4 Ways to Avoid Running Out of Money During Retirement

To qualified investors with $500,000 or more in your portfolio, we're giving away the latest retirement guide by *Forbes* columnist Ken Fisher's firm. Even if you have something else in place, this must-read guide includes research and analysis you can use right now. Don't miss it! **Click Here to Download Your Guide!** FISHER INVESTMENTS

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

- See a sample reprint in PDF format.
- Order a reprint of this article now

JOURNAL REPORTS

The Smart Way to Tap Investment Accounts in Retirement

Here's How to Make the Best Use of IRAs, 401(k)s, Social Security and Other Sources of Retirement Income

By ANDREA COOMBES

Updated April 6, 2014 4:47 p.m. ET

Craig Frazier

If you are like many Americans, you have a variety of investment and retirement accounts. When it comes time to live on that money, how do you decide which ones to tap first?

The goal is to maximize your ability to generate income throughout retirement while keeping your tax burden low. That may not be easy, however, given that many savers have money stashed in a variety of accounts, all with different tax implications, including tax-deferred 401(k)s and individual retirement accounts, after-tax Roth IRAs and taxable investment accounts.

Adding to the complexity, retirees must decide when to claim Social Security. That, in turn affects how much they need to pull from savings.

In the end, the financially smartest choice may not be immediately obvious—or easy to accept.

With that in mind, here is a guide on how to proceed:

First Things First

If you're already age 70½ or older, the first income source is a no-brainer: Take your required minimum distributions from IRAs and company retirement plans, or risk onerous penalties. (Some company plans let you wait until you retire if you are still on the job.)

Generally, the next step—which is the first step for those not subject to minimum distributions—is to begin withdrawing income produced in taxable accounts. You are likely to pay capital-gains or qualified-dividend tax rates on this income, which is lower than the ordinary tax rate you would pay on money withdrawn from traditional IRAs and 401(k)s. Plus it can be smart to let IRA and 401(k) assets continue to grow tax-deferred. (These are generalizations; all retirees should assess their own tax situation.)

When dipping into taxable accounts, taxes and asset allocation are two important considerations.

One strategy is to withdraw cash flows such as interest, dividends or capital gains that you had been reinvesting in additional shares. These payouts are taxable whether or not you reinvest, so consider having them deposited to a cash account at your brokerage.

Journal Report

Insights from **The Experts**

Read more at **WSJ.com/WealthReport**

More in Investing in Funds & ETFs

Do Country Acronyms Like BRICs Help Emerging-Markets Investors?
If Divorcing, Divide Investments With Care
High Hopes for 'Low Volatility' Funds
When Stocks Dither, 'Buy Write' Delivers

WSJ Radio

Andrea Coombes and Mathew Passy discuss strategies for tapping into your retirement savings.

00:00 | 05:37

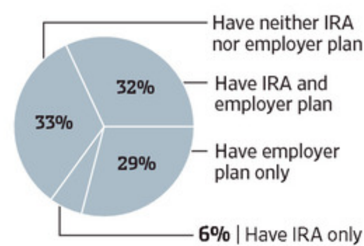
Join the Conversation

Have questions about making the best use of retirement accounts? Don't miss this interactive video interview, featuring a panel of retirement-planning experts.

Tap Retirement Investments and Social Security

Multiple Resources

Many Americans have both individual



Another idea: Pull income first from any asset class where your allocation has grown bigger than you'd like. Investors who are overweight in stocks might tap stock dividends "to keep their asset allocation closer to their target and reduce the need for future rebalancing," says Colleen Jaconetti, senior investment analyst in Vanguard Group's Investment Strategy Group.

Next is where it gets uncomfortable for some: dipping into the principal of taxable accounts.

Selling assets can be a psychological challenge for retirees who prefer the old-school method of living off investment income. But in today's low-interest-rate environment, that can be tough. Some retirees have reacted by shifting into higher-yielding—and riskier—assets.

"We hear all the time, 'I don't want to touch my principal,' " Ms. Jaconetti says. But ultimately, investors seeking to create sufficient income without touching their savings may "put their portfolio at much higher risk" than if they simply sold some holdings, she says.

Delay Social Security

After depleting taxable accounts, your next income source is likely tax-deferred accounts such as IRAs and 401(k)s.

It used to be that people not yet at minimum-distribution age would be advised to delay tapping these accounts to keep them growing as long as possible. But some experts now say that retirees who have a reasonable expectation of living beyond average life expectancy should accelerate withdrawals from these accounts if doing so will enable them to delay claiming Social Security.

Delaying Social Security benefits as long as possible (until age 70) can pay a hefty return in the form of higher benefits and, potentially, a lower tax bill on average over your retirement.

