

Your Ultimate Retirement Guide

These guidelines will help you accumulate – as well as properly manage – the wealth you'll need to live comfortably in retirement.

You've worked hard, played by the rules, and now you're nearing retirement with a nice nest egg put away. How do you manage the transition? In this special report, we show you how.

Let's start with divvying up your portfolio. Your retirement investment strategy should start with the right asset allocation, tailored to your financial goals.

When creating a diversified portfolio, you must forge an asset allocation plan that closely mirrors your individual investment goals – the way a thumbprint reflects identity.

An asset allocation policy entails dividing a portfolio's investments among different asset classes. The most common classes are U.S. stocks, international stocks, bonds, cash and cash equivalents, and real estate.

Your asset allocation plan should govern your choices when purchasing stocks, bonds, real estate and other investments. It also should be designed to provide an easy and transparent way for you to determine how your investments are performing.

Asset allocation is an art as well as a science. It's the investment alchemy whereby you balance several ingredients for the proper admixture of risk and reward.

Asset allocation is one of the most crucial decisions in investing. Investors generate returns through three basic activities: selecting specific investments to buy; deciding when to get in and out of the markets; and establishing asset allocation.

The first two activities are the hardest and least forgiving. However, asset allocation is the easiest to determine – and it wields the most power. According to financial industry studies, more than three quarters of portfolio performance and volatility is related to asset allocation.

Of course, in a bull market, your allocation should emphasize stocks. In a bear market, you should lighten up on stocks in favor of bonds and cash. And a transitional market that’s “in between” should strike a balance.

Your Allocation Checklist

Before establishing your portfolio’s asset allocation, first answer these questions:

- **What’s the purpose of your portfolio?**

Define your portfolio’s purpose. Here are some examples: to reap a lot of money over the short term, so you can make a big purchase such as a house; to generate reliable, future cash flow in retirement; to grow the family estate for your kids and grandkids; to set aside ample cash reserves for entrepreneurial investment opportunities; etc.

- **What’s your stage in life?**

For example: relative youth (aggressive growth); middle age (moderately aggressive); retirement in the next 10 years (income and moderately conservative); retired (stability and income).

There are several variations. Choose a category based not only on your approximate age, but also on your tolerance for risk. As long-term market history amply shows, you’ll have to withstand a lot of bumps along the way.

- **How much wealth do you already have?**

What’s your current net worth and how close is it to your ultimate goal? Do you already have a head start, which allows you to shoulder more risk, or are you starting from scratch?

- **What’s your self-imposed requirement for a minimum rate of return?**

Do you want to reap at least 10% a year? Do you want to at least equal –or beat – the S&P 500? The younger your age, the higher you can set your goals. But be realistic.

- **What’s your risk tolerance?**

If your portfolio takes a sharp turn for the worse when you’re in your 40s, you still have plenty of time to bounce back. But if your investments take a nosedive while you’re, say, 65, you’re in a far worse predicament.

- **Will your financial situation likely get better, deteriorate, or stay the same?**

Are you securely ensconced in a paying job that will remain steady for the next few decades? Are you about to retire? Are you afraid of getting laid off?

- **Will there be any withdrawals?**

If you plan to start taking out money, how much will you withdraw and when?

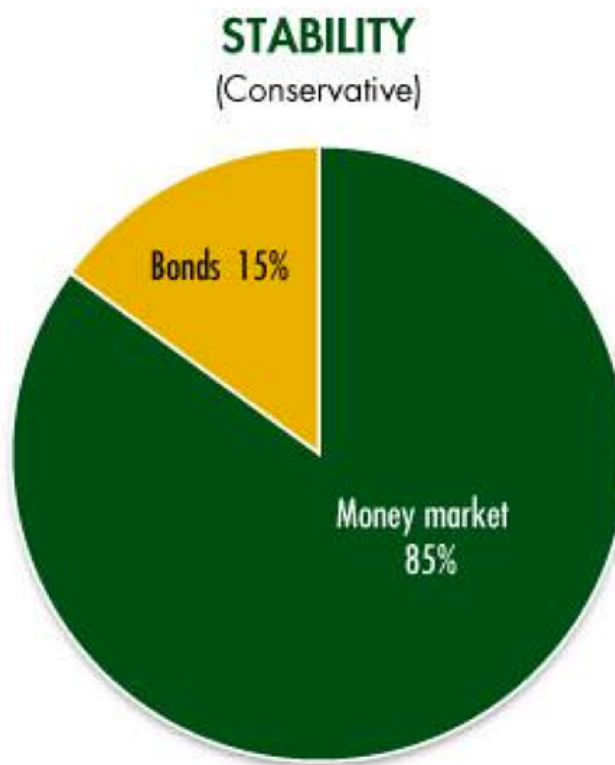
- **What are the regulatory requirements?**

