can be expensive, and with potential inflationary pressures, understanding, prioritizing and controlling expenses in retirement is more important than ever before. Lifestyle, location, and circumstance can all play a massive role in determining retirement cost.

We believe it is important for people to start by asking themselves what their plan is for retirement.

Once an investor has a firm understanding of what they want to do in retirement, they can begin to segment and budget their expenses.

- Do you want to spend time with family and friends?
- Focus on traveling and seeing the world?
- Move to a different city or state?
- Start a lifestyle business?

Expenses fall into two distinct categories:

Non Discretionary Expenses

Some things in life are pretty much impossible to live without…

Which is why all retirees need to plan for the basics! Non Discretionary expenses are the ones you don't have much control over. You can choose to relocate to a less expensive area, or downsize into a less expensive home, but you may still need to pay the mortgage.

01 **Basic Living Expenses:** Core living expenses are the costs you absolutely must pay to keep food in your refrigerator and a roof over your head. These expenses include everything from groceries, car insurance, heat and electricity. Most retirees already understand how much they pay in core living expenses.

02 **Taxes:** The saying goes that the only certainties in life are death and taxes… which is why taxes are classified as a non discretionary expense. Retirees do have access to a variety of different tax planning strategies that may potentially reduce tax liability but paying taxes in retirement is ultimately unavoidable.

03 **Healthcare:** The cost of healthcare for American retirees is unavoidable and rising. Investors should prepare for increasing future healthcare costs as well as the potential cost of long term care.

04 **Debt:** Many retirees are debt free before retirement but not everybody is able to retire without debt. Any mortgages, credit card balances and outstanding auto loans will need to be paid off out of income during retirement. Unfortunately paying outstanding debt may be an expense for retirees.

Discretionary Expenses

All retirement income plans must budget for discretionary spending. What you choose to spend money on in retirement will be unique to your personal preferences, and expenses that are optional for some people may be viewed as a requirement for others. Most discretionary expenses can be classified in the three following categories:

01 **Family:** For those that have the means, spending money on loved ones can often be immensely satisfying. If you want to offer financial support to your children or grandchildren, fund family activities and travel to see family, you would classify these expenses here.

02 **Hobbies:** Investors are often surprised to realize just how much free time they have in retirement. Many hobbies are not that expensive but most involve some cost. Retirement offers investors an incredible opportunity to spend time doing what they enjoy most.

03 **Indulgences:** What counts as an indulgence often depends on the individual, but these expenses are best defined as luxuries that are unnecessary but enjoyable. For some it might mean purchasing a new sports car. Others may budget for more meals at restaurants. Regardless, these expenses need to be accounted for to understand your actual retirement income needs.

Inflation: The Elephant In The Room

You can build the most comprehensive budget possible to try to predict how much income you will need in retirement but unfortunately the effects of inflation can skew even the best plans. Currency loses its buying power over time. The amount of money an investor needs to cover monthly expenses is going to be higher 10 years from now than it is today. Unfortunately, inflation also isn't uniform. The price of some goods and services increase faster than others.

While certain items have seen relatively linear increases (and in some cases like mass produced technology, price decreases), other services such as healthcare have increased in price at an alarming rate. The increase in the price of healthcare specifically is alarming because it is a non discretionary expense. Spending on healthcare as a percentage of GDP grew from 5% in 1960 to 17% in 2022**.

In order to properly balance your individual income equation, you must factor in a yearly inflation adjustment. Even though it is impossible to predict exactly how much inflation to expect, factoring in average price increases can allow a retiree to map future income needs with increased certainty.

***https://www.pgpf.org/blog/2024/01/why-are-americans-paying-more-for-healthcare*

Adding Up Your Retirement Income

After calculating both your discretionary and non discretionary expenses in retirement, you can begin to work on the income side of the equation. Income can be segmented into the following buckets:

