
Pre-Retiree – Building Retirement Income
Two Economic Powers® Approach
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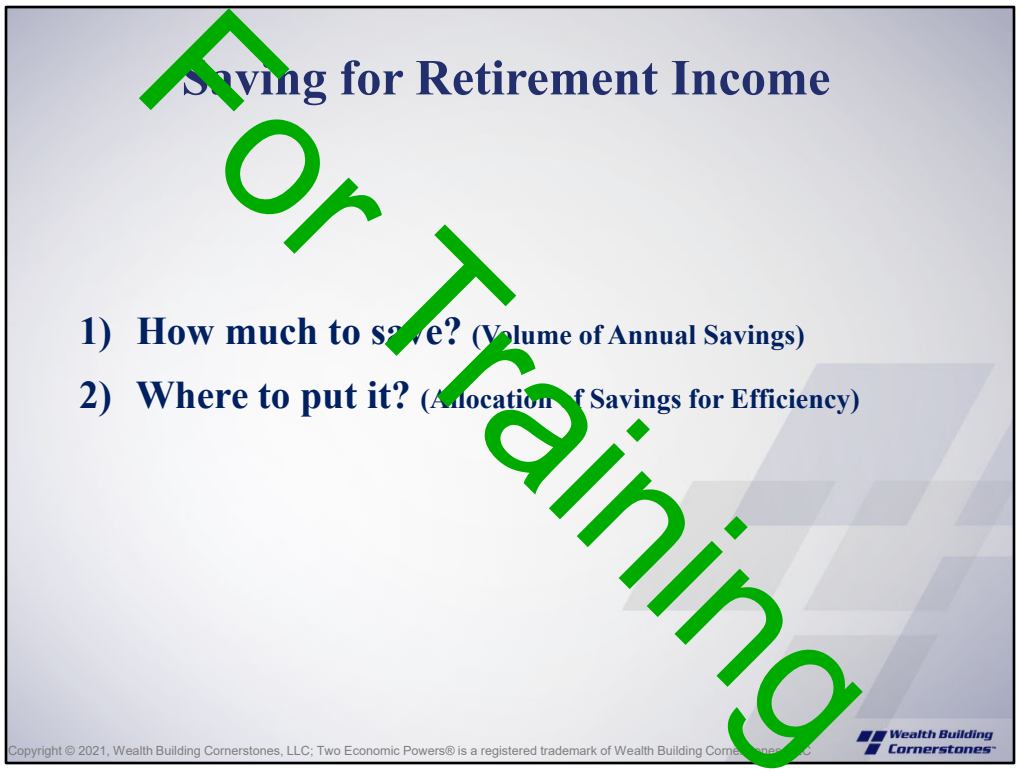


We all generally have one 30-40 year pre-retirement cycle to save for our retirement income. The two questions pre-retirees have are: 1) How much to save? And 2) Where to put it?. The first question pertains to the volume of annual savings you would do, and the second pertains to the allocation of that savings to an efficient retirement income strategy for the creation of your retirement income in the future. To help answer these questions we have to start with understanding what the objective is…

Many people are building just investments and focusing just on accumulation versus building retirement income for the future and taking into account both accumulation and distribution together.

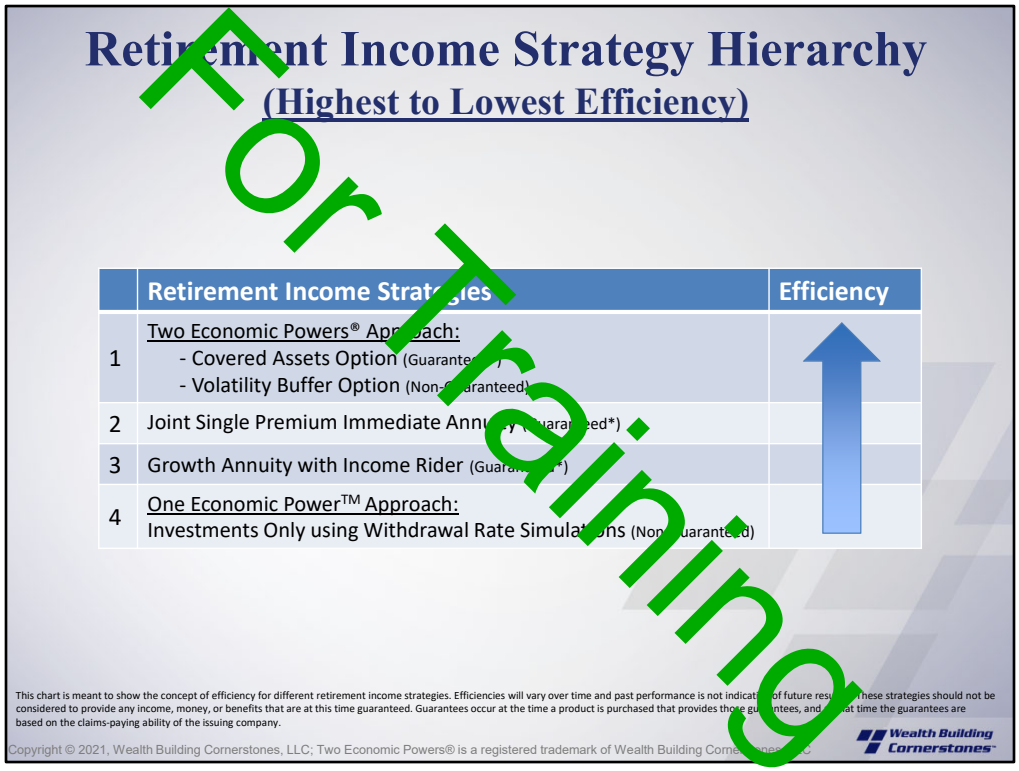
Think of it like climbing a mountain. Getting up the mountain is our pre-retirement accumulation phase and getting down the mountain is our retirement distribution phase. But these two phases are connected and are one continuous journey. When it's time to turn on your retirement income, you don't have the luxury of calling in a helicopter at the top of the mountain if you didn't pack enough of the right supplies to make it back down safely.

There are two rates that make up everyone's retirement income and both are equally important. The accumulation rate, which is how fast you accumulate money going up the mountain, and then the distribution rate which is how fast you can distribute money from the assets you've built without running out on the way down the mountain.

