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

THE WALL STREET JOURNAL.
WSJ.com

September 5, 2012

Making Your Retirement Assets Last

Retirees want to make sure their portfolios survive as long as they do. Here are steps that can help.

By ANNA PRIOR

It's a retiree's nightmare: outliving the assets in a retirement portfolio.

Between historically low interest rates dragging on fixed-income yields and uncertainties about taxes, not to mention the threat of future inflation and volatile markets that send skittish investors seeking shelter, retirees who are living longer are finding it challenging to keep their portfolios up to speed.

More in Investing in Funds

If Adults Were Graded on Investing Smarts...
Are These Expenses OK for Tax-Free 529 Spending?
The Bullish Case for Dividend Stocks
Six New Funds That Have Attracted Lots of Cash
Read the complete report .

WSJ.com Podcast

Anna Prior discusses strategies for your nest egg.

C.J. Burton

Recent calculations from the Employee Benefit Research Institute show that roughly 44% of those born between 1948 and 1978—baby boomers and Generation X—won't have adequate retirement income, and that is assuming interest rates go back up in 2014. But the current environment is weighing even on those heading into retirement with what seems like a tidy sum.

Retirees need an efficient plan of attack to squeeze all the juice out of their portfolios, ensuring they have sufficient assets for their golden years. Here are some strategies:

Dedicate dollars for fixed expenses.

Retirees should map out a budget for necessities—include everything from housing to food, transportation, health expenses and utility bills—and set aside a chunk of a portfolio for these costs.

Many planners suggest putting funds to cover three to five years' worth of expenses into safe and liquid vehicles, so the retiree has cash on hand, even if the market drops.

"That way you don't have to liquidate in a down environment," says Marty Leclerc, portfolio manager for Barrack Yard Advisors in Bryn Mawr, Pa.

Even though money-market funds are returning basically nothing, funds earmarked to be used within three years should go into these instruments, says Michael Gibney, a financial planner in Riverdale, N.J. "There is no reason to put money that will be used within a short time period at risk," he says.

For five-year time frames, look to add in a short-term bond fund or certificate of deposit to gain a little more yield, he says.

Watch out for longevity risk.

With many people living well into their 90s, retirees need to think carefully about how to protect themselves from running out of money in their later years.

(Longevity calculators that factor in your family history and current health can be found at websites such as gosset.wharton.upenn.edu/mortality and livingto100.com.)

Some financial advisers say retirees should consider long-term-care insurance as a hedge against the future cost of nursing-home care, which has the potential to decimate even hefty nest eggs.

With 70% of people over age 65 running into some type of health problem that could necessitate some form of long-term care, it's a big expense that many retirees initially forget about in planning, says Robert Stammers, director of investor education for the nonprofit CFA Institute.

C.J. Burton

Critics say long-term-care policies can be pricey and may have limits on the benefits they pay out, so retirees need to make sure they understand what they are getting before buying. The average annual cost of such a policy for a 57-year-old single individual is about $1,900, while a couple of the same age would pay about $2,500, according to the American Association for Long-Term Care Insurance, an industry trade group.

Annuities are another long-term planning tool that can provide a steady stream of income in later life, and a relatively new type of annuity known as longevity insurance is gaining in popularity.

Longevity insurance is similar to an immediate annuity in that it allows holders to take a lump sum and convert it into a lifelong income stream. It is different in that it requires policyholders to pick a date in the future to start getting that income, typically at age 85, says Christopher Jones, chief investment officer at investment adviser Financial Engines Inc.

This guarantees a retiree won't outlive a portfolio, some advisers say, plus delayed payments are typically larger than those from annuities that allow policyholders to start collecting money immediately.

"It takes a problem that has this uncertain length and turns it into a certain horizon," says Mr. Jones.

Don't be too conservative—bonds aren't always your friends.

Advisers warn against falling victim to traditional wisdom: Portfolio protection through conservative investing in retirement could actually do more harm than

good.

With bonds not generating enough income, "the math is scary," says Mr. Leclerc. "Retirees need a lot more money than they ever thought they would to produce simple income."