Every year you delay claiming benefits after reaching your full Social Security retirement age (age 66 to 67 for those born after 1942), your benefits increase by about 8% of your full-retirement-age benefit. You can claim as early as age 62, but your monthly benefit will be cut by about 20% to 30%.

Think of Social Security as insurance against living a long life, says Wade Pfau, professor of retirement income at the American College. If you delay but then die at a young age, "you would regret having delayed, but at that point it doesn't matter," he says. "If, instead, you take Social Security early but live to 100, you may have lost $100,000 over your lifetime. The longer you live, the more costly it is to start Social Security early."

Here's a hypothetical example: A man eligible to collect $750 a month at age 62 is eligible for almost twice that—$1,320—at 70, Mr. Pfau says (assuming the man stops work at 62). Factor in a 3% annual cost-of-living adjustment and the benefit jumps to $1,672.

Delaying Social Security means forgoing benefits for a number of years, but for those who live to life expectancy, delaying is equivalent to earning a risk-free return about 3 percentage points above the inflation rate, Mr. Pfau says. That return rises the longer you live. Generating a similar return with investments generally entails a lot of risk, he says. Delaying also maximizes the benefit to which a surviving spouse is entitled.

There also are tax benefits associated with delaying. Up to 85% of a married couple's Social Security benefits are subject to tax once their income tops $44,000 ($34,000 for single people), and up to 50% of benefits are taxable at lower income levels. Distributions from IRAs and 401(k)s are included in the income calculation, but only half of Social Security benefits are. If you wait to collect Social Security, the larger benefit you've earned may enable you to withdraw less from investments, making it easier to keep your income below the threshold.

This strategy means ignoring the "4% rule" or any other that relies on a steady portfolio withdrawal rate through retirement. A higher initial rate is fine for some people, Mr. Pfau says, "because they're going to cut their withdrawal rate after Social Security starts later on." But don't go too far, he warns: Retirees shouldn't exhaust their savings.

Still, many retirees resist delaying Social Security. "A lot of people just claim it because they don't want to deplete their savings," says Michael Falcon, head of retirement at J.P. Morgan Asset Management. "That can be an emotionally comforting thing—but not the right financial decision."

Keep in mind that married couples have a variety of Social Security claiming options, and often it's beneficial for one spouse to claim early while the other delays.

Exploit Your Tax Bracket

If, in addition to your tax-deferred accounts, you also have an after-tax Roth IRA or Roth 401(k), experts generally suggest leaving that account alone as long as possible, in part so it continues to grow tax-free.

But in some cases, those accounts can be used to reduce your annual tax hit, experts say.

Each year, they say, you should estimate your taxable income and how much more income it would take to push you into the next higher tax bracket.

Say you expect to be in a lower tax bracket in the future. You might take just enough from your traditional IRA to maximize your current tax bracket without getting bumped into a higher one. If you need more money, take it from a tax-free Roth.

If you expect to be in a higher tax bracket in future years—maybe a spouse's pension is going to kick in—then consider making the most of your lower bracket now: Withdraw money from tax-deferred accounts, even if you don't need the cash, to pay taxes at a lower rate.

This year, the 15% tax bracket for married taxpayers stretches from $18,151 to $73,800 (it's half those amounts for single filers). "Say your taxable income is $50,000. You've got $23,800 more you could draw on that IRA and have it taxed at 15%," says Rick Kahler of Kahler Financial Group in Rapid City, S.D.

If you employ this strategy, stash money you'll need soon in a savings account, he says. Whatever you don't need could be converted to a Roth, where earnings will grow tax-free. Be wary of penalties on conversion money withdrawn from a Roth in the first five years.

These strategies take work: You'll need to do a trial tax return in December, including estimating income and deductions, to see whether you have wiggle room in your tax bracket. Then make any distributions in the same calendar year.

Monitor Asset Allocation

Remember that once you start withdrawing income from various accounts, your asset allocation can get out of whack.

Generally it makes sense to hold stocks in taxable accounts, where they enjoy capital-gains rates, rather than in IRAs, where distributions face ordinary-income tax rates. Once you start tapping your taxable accounts for income, however, your portfolio may tilt heavily to bonds.

In that example, "You may have to start buying stocks in your 401(k)," says David Blanchett, head of retirement research at Morningstar Inc. 's Morningstar Investment Management.

Also, don't set it and forget it. Every year, Mr. Blanchett says, retirees should ask themselves: "Does my current allocation make sense for me? Does this withdrawal rate make sense?"

Ms. Coombes is a writer in San Francisco. She can be reached at reports@wsj.com.

Copyright 2013 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit
www.djreprints.com