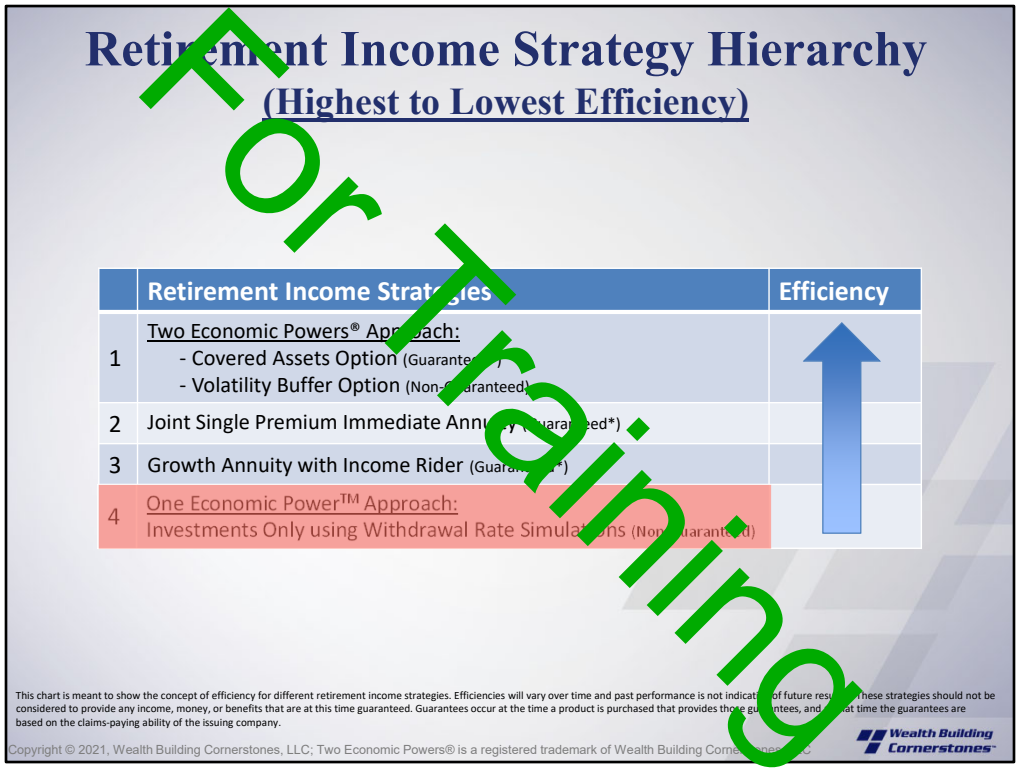
Understanding the different retirement income strategies available to use defines how to pack your bag (where to put your savings) in Pre-Retirement. It's a begin with the "purpose in mind" approach.

If you were going to climb a mountain would you get a guide? What if the guide said to you that they were pretty sure they can get you to the top of the mountain, but they weren't sure how you were going to get back down? Would you use that guide or find a different one?

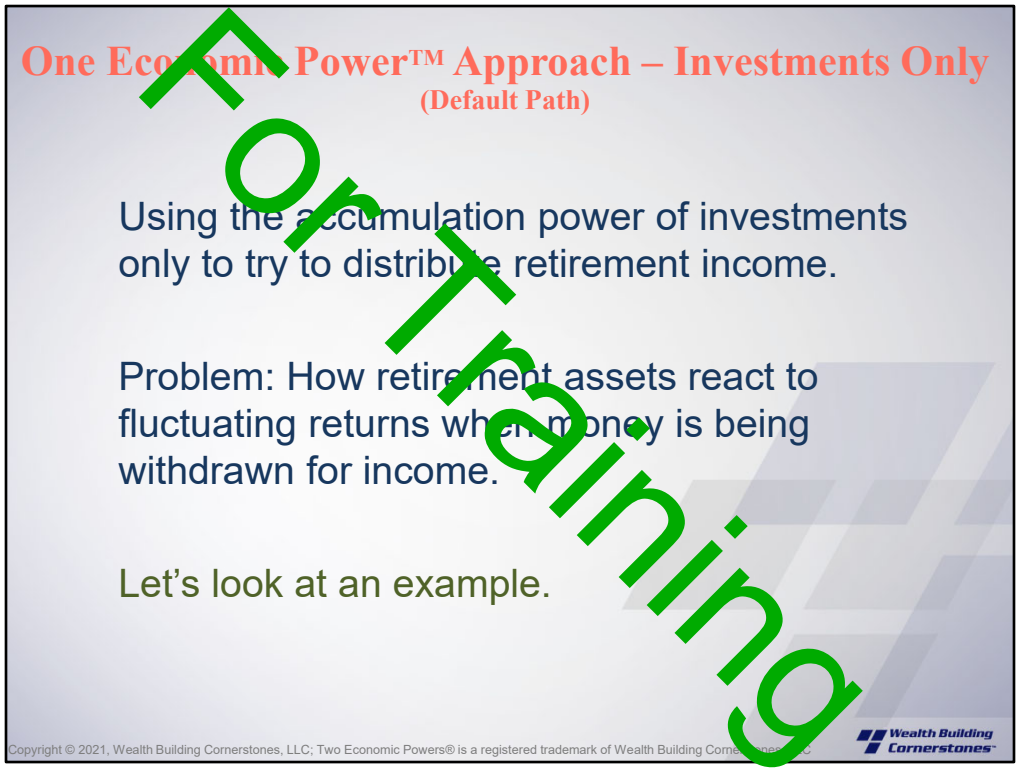
Let's take a look at the different retirement income strategies available to utilize.