Retirees looking to generate more yield may be tempted to buy long-term bond funds, but advisers warn against locking in an investment now that could be disastrous when interest rates eventually start to rise. When rates rise, prices fall, so your principal would take a hit.

"So-called safe assets are paradoxically not safe right now," says Mr. Leclerc.

Some advisers suggest intermediate-term bond funds as a way to help mitigate interest-rate risk, while still getting more yield than what's available from short-term bond funds.

Spending Math per $100,000 of Retirement Savings

See additional numbers from Financial Engines on possible retirement spending amounts, based on an initial $100,000 nest egg.

Keep the duration at about five years, says Mr. Gibney, and look for low expense ratios and a well-diversified portfolio to keep default risk low.

As a category, intermediate bond funds returned an average 5.5% in the first eight months of this year, according to researcher Morningstar Inc.

Don't forget about inflation.

Although inflation hasn't strayed far from the historical average of 3.2% annually in recent years, advisers says retirees can't ignore this "silent killer."

"When clients come in, it isn't the first five to 10 years that projections look bad, it's the second half of their retirement where they get beat up," says Frank Fantozzi, a Cleveland-based financial adviser.

To protect themselves, retirees should add to their portfolios multiple types of assets that can keep up with or even beat rising costs. Still, many advisers maintain that the best way to combat inflation in a well-diversified portfolio is by investing in equities.

"It's the only asset class that will give them returns greater than inflation," Mr. Gibney says.

Real-estate investment trusts, or REITs, can be an inflation hedge, but advisers say retirees should be cautious about which parts of the real-estate market they invest in.

"Focus on the most stable, high-quality corporate tenants," says Tim Lee, managing director of Monument Wealth Management in Alexandria, Va.

Use alternatives to help manage volatility.

Market volatility can be nerve-racking for retirees, prompting some to flee to ultraconservative investments.

To iron out some of the big ups and downs—and therefore quell some of the urges to swing too far to "safety"—some advisers recommend constructing a diverse portfolio that includes a slice of alternative investments, including nontraded REITs, which are similar to traditional REITs but don't trade on exchanges, managed futures, which are futures positions entered into by professional money managers on behalf of investors, and long/short funds.

"Alternatives can help control risk because they don't tie or correlate well with fixed income and equities," says Mr. Fantozzi, who suggests putting 5% to 20% of a portfolio into alternative investments, depending on market conditions.

Long/short funds, for example, employ trading strategies similar to those used by hedge funds, simultaneously betting for and against a set of stocks. In a sideways market, these funds can be useful, says Mr. Fantozzi.

Limit the tax man's bite.

It's a particularly difficult time for tax planning, given the uncertainty surrounding next year's tax rates. Still, there are things retirees can do now to keep portfolio withdrawals as tax-efficient as possible.

The required minimum distributions that most retirees have to start taking at age 70½ are based partly on the plan's account balance as of the preceding December. To reduce that total balance—and potentially the required minimum distributions later on—some retirees might want to start taking withdrawals in their 60s.

This is especially true for early retirees who are currently in lower income brackets because of a recent job loss or forced retirement, says Michael Eisenberg, a certified public accountant in Los Angeles.

Still, it's not a simple decision. Each year, retirees need to weigh the consequences of pulling funds from one account versus another.

In a taxable account, net long-term capital gains are taxed at a rate lower than the ordinary income-tax rate for withdrawals from tax-deferred retirement plans.

Be aware that taking money out of a retirement account or selling securities at a sizable taxable gain—rather than pulling cash from a certificate of deposit, money-market fund, savings or checking account—could result in higher taxes on Social Security benefits if it bumps income above a certain threshold.

"When you reach a certain level of income, then some of your Social Security becomes taxable," says Mr. Eisenberg.

Ms. Prior is a reporter for Dow Jones Newswires in New York. Email her at anna.prior@dowjones.com.

A version of this article appeared September 5, 2012, on page C9 in the U.S. edition of The Wall Street Journal, with the headline: Making Your Retirement Assets Last.

Copyright 2012 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