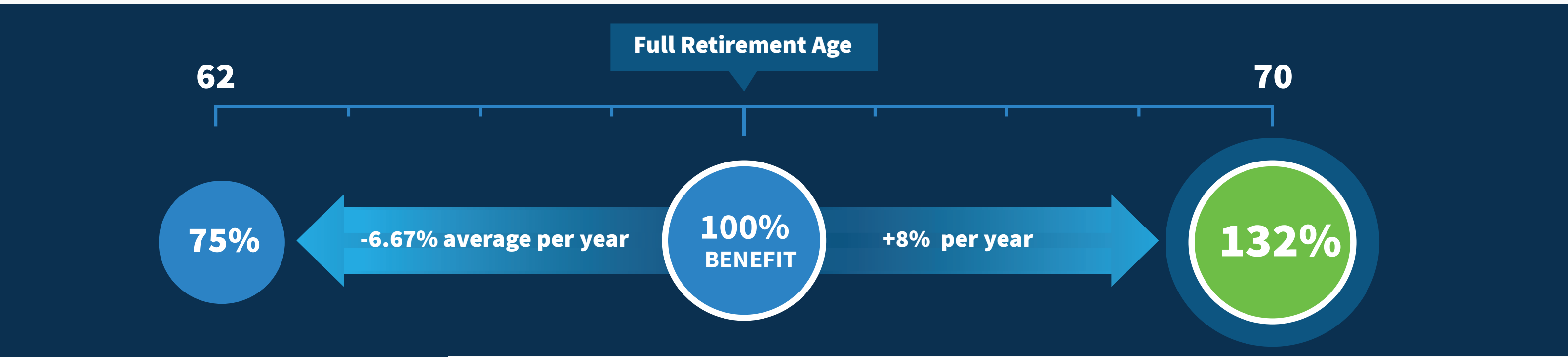
— Social Security
— Pension
— Miscellaneous Income
— Part Time Work Income
— Business Income
— Real Estate Rental Income
— Investment Portfolio Income
— Bond Coupon Payments
— Stock Dividends
— Selling Stock For Income
— Annuities
— Alternatives
— Income Generating Private Placements

Social Security

The United States Social Security Administration is an independent agency of the federal government that manages the Social Security system. Social Security is a social insurance program that consists of retirement, disability and survivor benefits.

For many investors, Social Security offers an important source of cash flow once they reach retirement age. The benefit amount an investor receives is dependent on the decisions made leading up to retirement.

Eligible retirees will need to decide when to start receiving benefits. There are a few choices that will depend on employment status and age. Retirees that defer benefit payments until they are older are rewarded with a larger benefit.



The best time to start taking social security benefits is going to depend on the specific circumstances of your individual financial plan. Investors who are under the full retirement age and continuing to work are unlikely to benefit from taking their benefits early.

Investors who are under the full retirement age but have already retired may want to consider deferring their benefits and living off investment income to avoid receiving a reduced benefit. However, the specifics of your situation will impact this decision as there are trade offs. People with health challenges who are concerned about lifespan may want to consider taking their benefits early.

**https://www.ssa.gov/benefits/retirement/planner/delayret.html*

Investors with longevity in their families will ultimately benefit from deferring benefits for as long as possible. Those who wait until age 70 may receive a higher benefit, and any cost of living increases will be applied to a higher base benefit amount.

The bottom line is that Social Security is a reliable form of income in retirement and an important part of the income equation.

Pension

A Pension is a type of employer sponsored retirement income plan. Pensions require that employers make contributions to an investment fund that are then invested on behalf of the employee so they can receive income upon retirement.

Pensions are not as common as they used to be, and they may be entirely or partially employer funded. There are two types of pension plans that are typically available.

In a **Defined Benefit Plan,** the employer guarantees a set amount of money to be paid to the employee upon retirement. This amount must be paid regardless of the performance of the investments in the pension fund.

In a **Defined Contribution Plan** employers make plan contributions for workers, in many cases matching contributions made by employees. However, the final benefit to the employee isn't defined, and the amount the employee ultimately receives in retirement is based on the performance of the investments.

If you have a pension, it is important to understand what kind you have so you can determine the quality and stability of any provided income in retirement.

Annuity Income Benefits

One of the key benefits of an income annuity is that they provide a guaranteed stream of income for retirees. With the capability to safeguard against the daunting prospect of outliving one's savings, annuities provide lifelong income options. This assurance not only grants peace of mind but also instills greater confidence in your long-term financial plan.

Income Annuities

An income annuity transforms a lump sum of money into a guaranteed consistent flow of payments over time. By entrusting your funds to an insurance company, you secure an agreement where the insurer commits to disbursing payments for a specified duration or for your entire lifetime.

The frequency of these payments—whether monthly, quarterly, or annually—depends on your agreement. Additionally, you have the flexibility to tailor your income annuity contract to commence payments immediately or defer them to a later date.

Reducing Market Risk

Certain types of annuities offer the option to mitigate market risk by limiting risk to stock market losses. This allows you to create a gauranteed income stream that remains relatively unaffected by preassures that can occur from stock market losses.

A traditional investment portfolio that you may rely on for income as you enter retirement can experience serious pressure if the market were to take a dive as you begin drawing on your portfolio for income.

Generating an Income Floor

Annuities establish an income floor through contractual guarantees, offering policyholders a dependable stream of regular payments regardless of other financial variables. These contracts, typically formed with insurance companies, assure a minimum level of income either for a fixed period or throughout the policyholder's lifetime. This lifetime income option shields against the risk of outliving one's savings, providing financial security for the long term. Moreover, fixed annuities often secure interest rates at the time of purchase, ensuring stable payments despite future interest rate fluctuations.