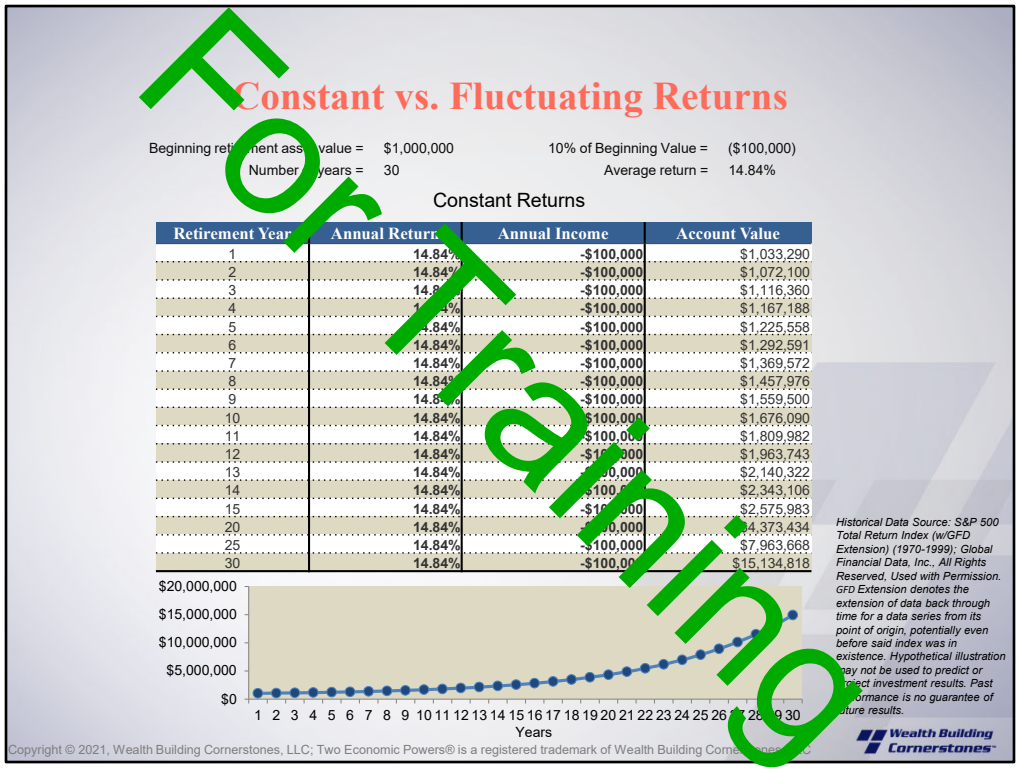
The 4 main retirement income strategies can generally be ranked from highest to lowest efficiency. Having an efficient retirement income strategy can possibly create more retirement income down the road for the savings you did along the way. First we have 1) The Two Economic Powers® Approach that includes the Covered Assets and Volatility Buffer options, 2) A Joint Single Premium Immediate Annuity, 3) A growth annuity with an income rider, and 4) The One Economic Power™ Approach of investments only using Withdrawal Rate Simulations for retirement income.



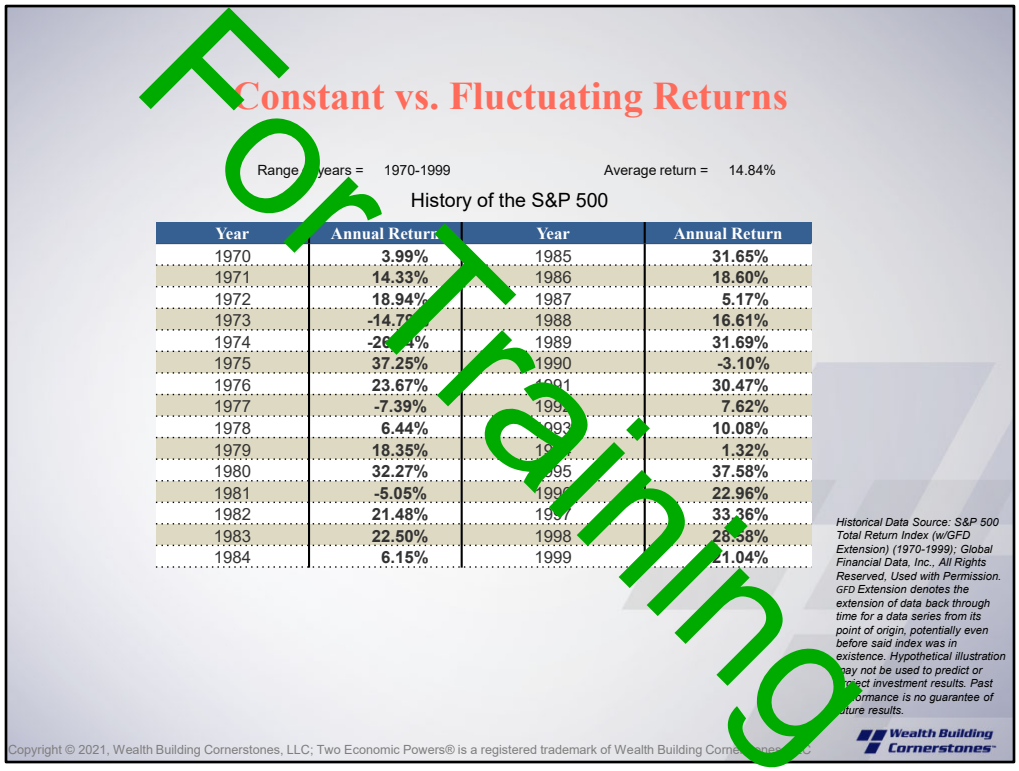
This bottom strategy is the default for many people. Let's go through how this strategy conceptually works and then we will contrast that to the top line strategy of the Two Economic Powers® Approach options.



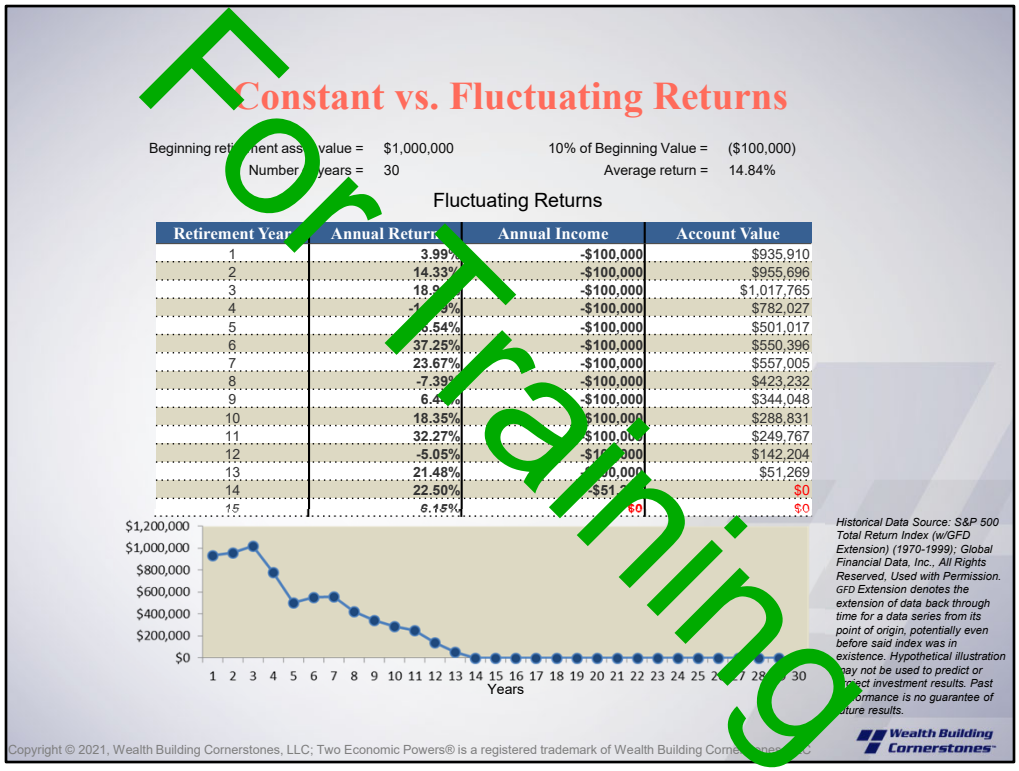
The One Economic Power™ Approach attempts to use the accumulation power of investments to try to distribute retirement income. This approach encounters the problem of how retirement assets react to fluctuating returns when money is being withdrawn for income. Let's look at an example.



