The FINANCIAL SUCCESS Library

Money Minute

Financial Planning & Investing Newsletter

"Smart Ideas for Secure Finances"

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PROVIDED BY

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FEATURE

Examining Ways to Create Income During Retirement

Whether you're already retired, just starting to save for retirement, or somewhere in between, we will all likely face a time when we have stopped working and must turn our savings into income in order to pay our bills and live in retirement. You may have social security and perhaps a pension, but chances are you'll want or need more than that. This month, I'll examine several ways to create income during retirement.

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1) "The 4% Rule"

A popular method of creating income is to simply withdraw a set percentage of ones assets each year. Over the past 20 years many financial planners have relied on a 4% withdrawal rate as a safe, sustainable withdrawal rate. A portfolio is invested in a set asset allocation (60% stock / 40% bonds - for example). 4% of the portfolio is withdrawn each year and taken as income, and this amount is increased modestly each year to keep up with inflation. The theory is that would under most circumstances, the portfolio experiences sufficient growth to provide income for a ~30 year retirement.

Though a 4% withdrawal rate would likely be sustainable under most circumstances (according to randomly-generated simulations using past market data), I'm not an advocate of this approach. As with most rules-of-thumb, it oversimplifies things greatly and ignores opportunities to tailor a portfolio to ones individual risk tolerance and income needs.

2) "Live off of the Interest"

For years, conservative investors have espoused the virtues of "not touching the principal" and "living off of the interest." There is no more secure strategy than continually investing your principal in a one-year FDIC-insured certificate of deposit. The problem in today's low-interest environment is, of course, that you'll need quite a bit of principal to generate any meaningful amount of income. $1 million invested in a CD earning 0.90%, the national average on a one-year CD according to Bankrate.com, nets $9,000 per year in interest earnings, or just $750 per month before taxes. In normal times, this may be a valid strategy.

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QUOTE OF THE MONTH

"Climbing out of poverty by your own effort...that is something on which to pride yourself, but poverty itself is romanticized only by fools."

~ J. K. Rowling
Author

DID YOU KNOW?

A teenager in India recently had 232 tooth-like growths called denticles removed from his mouth in a 6-hour surgery. The boy will take 3-4 months to recover fully.

Source: CNN.com

Potpourri ---Stock, Company & Market News and Notes---

Citi Settles with DOJ for $7 Billion, Merger News, FedEx Charged, etc.

Citigroup (C) agreed to pay $7 billion as part of a settlement with the Department of Justice for its role in the sale of mortgage-backed securities leading up to the recent recession. Of the $7 billion, $4 billion is a civil penalty, $2.5 billion will go to consumer mortgage relief, and $500 million will go to states' attorneys general. Citi took a $3.8 billion charge in the second quarter because of the settlement. The only remaining large bank yet to settle with the DOJ is **Bank of America (BAC)**. Its settlement is expected to top the $13 billion settlement reached by **J.P. Morgan (JPM)** and the DOJ. Since 2010, the three aforementioned banks have paid roughly $70 billion in litigation charges stemming from their behavior leading up to the financial crisis.

FedEx (FDX) was recently indicted for shipping packages from illegal online pharmacies. Profits from the shipments totaled some $820 billion, and the company faces a fine of up to twice that amount. The indictment states that FedEx was warned on at least 6 occasions that illegal pharmacies were using its services. Drivers for FedEx said they had been stopped on the road by customers demanding packages of pills, and delivery addresses for the illegal shipments included parking lots and vacant homes. The company has pleaded not guilty. It reported $11.8 billion in revenue in its most recent quarter.

Fighting slumping sales, **Walmart** (WMT) is now pressing forward with its small store concept and pushing to open hundreds of smaller shopping outlets. The new smaller stores will measure between 5,000 and 12,000 square feet, as compared to its Supercenters that measure a gigantic 180,000 to 230,000 square feet. Sales and store traffic have trended lower over the past five quarters, and management hopes the new, smaller stores will appeal to customers. The company posted $115 billion in revenue in its most recent quarter.

Tobacco companies **Reynolds (RAI)** and **Lorillard (LO)** have announced a proposed merger that would join the current #2 and #3 tobacco companies. Reynolds sells brands such as Camel, Winston, Kool and Pall Mall. Lorillard markets the Newport cigarette brand, which is the best selling brand of menthol flavored cigarettes and which make up roughly a third of overall cigarette sales. Lorillard also owns the fast-growing e-cigarette brand Blu. Menthol cigarettes and e-cigarettes are two of the few areas of growth in the smoking industry, and the acquisition of Lorillard by Reynolds would bring it within striking distance of industry leader Altria, which markets Marlboro cigarettes among others.