By investing premiums into a diversified portfolio of low-risk securities, such as bonds, insurance companies manage risk and ensure they can fulfill their payout obligations. Additionally, annuities benefit from mortality pooling, where longevity risk is spread among policyholders, allowing those who live longer to draw from the premiums of those who pass away earlier. Through these mechanisms, annuities create a reliable income floor, offering peace of mind and financial stability regardless of market conditions or personal circumstances.

Tax Advantages

Annuities offer tax-deferred growth, meaning earnings within the annuity contract aren't taxed until funds are withdrawn, potentially accelerating investment growth compared to taxable accounts. Additionally, if you fund your annuity with after-tax dollars, a portion of each payment is considered a return of principal and isn't taxed upon distribution, providing tax advantages during the distribution phase. These features allow annuity holders to optimize retirement income while potentially minimizing overall tax liabilities, making annuities a valuable tool in retirement planning.

Inflation Protection

Some annuities offer inflation-adjusted payouts, which help your income keep pace with rising living costs over time. With inflation-adjusted annuities, also known as indexed or variable annuities with inflation riders, the income payments received can be adjusted periodically to keep pace with inflation. This adjustment ensures that the purchasing power of the annuity payments remains relatively stable, allowing retirees to maintain their standard of living despite the increasing cost of goods and services.

By providing this inflation protection, annuities offer a valuable hedge against the risk of inflation eroding the real value of retirement income over the long term. This feature is especially important for retirees who rely heavily on fixed income streams to cover essential expenses throughout their retirement years. With inflation-adjusted annuities, retirees can have greater confidence in their financial security, knowing that their income will continue to provide meaningful support even as the cost of living rises.

Beneficiary Protection

Beneficiary protection is a fundamental feature of annuities that provides peace of mind and financial security for policyholders and their loved ones. By allowing annuity holders to designate beneficiaries, annuities ensure that any remaining funds within the annuity contract are passed on to chosen heirs or beneficiaries upon the annuitant's death. This aspect of annuities serves as a crucial estate planning tool, enabling individuals to create a legacy and provide ongoing financial support for their loved ones beyond their lifetime.

The ability to name beneficiaries offers flexibility and control over the distribution of assets, allowing annuity holders to tailor their estate plans according to their specific wishes and family circumstances. Whether it's providing for a surviving spouse, supporting children or grandchildren, or contributing to charitable causes, annuities empower individuals to shape their legacy and leave a lasting impact on future generations. Additionally, the beneficiary designation process is typically straightforward and can be easily updated to reflect changing life circumstances, ensuring that the intended beneficiaries receive the assets as desired.

Simplicity

Income annuities stand apart from other retirement accounts or investment vehicles due to their hands-off nature. Unlike traditional investment options, income annuities do not demand ongoing investment decisions or management. Once the annuity is established, payments are automatic, streamlining financial planning and minimizing the necessity for active management.

Alternatives

Many investors have already considered alternative portfolio investments designed to offer income instead of the more commonly used stocks, bonds and annuities. Alternative portfolio investments can include the following:

Real Estate Investment Trusts which are also known as REITs are companies that own, finance, or operate real estate properties for the specific purpose of generating income. REITs offer investors income generation potential in exchange for the risk of owning the underlying properties. The advantage of a REIT is that it offers investors the potential to earn income from Real Estate without having to operate a real estate rental business.

Equity REITs own and manage income producing properties. Mortgage REITs can potentially generate interest income for investors by either lending directly to real estate owners and operators or through the ownership of mortgage backed securities. There are also hybrid REITs that use both equity and mortgage strategies.

Master Limited Partnerships, commonly known as MLPs are publicly traded partnerships that offer purchasing investors the potential to receive tax advantaged income, often in natural resource energy investments due to the fact that they must generate income from qualified sources. Due to the fact that MLPs are partnerships, they are not subject to state or federal corporate income tax. Instead, the tax liability associated with the investment is passed on directly to the individual investor. MLPs often have significant depreciation and other non-cash charges which means that investors often get taxed on less income than they ultimately receive. Any cash investors receive in excess of taxable income is considered a return of capital, making MLPs particularly effective at deferring tax. Due to the fact that MLPs are mostly found in the energy sector, they are susceptible to fluctuations in commodity prices, interest rates, and overall economic conditions. Risk is typically commensurate with yield.

Ultimately, investors should be sure to consult a professional and understand the risks, but in some cases alternatives may offer attractive income generating opportunities as well as tax efficiencies.

Income Generating Private Placements are the sale of either stocks or bonds directly to pre-selected investors. Typically these investments are subject to less regulation, are only sold directly to wealthy investors or institutions, and come with higher income potential and higher risk than a traditional stock or bond.

What does luck have to do with it?