What we have here is a person entering retirement with a million dollars, wanting to pull one hundred thousand dollars per year of retirement income to live on, which is ten percent of the initial value. The way they might justify being able to do this is by thinking they could earn a return on average, equal to or greater than, the 10% they are pulling out which in this case is 14.84%. And if they earn this 14.84% constantly every single year, you can see their account grows even as they pull income out, to the point where it's close to fifteen million dollars thirty years into retirement. But, are we going to be able to earn that average return constantly, every single year or are we going to get all of the ups and downs along the way? We're going to get all of the ups and downs. So, where does this 14.84% come from?

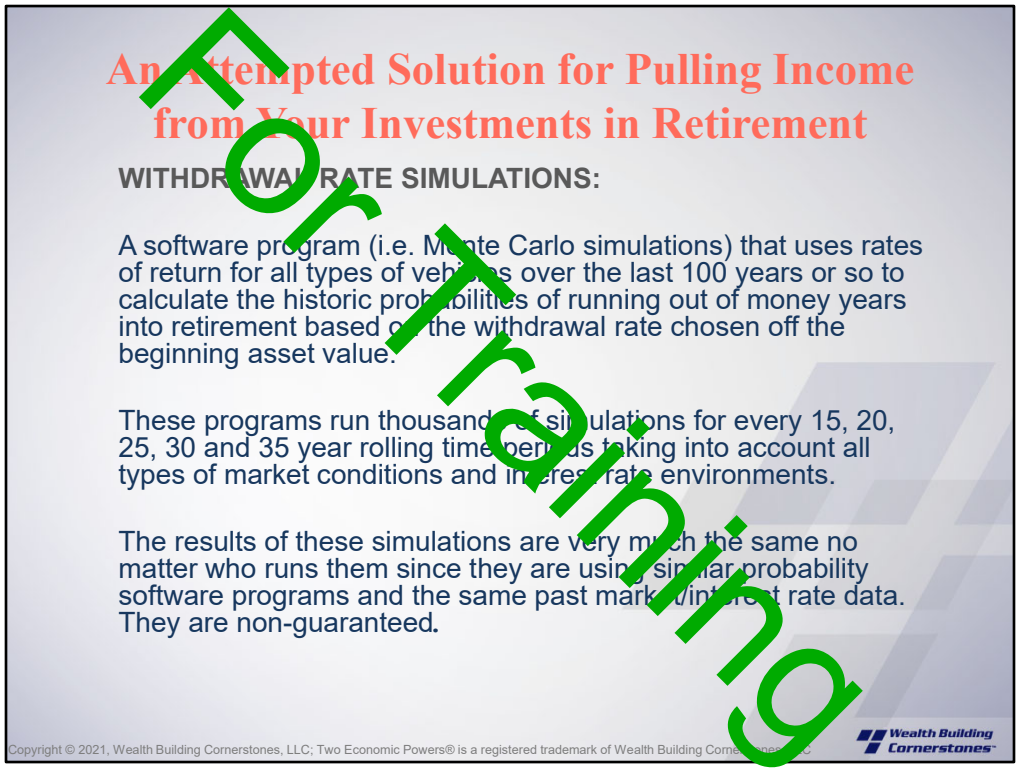


It comes from the history of the market, and in this case the history of S&P 500 hundred from 1970 through 1999. So we see each year, all the annual positive and negative returns during that thirty year period. We add them all up and divide by thirty and we get the average return of 14.84%. So what we are going to do now is take the fluctuating positive and negative annual returns we see here and put them into the same table we were just looking at, paying attention to what happens to our account value as we do this.



When we put the annual fluctuating returns into our table, we still have the same average return over thirty years. But now instead of having close to fifteen million dollars at the end of thirty years, we are down to zero dollars between years thirteen and fourteen. “Why does this happen,”? It’s because of the rule change at the top of the mountain, which states that any year you earn less than you pulled out, you just killed off the dollars that are supposed to be earning the returns for you the next year. For example, a great return year is this 37.25% in year six, but the issue is that you’re not earning this on the million dollars you started with, you’re earning that on the account value of the year prior, which is substantially less, and you still have to pull your retirement income that year.

We’ve used this one 30 year time frame as a simple example to demonstrate the difference between constant and fluctuating returns during distribution, but it’s not conclusive by itself. The question is, if we are at the top of the mountain trying to use fluctuating return assets to provide us retirement income, how would we go about determining what a safe withdrawal rate might be when we can’t predict the future returns we will receive? The industry has attempted to solve this problem for this type of strategy using what are called “withdrawal rate simulations”.