Dollar Tree (DLTR) said it will buy rival discount store **Family Dollar (FDO)** for $8.5 billion. Activist investor Carl Ichan had pressed for a sale for months, and the deal would give the combined store more than 18,000 stores in the U.S. and Canada and combined sales of over $18 billion. Dollar Tree sells all of its products for $1 or less, where Family Dollar has much broader pricing and sells many items for more than $1. The merger would result in $300 million in savings from consolidation of distribution networks and better buying power. Both brands would be maintained after the merger. Dollar stores thrived in the wake of the recession as cash-strapped customers traded down to these stores and their bargain-basement prices. **Dollar General (DG)** is currently number one in sales in the deep discount / dollar store category.

Online real estate listing site **Zillow (Z)** is acquiring rival **Trulia (TRLA)** in a stock deal worth $3.5 billion. The companies make money primarily by charging agents to post their names alongside their listings. Both companies have transformed the way people shop for houses by making information once only available through realtors accessible over the internet. Existing Trulia shareholders will own about 1/3 of the combined company after they receive 0.444 shares of Zillow stock for every share of Trulia stock they own. The combined company will have $341 million in annual revenue based on last year's figures, and it expects to realize $100 million in cost savings by 2016.

Market and Economic News

-Economic growth (measured by gross domestic product (GDP)) for the 2nd quarter of 2014 was +4.0%. This was a huge rebound compared to the -2.9% reading for the 1st quarter. Economists blamed the harsh weather for the 1st quarter contraction, and the initially strong 2nd quarter reading seems to confirm that the 1st quarter was not the start of a new trend.

-The U-3 unemployment rate checked in at 6.2% this month, and the job market added a solid 209,000 non-farm jobs last month as compared to a revised 288,000 during June. This was a relatively soft jobs report and will not do anything to accelerate the Fed raising interest rates. See this month's "Up Close" and Editorial stories for more on the unemployment situation, inflation and how the Fed's interest policy is related to employment numbers.

At a Glance…
(as of August 8) **DJIA** – 16,430 **S&P 500** – 1,919 **NASDAQ** – 4,358 **10-yr T-note** – 2.44%

Readers' Q&A

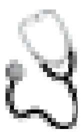
Questions can be e-mailed to: Brad@R1FinancialGroup.com

Q. "I recently rolled over about $25,000 into an IRA from an old 401(k). I've read that doing a Roth conversion would allow me to pay no taxes on this money in the future. Is this a good idea? I make too much to contribute to a Roth IRA directly."

-Mary – Allen, TX

A. You're correct: anyone with money in a Traditional IRA can do a "Roth conversion" on part or all of the money inside that Traditional IRA. Here's how it would work: for the $25K in your Traditional IRA, you have almost certainly not paid any income tax on either the principal or growth inside the account. You could do a Roth conversion on the full $25K this year and pay income tax on this $25K at whatever rate / tax bracket you fall into. Going forward, your money will be allowed to grow and you'll be allowed to make tax-free withdrawals of principal and future investment growth during retirement. In other words, you will pay taxes now in exchange for not having to pay any taxes in the future on this money. Also - Roth IRAs do not have required minimum distributions (RMDs) like traditional IRAs and 401(k)s, so you won't be forced to take withdrawals starting at age 70.

Whether or not this is a good idea depends on a few factors. Most people agree that tax rates will trend higher over time, making the Roth conversion attractive; however, if you're in a relatively high tax bracket now, you may find yourself in a lower tax bracket during retirement due to reduced earned income, even if tax rates have increased overall. It's almost impossible to know what the situation will be in the future with regard to tax rates and your income levels, and most financial planners like the idea of having the future flexibility that a Roth IRA will provide. If you can tolerate paying the $7,000 - $10,000 tax bill this year and can do so using outside money (not money from the IRA), you will likely be no worse off in the future and will probably benefit from having a tax-free source of funds during retirement. I recommend you consult your accountant and get his/her opinion before taking any action.