Understanding Sequence Risk

Sequence risk, or the risk associated with a poor sequence of returns, describes the potentially detrimental effect of poorly timed withdrawals from an investment portfolio. Even though historical rates of return for an investment such as stocks or bonds may be favorable, poor returns right when an investor is retiring may have an outsized impact on the overall performance of a portfolio, significantly impacting the income generating potential of that investment for a retiree that is no longer making contributions to their accounts.

The more conservative the investment, the less susceptible it is to sequence risk. For example, bonds and annuities tend to be less vulnerable to sequence risk than stocks or alternatives.

Unfortunately sequence risk largely depends on luck. One way to insulate the income generating potential of a portfolio from sequence risk is to diversify into conservative investments and consider postponing retirement for as long as possible. The less income a portfolio is required to provide in retirement the less susceptible it is to sequence risk.

The less income a portfolio is required to provide in retirement the less susceptible it is to sequence risk.

The 4% Rule

Since there are so many different options available for investors to choose from when selecting investments that can generate portfolio income, it is important to view everything within the context of longevity when building an income plan.

The income equation can tell an investor how much money they need to withdraw from their portfolio during retirement to support a given level of expense, but it doesn't give a definitive guideline on whether a retiree is going to run out of money.

The 4% rule is a commonly used rule of thumb that determines how much a retiree should withdraw from a retirement account each year.

While experts are divided on the actual safety of building a plan around the 4% rule, especially given that 4% may be too high of an annual withdrawal rate in the current higher interest rate environment, it can still serve as a helpful guideline to help investors determine how much they need to save for retirement.

Essentially, by assuming a maximum safe withdrawal rate of 4%, an investor can complete their income equation to understand how much income they are going to need, and then back out the numbers to determine the necessary starting balance for their investment portfolio when they retire.

Balancing the Equation:

Building an Income Plan

Now that we have gone through all of the variables in the Retirement Income Equation, we can use it to determine how much income an investor will need to draw from their investment portfolio.

For example, let's use the equation to determine how much income a retiree will need to draw from their retirement portfolio to fund their desired level of discretionary expenses:

Social Security:	$3,000 per month
Pension:	$2,000 per month
Miscellaneous Income:	$500 per month
Portfolio Income:	?

Non Discretionary Expenses:	$5,000 per month
Discretionary Expenses:	$3,000 per month

Now we can set up our equation and determine how much income this hypothetical retiree will need from their investment portfolio before taking inflation into account.

Social Security + Pension Income +
Miscellaneous Income + Investment Portfolio Income
=
Non Discretionary Expenses + Discretionary Expenses

We know that combined expenses are equal to **$8,000** per month and we know that this hypothetical retiree has **$5,500** a month in non portfolio income so our equation reads as follows.

$5,500 + ?
= $8,000

Solving for our variable, we can see that this retiree needs a minimum of $2,500 a month or $30,000 per year from their investment portfolio.

Since $30,000 is 4% of $750,000, by using the 4% rule we can see that this retiree would want to have an absolute minimum portfolio size of $750,000 in an attempt to avoid potential income shortfalls due to longevity risk or a poor sequence of returns. In reality, both discretionary and non discretionary expenses are likely to rise each year due to inflation. Social security offers cost of living adjustments (COLA) but many pensions do not. Miscellaneous income may or may not adjust to meet inflation expectations and investment portfolio performance varies.

> ***Hypothetically, this investor could work for an extra few years, save $850,000, and still run out of money due to unexpected inflation and a poor sequence of returns. On the other hand, the investor could retire early with just $700,000 in their portfolio and end up being completely fine if they get lucky with market performance.***

Additionally, they could also spend less, which would reduce the income needs from their portfolio.

It is for this reason that many financial advisors use a type of mathematical modeling called a Monte Carlo Simulation, which is a type of multiple probability simulation that is used to estimate the possible outcomes of an uncertain event. Using Monte Carlo Simulations, advisors can give an investor the exact statistical likelihood that they will or won't make it through retirement without running out of money at a given level of income or expense.

Ultimately, investors should be cautious when approaching their income equation, and retirees should consider working with a professional to understand the approach that may be best suited for them.

Income Equation Worksheet

Income

Social Security ______________

Pension Income ______________

Miscellaneous Income ______________

Investment Portfolio Income ______________

Expense

Non Discretionary Expenses ______________

Discretionary Expenses ______________

Social Security + Pension Income + Miscellaneous Income + Investment Portfolio Income

=

Non Discretionary Expenses + Discretionary Expenses

____

How Can We Help?

A good financial advisor can help you craft and implement a comprehensive financial plan while building an appropriate portfolio strategy that targets the best risk adjusted returns. This is all done to help you fund your retirement goals.

The equities and fixed income markets are relatively straightforward, but investing can often be emotionally taxing and involve tough choices. All investors need to have a complete understanding of how their investments and time horizons of their goals work together. Only informed investors can make good decisions.

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