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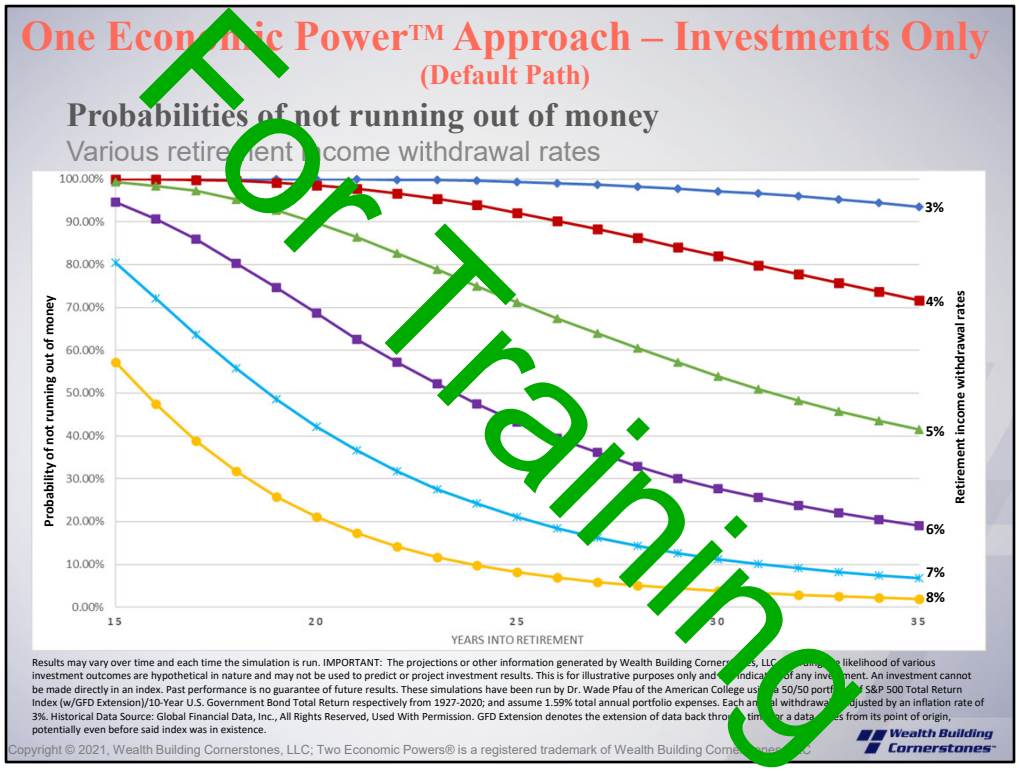
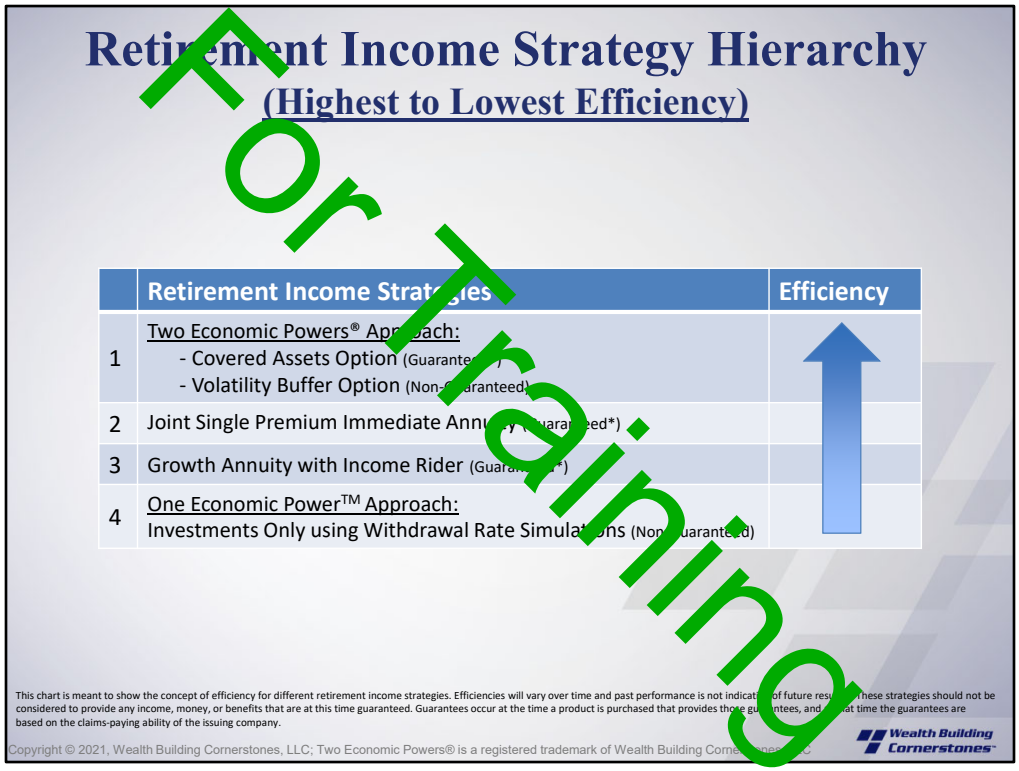
What are withdrawal rate simulations? It's a software program (i.e. Monte Carlo simulations) that uses rates of return for all types of vehicles over the last 100 years or so to calculate the historic probabilities of running out of money years into retirement based on the withdrawal rate chosen off the beginning asset value.

These programs run thousands of simulations for every 15, 20, 25, 30 and 35 year rolling time periods taking into account all types of market conditions and interest rate environments.

The results of these simulations are very much the same no matter who runs them since they are using similar probability software programs and the same past market/interest rate data. They are non-guaranteed.



Let's take a look at the results of these simulations. This chart shows the historic probabilities of not running out of money years into retirement based on the withdrawal rate someone chose off the beginning asset base. **It is important to understand that these are withdrawal rates on the right side and not interest rates on your money in retirement. These simulations and curves exist because we are acknowledging that we have to establish our income withdrawal rate before knowing the fluctuating returns we will earn on our money into the future.** As an example, let's say you chose an 8% withdrawal rate, which would be $80,000/yr from a starting asset value of $1,000,000. This would put us on the orange line on the bottom. What this is saying is 25 years into retirement, historically I've had about a 10% chance of not running out of money and around a 90% chance of running out of money. So it doesn't take a rocket scientist to tell us that by lowering our withdrawal rate we'll have a better chance of not running out of money. The financial industry has generally settled on somewhere between a 2.5%-4.5% withdrawal rate as being a quote "safe withdrawal rate" depending on the chance of failure you are willing to accept. So, that would be $25,000-$45,000/yr of retirement income per $1,000,000 that you would have accumulated by retirement age. But at a 4% withdrawal rate, you would have to be willing to accept around a 30% chance of running out of money long term with this strategy.