YOUR HEALTH

Sleep Study: 8 Hours of Sleep Does Not Seem To Be Ideal


Recent sleep research may suggest that the long-held recommendation to get 8 hours of sleep per night may not be ideal. A study in the journal Frontiers in Human Neuroscience used data from the cognitive training website Luminosity. 160,000 users took spatial-memory and matching tests, and 127,000 users took arithmetic tests, and researchers found that peak performance occurred when individuals got seven hours of sleep. Performance began to decline when users got more than seven hours of sleep. Researchers also saw declines in cognitive performance when individuals repeatedly got 20-30 minutes less sleep than the minimum recommendation often given, which is 7 hours. For maximum cognitive performance, the study suggests 7 hours should be the target, not the minimum to shoot for. Another study in the Journal of Clinical Sleep Medicine placed healthy adults in "Stone Age" conditions without electricity, alarm clocks or running water for two months. On average, participants fell asleep 2 hours earlier than they did in their normal lives, and they slept 1.5 hours more than they had in their normal lives prior to the study. Their average amount of sleep per night was 7 hours, 12 minutes.

New sleep guidelines will be drawn up by the American Academy of Sleep Medicine, the Sleep Research Society and the CDC, and the new guidelines are expected to take gender and age into account when they are released. Current recommendations range from 7-9 hours but are likely to trend downward in light of these and other recent studies. American adults currently report sleeping an average of 6 hours, 31 minutes per night on an average weekday and 7 hours, 22 minutes on weekends. Surveys have shown that on average, healthy adults say they need 7 hours, 13 minutes of sleep to perform their best.

*Source(s): CDC, Wall St. Journal

Money Minute Trivia Question

A Malaysian Airlines passenger jet was accidentally shot down recently by a rocket in a conflict inside of what country?

A) Russia *B) Turkey* *C) Ukraine* *D) Israel*

*Email your answer to **Brad@R1FinancialGroup.com** for a chance to win a **$25 gift certificate to a local restaurant.** Each

Last Month's Winner – **Jim R. of Dallas, Texas**

Which team recently won soccer's FIFA World Cup tournament?

A) Brazil ******B) Germany*** *C) Netherlands* *D) Argentina*

Examining Ways to Create Income During Retirement

(Continued from page 1)

At present, however, such a strategy is simply not practical or attractive.

3) Buy an Immediate Annuity

An immediate annuity is a contract between an individual and a life insurance company in which the individual trades a lump sum in exchange for monthly payments for life.

For example, a 65-year old man might purchase a $200,000 immediate annuity and receive $1,134 per month for the rest of his life.

Under such an arrangement, income stream ceases once the man dies. This means the man must live roughly 14 years and 7 months before recouping his original investment. The insurance company makes more if the man dies sooner and makes less if the man lives past normal life expectancy. Immediate annuities can also be structured to cover the lives of two individuals (a husband and wife, for example), provide a guaranteed period of income (10 or 20 years, for example), and/or provide a refund of principal in the event the annuitant dies before he has received at least as much in monthly payments as he paid in initial premium. All of these guarantees and additional features reduce the amount the annuitant would receive monthly.

There is a great deal of comfort and security associated with an immediate annuity. The obvious drawbacks are the permanent loss of access to ones principal while the annuitant is living in addition to the potential to receive less than the initial lump sum payment in return if the annuitant dies and no guarantees are chosen. Payout rates are affected by prevailing interest rates, and as such, current payout rates are far lower than they were just five years ago. For a conservative investor, however, annuitizing part of one's nest egg to create income is a valid option.

4) Invest in a Bond Mutual Fund or ETF

Bond mutual funds or exchange-traded funds can provide a monthly income. These pooled investment vehicles typically invest in thousands of individual bonds and pay out monthly dividends derived in large part from the bonds owned by the fund. Bond mutual funds can invest in relatively safe U.S. Treasury bonds as well as corporate bonds and municipal bonds. Funds investing in bonds with longer maturities and lower-rated bonds will - all else being equal - carry greater yields. Such bond funds will also be accompanied by greater volatility of principal.

Investing in a bond mutual fund or ETF carries no guarantee of principal, and depending on the particular flavor of bond one invests in, there could be significant volatility. In particular, high-yield bond funds that invest in lower-rated corporate bonds can carry relatively high yields (6.0 - 7.5% currently), but the volatility of the fund during times of economic uncertainty can be on par with a mutual fund that invests in common stock.

Overall - bond mutual funds as well as individual bonds require a much greater tolerance for principal fluctuation and variance of monthly income. For investors who understand these risks and can tolerate them, bond mutual funds can provide an excellent source of income while retaining access to ones principal if needed. Because of the many different types of bonds available, investors should be willing to put in the time to understand fully each type of bond and its characteristics.