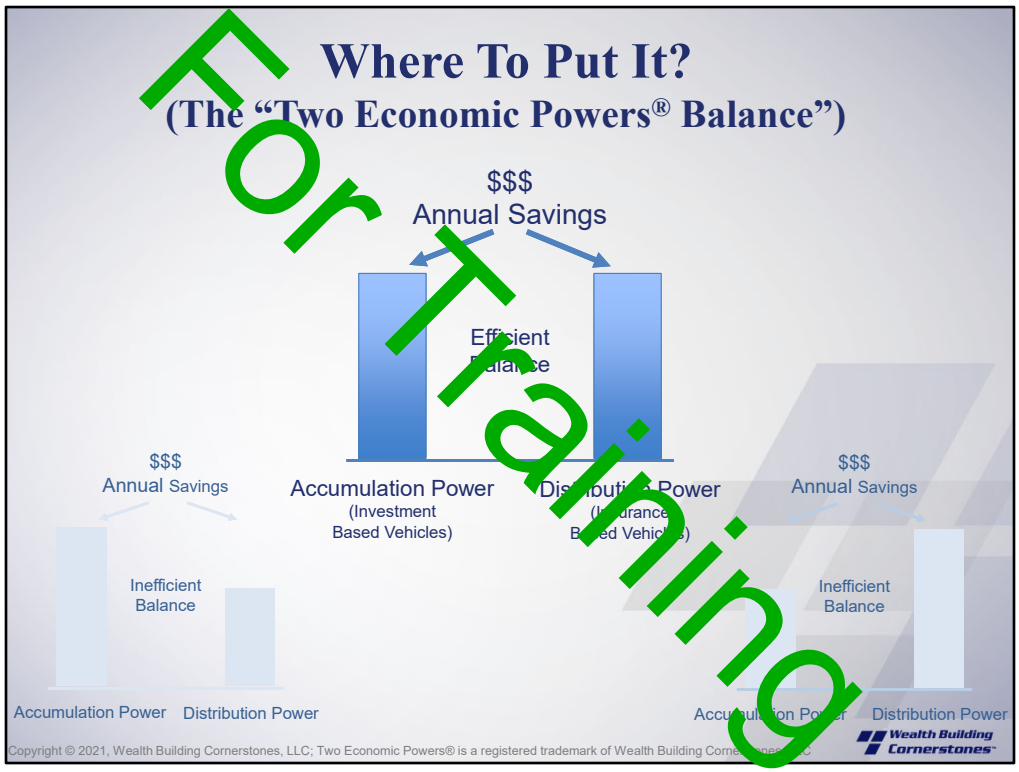


So, now that we've defined the bottom strategy, let's move up to the top line, and first understand why the efficiency level goes up.

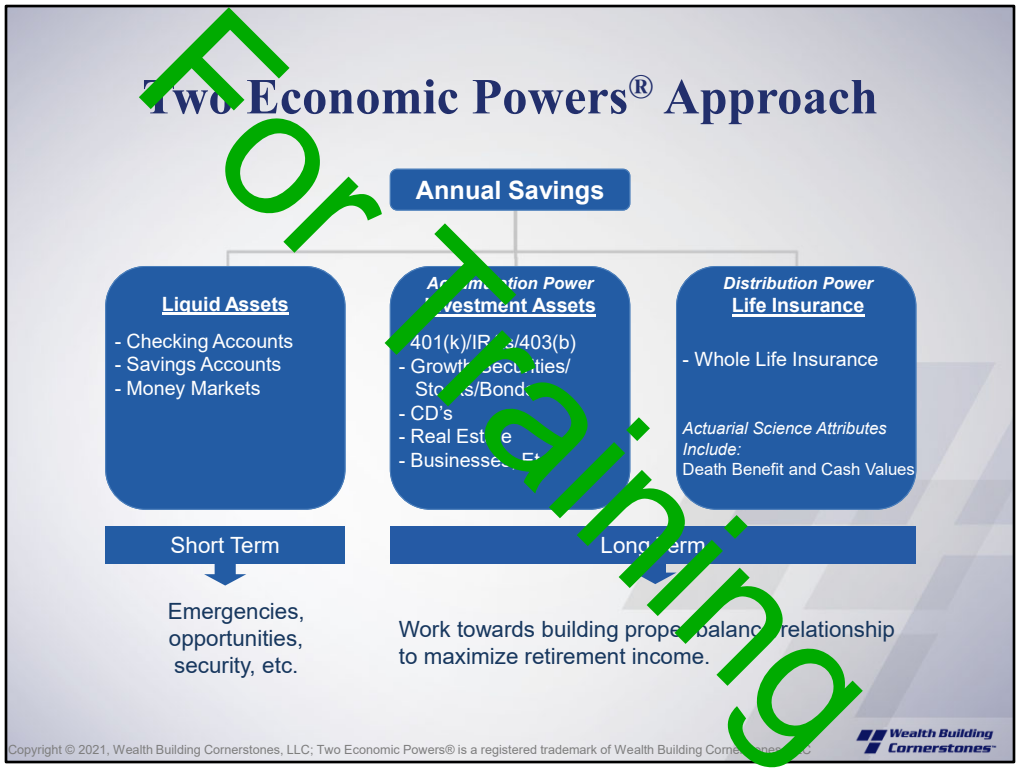
The efficiency level goes up because you are building both the accumulation power and distribution power of the financial industry together in balance for the building of retirement income. The Accumulation Power is driven by short term fluctuating interest rates and is generally provided by investment-based vehicles. The Distribution Power is driven by actuarial science and the law of large numbers, and is generally provided by insurance-based vehicles. One power is generally not good at doing the other power's job.

Prior to the 1980's these powers were by default built together and balanced automatically to create people's retirement income through defined benefit pension plans offered by employers. In the 1980's defined contribution plans (like 401ks, 403bs, etc.) started becoming more popular which is what many people now have today. These types of plans are generally accumulation power focused and don't automatically incorporate the distribution power for the creation of retirement income.

Since we are no longer getting the distribution power by default we need to reincorporate it into our retirement income building for efficiency.



To build efficiency we want to place the savings we are doing during pre-retirement in a way that gives us a balance between the two powers by retirement age so we can potentially get more retirement income for the savings we did along the way. From an efficiency perspective you don't want to have too much of either power. These powers were always meant to work together in proper balance and not be fighting each other or doing each other's job. It is not an "either or" situation with these powers… It's an "And" situation in balance for retirement income building efficiency.



The way we can build these two powers together is shown in the long term area. The accumulation power of short term fluctuating interest rates can be built over time using the different investment assets listed there such as 401(k)s, growth securities, stocks, bonds, real estate, businesses, etc. The distribution power of Actuarial Science can be built using Whole Life Insurance, as the power of actuarial science is built into the permanent death benefit and cash values.

Let's go through the Two Economic Powers® Approach strategy options starting with how the Covered Assets Option conceptually works.

Visually, this is how this would look. On the left side in pre-retirement we put all of our savings towards building retirement assets only using the One Economic Power™ approach of withdrawal rate simulations for creating retirement income. Let's say they could accumulate a unit of money that we will call a million dollars here. At retirement time along this path, we would have set ourselves up for withdrawal rate simulation income at that time somewhere between 2.5-4.5%, that's $25,000-$45,000/yr of non-guaranteed retirement income going down that path.

On the right side, we are going to take the same amount of annual savings in pre-retirement that we had on the left side, but now we are going to split it between building retirement assets and whole life insurance. We are not going to end up with the same amount of retirement assets that we did on the left side because we are splitting where we are putting our annual savings every year. So you have seven hundred and fifty thousand of retirement asset value and seven hundred and fifty thousand of whole life death benefit with two hundred and fifty thousand dollars of cash value. So now what we get to see is the interaction between the death benefit of the whole life insurance policy and how we could use our retirement assets to create much higher income streams.

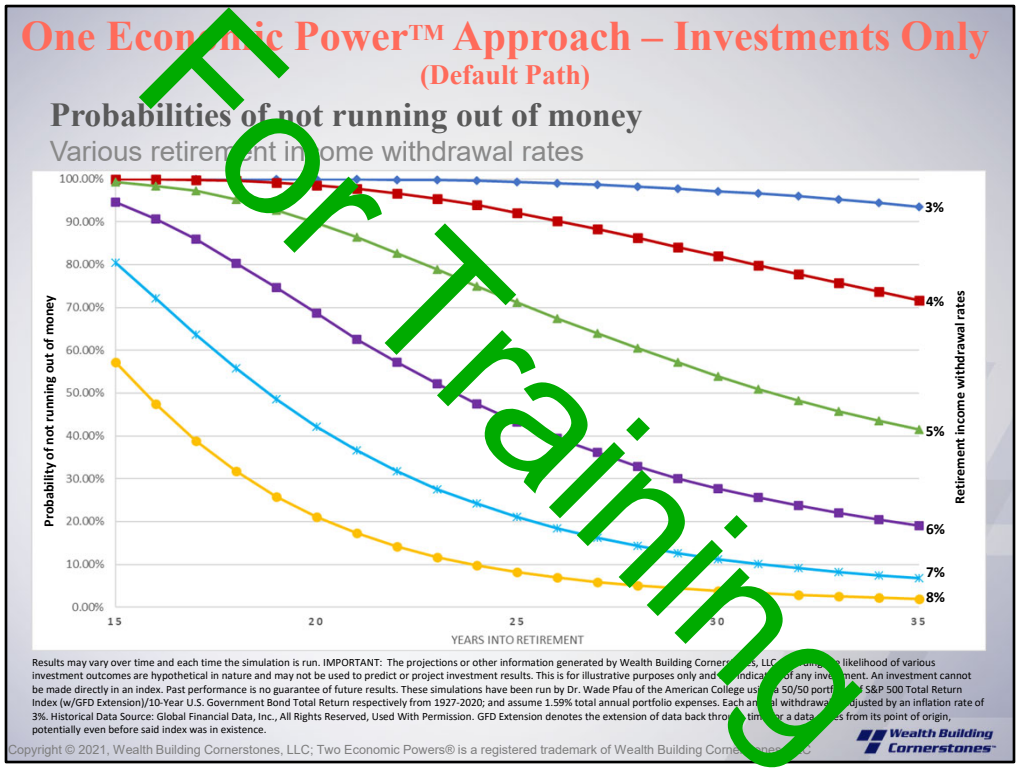
Since we know that we'll have seven hundred and fifty thousand in death benefit the day someone passes away, this allows us to take the retirement assets we have and trade them for a self-made pension on that person's life. This is called an income annuity. You are physically trading this to an insurance company at the time of retirement in exchange for a guaranteed income stream for life, which for a sixty five year old male has ranged between approximately 6-13% as an income annuity rate over the past few decades depending on the economic environment on the day of retirement. Once that rate is set, it doesn't fluctuate. In this case we have seven hundred and fifty thousand being traded for a guaranteed income of $45,000-$97,500/yr of income for that person's life. Now, when that person passes away, that income stream stops and the retirement asset that was traded for that income stream is no longer there. Then the death benefit for the whole life insurance policy kicks in to replace the retirement asset that was originally traded to create the initial income stream. The remaining spouse can use that death benefit to recreate a similar income stream or maybe it's just a legacy at that time for heirs or charities. This is how the covered retirement asset option works. In this example, you have $45,000-$97,500/yr of guaranteed retirement income versus $25,000-$45,000/yr not guaranteed.

Now let's go through how the Volatility Buffer Option of the Two Economic Powers® Approach conceptually works.

Again, on the left side we have the One Economic Power™ Approach which provides the $25,000-$45,000/yr of non-guaranteed retirement income. On the right side we now have the Volatility Buffer Option of the Two Economic Powers® Strategy. It's the same set up but now instead of using the death benefit in conjunction with our other investment assets we are going to use the life insurance cash values as a Volatility Buffer. The life insurance cash values are driven by actuarial science and aren't as significantly affected by the short term interest rate swings and market fluctuations of our other investment assets.

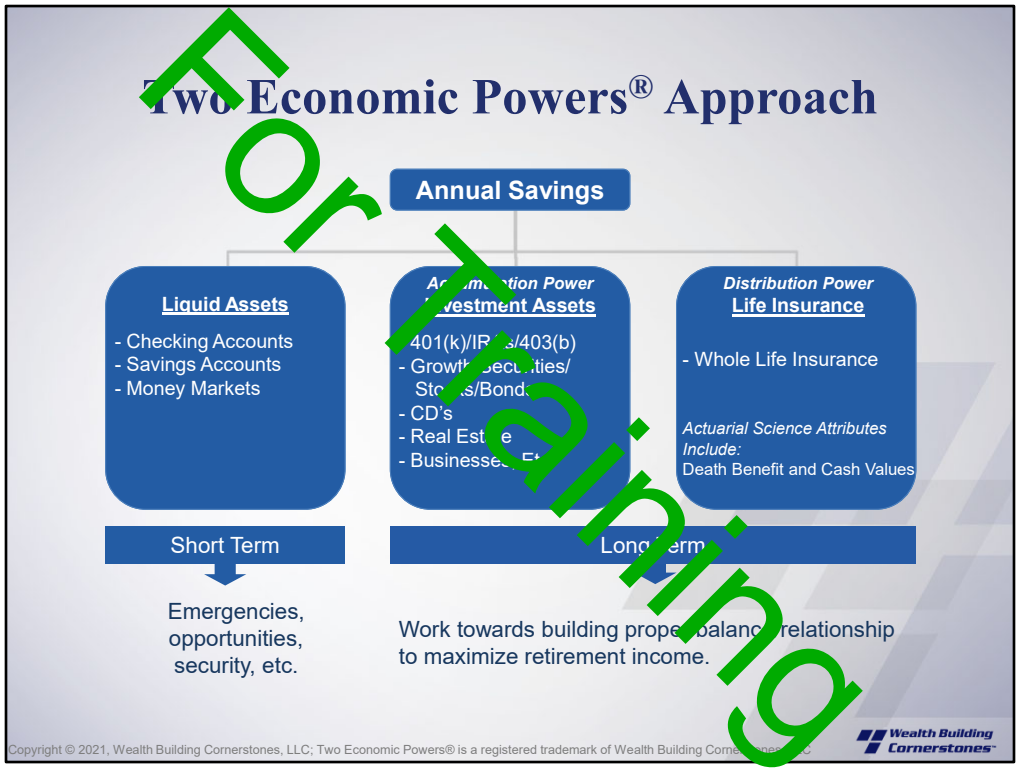
So, in this option we aren't going to trade the investment assets for guaranteed annuity income like we did in the Covered Assets option. Instead, we are going to keep the Investment Assets invested in whatever fluctuating return investment we want at the time. We are going to pull a higher income rate from the invested assets than what withdrawal rate simulations would normally say is prudent from a probability standpoint because we know we have the ability to also pull income from the life insurance cash values as a volatility buffer. In this example it shows a general income rate range of 6-12% that is non-guaranteed.