5) Invest in Dividend-Paying Stocks

Many stocks, particularly stocks of large-cap companies, pay a quarterly dividend. Companies choose to return cash to shareholders in the form of dividends, which act as an incentive for individuals to own the stock. Utility stocks in particular are known for paying relatively generous dividends that can equal 3-4% on an annualized basis. There are mutual funds that specialize in seeking and owning dividend paying stocks, and owning such a fund can provide an easy way to own these stocks and generate income.

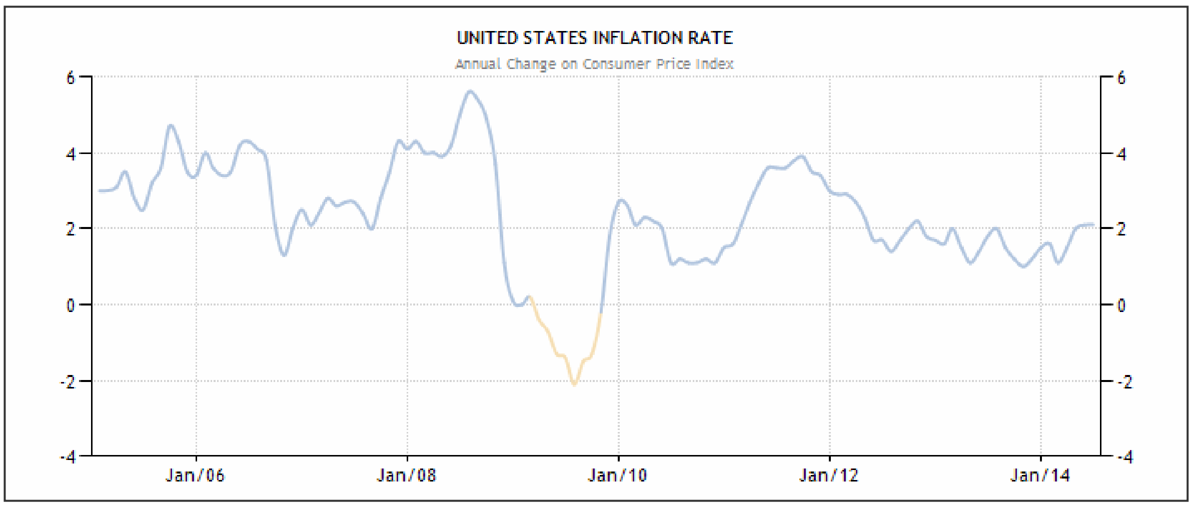
The obvious downside of relying on stock dividends for income is the volatility associated with owning stocks as well as the lack of guarantee associated with these dividends. Companies declare dividends each quarter and are under no obligation to make a certain level of dividend payment from one quarter to the next. For this reason, dividend paying stocks should be used as a secondary option and act as a complement to a more reliable income source.

The task of creating a lasting, reliable income stream during retirement is one of the most important undertakings individual investors encounter during retirement. The income sources mentioned are some of the most popular ways individuals create income, but there are many others such as real estate investment trusts (REITs), selling stock options, purchasing individual bonds, and using variable annuity withdrawal features. Luckily, it is not necessary to become an expert in every available option. By focusing on your personal risk tolerance, educating yourself and perhaps working with a financial advisor, it is possible to create a strategy using one or more of these options and generate a reliable, lasting income stream that will last throughout your retirement.

Long-Term Unemployment Rate and its Effect on Inflation

Economic growth and inflation have, for the most part, been subdued since the end of the recession in mid-2009. Federal Reserve board members and economists are divided as to whether the Fed's low-interest-rate policies have done all they can to spur economic growth, inflation and job growth or whether it is time to begin raising its benchmark interest rates. Increases in GDP and inflation (see below) have slowed considerably over the past two plus years, and the rate of inflation has remained below 2% for most of the past two years. The long-term unemployed,

U.S. Inflation Rate - Change in Consumer Price Index (2005 – Present)



Source(s): U.S. Dept of Agriculture, Census Bureau, Wall Street Journal

defined as those out of work for greater than 27 weeks, are central in this debate. The long-term unemployment rate stands at over 2% currently, still above the historical average of 1.5%. Of those who became long-term unemployed between May 2008 and June 2009:

-21.9% have found full-time jobs;
-28.4% took part-time or unsteady work;
-14.4% are still unemployed and looking for work;
-35.2% have dropped out of the labor force entirely.

This subset of the labor market (the long-term unemployed) is a focus of policymakers, and rightly so. The above stats have contributed to the declining labor participation rate (percentage of adults working or looking for work), which has fallen from over 66% to just under 62.8% and continues to trend lower.