As we pull income annually from the invested assets we will look to see how the income withdrawal and account earnings for that year affected the end of year account balance. And for any year where the ending account balance is less than the beginning of retirement account balance we would make the conscious choice not to pull our income the next year from that invested account.. and instead, we would pull our income from the cash values of the life insurance for the next year. This gives the invested assets a break from withdrawals and a chance to recover with the next year's returns. We call this "preserving your workers". And we use the volatility buffer as needed as many times as we can. You will generally get between 3-9 years of volatility buffer in the cash values for what you have balanced in the Covered Assets strategy. In this example we showed 3 volatility buffer years based on what was available in the cash values. Let's see how the Volatility Buffer strategy looks when included in withdrawal rate simulations.

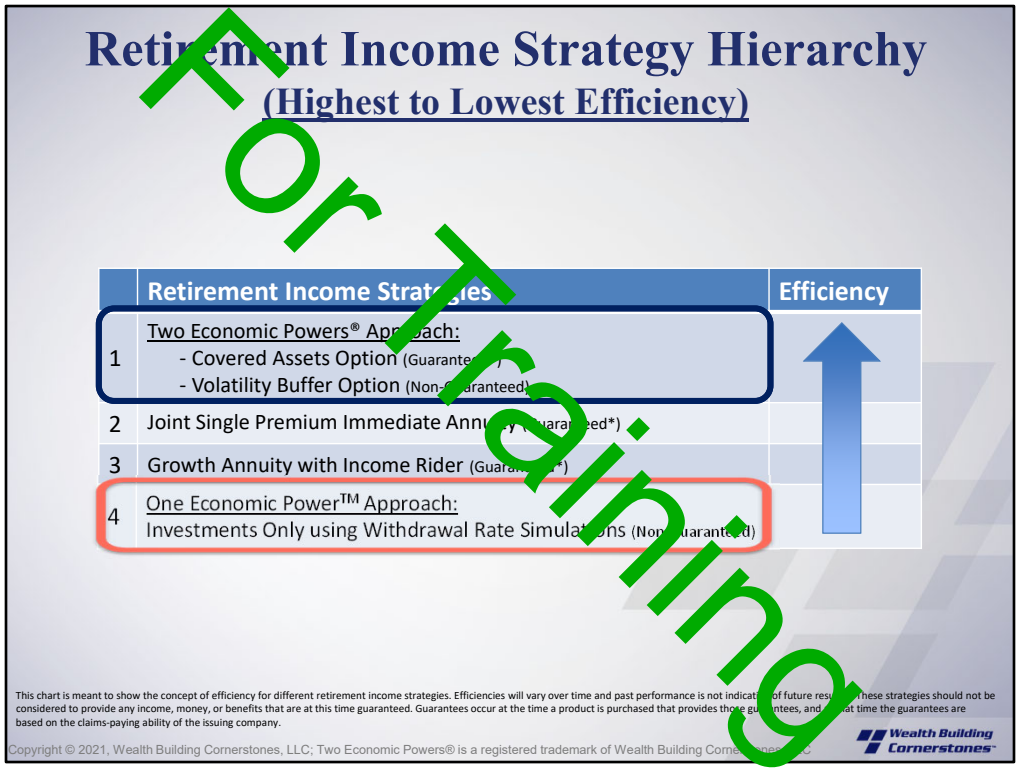


This is the regular withdrawal rate simulation chart that we looked at before that doesn't include any years of volatility buffer. In the next slide we will incorporate the Volatility Buffer strategy with years of buffer.

This is the withdrawal rate simulation chart for the Volatility Buffer strategy with 3 years of buffer included.



So, as we build our retirement income we want to work towards balancing the powers of Accumulation and Distribution to maximize efficiency.



The next time we get together we can review retirement income calculation scenarios run with your own numbers comparing the outputs of the One Economic Power™ Approach strategy to those of the Two Economic Powers® Approach strategy. This will help to give you frame of reference for answering the questions of 1) how much to save? And 2) Where to put it? for your own retirement income building.

This is an example summary comparison for a couple that has approximately 32 years until their assumed retirement ages. The first thing we'll do is set the Inflation Adjusted Retirement Income range you want to be shooting for taking into account applicable items such as social security, pensions, no more annual savings, no more mortgage payments, etc. Then we will run different calculation scenarios starting at your current age going to your assumed retirement age. What we'll measure is the volume of annual savings along with the efficiency of placement between the two economic powers in each scenario. The calculations then give you a hypothetical comparison of the outputs for the One Economic Power™ Strategy versus the Two Economic Powers® Strategy. This will start to give you frame of reference for answering the two questions of how much to save and where to put so you can make a smooth transition from your pre-retirement lifestyle to your retirement lifestyle later on. And then we will work with you to implement the scenario you would like to start with for your own retirement income building.

Optional Underwriting Discussion: To be able to run these calculations though we need to know what you might qualify for with regard to the Life Insurance, because you can't just get life Insurance, you have to be underwritten for it by an insurance company. The underwriting process usually takes a few weeks. What I'd like to do with you today is get you into the underwriting process by filling out an application to get this process started. You're not buying or committing to anything today, we're just asking the insurance company for an underwriting classification for you. Then while this process is going on behind the scenes we can get back together in a week or two to run through your own calculations. How does this sound to you?