Proponents of continuing the Fed's low-rate policies cite these statistics as evidence the labor market is still in need of a boost. Opponents argue that persistently low rates may not do anything to aid the long-term unemployed but will eventually lead to high inflation, harming those least able to cope with rising prices. What is clear is the Fed has moved toward reducing its bond-buying program substantially over the past 4-5 months and will cease completely within the next 2-3 months. Chairwoman Janet Yellen has suggested the Fed will begin to raise interest rates within the next 12 months, and a strong GDP reading last month (+4.0%) seems to support that action. At this point, it may be that policymakers have no choice but to leave the long-term unemployed behind.

Editorial: *Decoding a Misleadingly Low Unemployment Rate*

On the surface, the labor market seems to be well on its way back to a healthy place. The unemployment rate stands at 6.2%, down from a high of 10.0% in early 2010. The 8 million+ jobs lost during the recession have all been recovered. The economy has added an average of roughly 220,000 jobs per month over the past 12 months. These headline statistics all paint a fairly positive picture of the labor market and have likely caused the Federal Reserve to move up its timetable for raising its benchmark interest rate...a sign that the economy no longer needs exceedingly "cheap" money to spur borrowing and activity. Looking deeper, the current condition of the labor market is far more nuanced and is, perhaps, not as rosy as it seems. Consider the following numbers:

Editorial: *Decoding a Misleadingly Low Unemployment Rate*

-The widely-quoted unemployment rate is what the Bureau of Labor Statistics calls the "U-3" unemployment rate. To be counted as unemployed, a person has to have actively looked for work in the previous 4 weeks. Discouraged workers who have stopped looking because they believe there is no work available, workers who are "marginally attached" and work inconsistently, and part-time workers who would like to work full time (underemployed) are added to the U-3 rate to make up the U-6 unemployment rate. This broader definition of unemployment stands at 12.2% currently. Of this 6% jump, 4.4% is due to part-time workers who desire full-time work.

-When broken down by education level, the U-3 unemployment rate for those over the age of 25 with a bachelor's degree or higher is just over 3%, while for those with only a high school diploma is just over 6% and for those with less than a high school diploma is just under 10%. It is not terribly surprising that those without even a high school diploma are disproportionately unemployed and underemployed.

-The labor participation rates for 16-19 year olds, 20-24 year olds, and 25-29 year olds are all fractions of a percentage point from their lowest levels in the past 40+ years.

-The U.S. population of employable individuals increased by 14.2 million over the past six years, and the number of unemployed people increased by 1.4 million (through May 2014).

One obvious takeaway from these figures is that less educated, lower-skilled and younger workers are still in a position of need in terms of jobs, many of whom have been pushed out of the work force entirely or settled for part-time work. What is not so obvious is how best to help create jobs for these lower-skilled, less educated workers. Various states and municipalities have increased their minimum wage, and President Obama and many other Democrats are pushing for an increase in the federal minimum wage to $10.10 per hour. Such an increase would undoubtedly help those who hold these jobs, but it would also cause businesses to employ fewer people. The Congressional Budget Office estimates that between 500,000 and 1,000,000 people would lose their jobs as businesses reign in their cost of employment, and it stands to reason that the least experienced and skilled workers (the ones for whom businesses can't justify paying a higher wage) would be the ones to lose their jobs.

The Affordable Care Act's mandate for businesses with more than 50 employees to offer health insurance to full-time employees working 30 or more hours has also had an effect. The mandate, which has been twice delayed, has given businesses financial incentive to cut workers' hours to below 30 hours per week. This has and will continue to make some workers seek second part-time jobs to supplement their paychecks. It seems that government policy may be doing more harm than good in terms of encouraging businesses to hire the least-skilled and least-educated workers.

What should be done then? Sen. Paul Ryan released a plan to expand the earned income tax credit, which may encourage more individuals to seek work, but this will not incentivise businesses to hire more low-wage workers. Perhaps a sliding scale minimum wage - by age and dependent status - could be implemented, but there would almost certainly be unintended consequences associated with any such regulation. For example, businesses may simply opt to hire younger and cheaper workers and shun older, more expensive workers if there is an option to do so. Perhaps federal and state governments should sharply limit or stop making unemployment benefit payments and crack down on fraudulent disability payments in an effort to remove the economic incentive not to work. This would motivate many individuals to seek work, but it would also harm many who legitimately need the help.

While the labor market receives little attention outside of the monthly U-3 unemployment rate, there are much deeper issues at hand and few clear solutions.

Please send comments via e-mail to: Brad@R1FinancialGroup.com

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