Don't be blindsided by unforeseen rules and regulations. If your portfolio is an Individual Retirement Account (IRA) or 401(k), what are the mandatory distribution requirements?

As noted above, basic asset classes include: U.S. stocks; international stocks; real estate (real estate investment trusts, or REITs); and cash and cash equivalents (money market). The appropriate percentages depend on your answers to the above checklist.

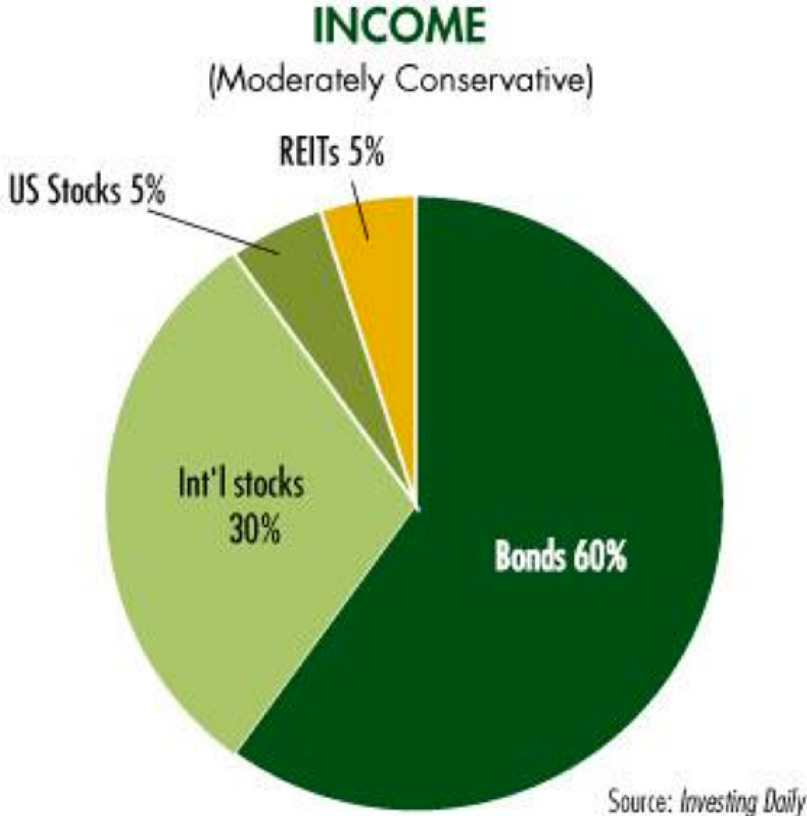
The five pie charts below depict general "Allocation Scenarios," which you can tweak according to your specific situation:

Allocation Scenario #1:

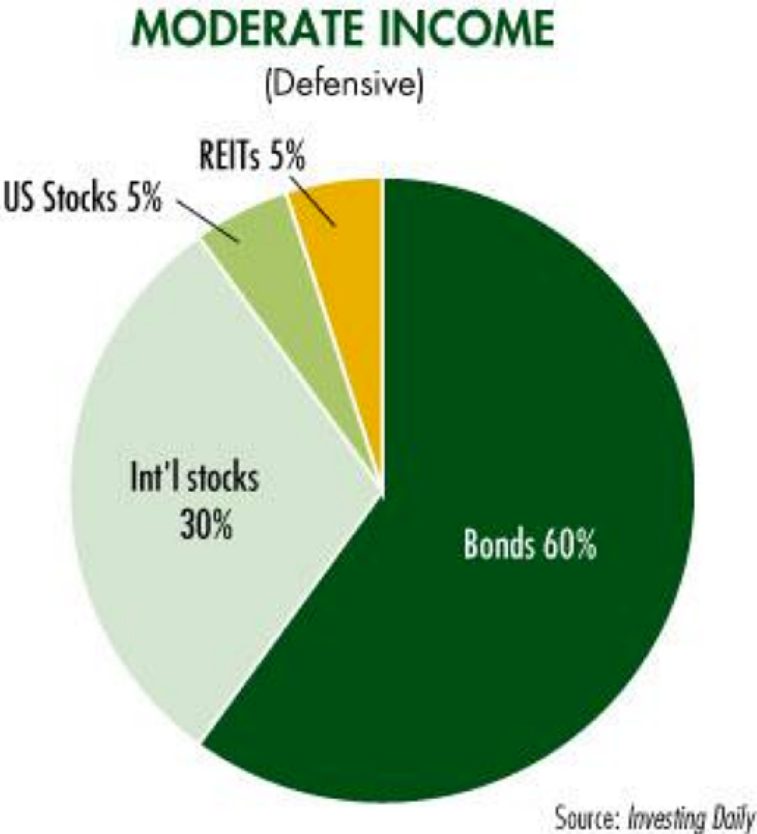


Source: *Investing Daily*

Allocation Scenario #2:



Allocation Scenario #3:



Allocation Scenario #4:

GROWTH AND INCOME

(Moderately Aggressive)

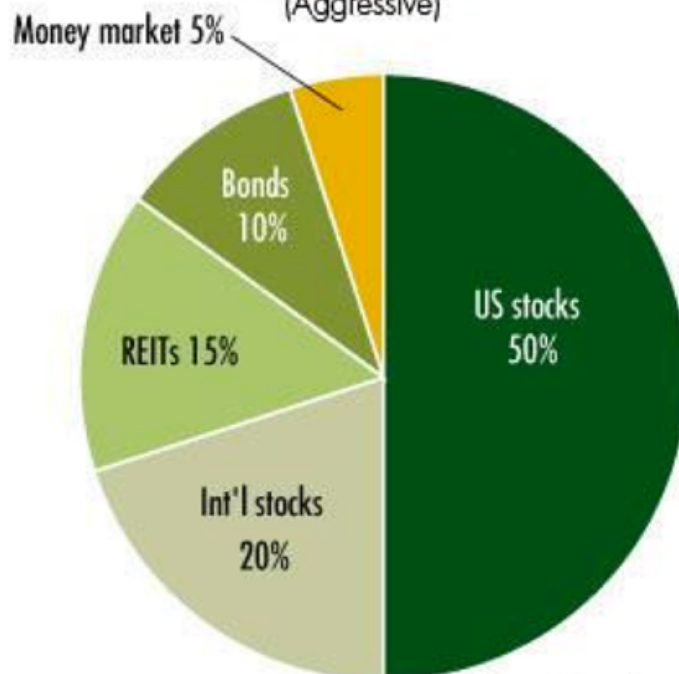


Source: *Investing Daily*

Allocation Scenario #5:

GROWTH

(Aggressive)



Source: *Investing Daily*

Not a Panacea

Many investors are becoming enamored with asset-allocation mutual funds, also known as “target date” funds, which try to provide investors with portfolio allocations predicated on their age, risk tolerance and investment objectives. However, even this “solution” is too standardized and doesn’t address highly individual requirements.

According to the financial research firm Ibbotson Associates, about a half-trillion dollars are now invested in target date funds. Target date funds are simple to use—you pick the target date fund that will “mature” closest to your designated retirement date.

These funds are typically issued in five-year increments – 2020, 2025, 2030, etc. As the target date approaches, the fund’s allocation grows more conservative. The exposure to equities is diminished as the allocation to bonds and cash increases, reducing risk and volatility.

Target date funds would seem to be the perfect solution to the challenge of asset allocations, but there are no panaceas when it comes to investing.

It’s never advisable to put your investments on automatic pilot. One problem with target date funds is that their allocations are based on past returns, without accounting for the current market environment. Many also entail high expense burdens.

There’s no substitute for doing your own homework. As you determine asset allocations, stay focused on the economic big picture, not the markets’ quarter-to-quarter roller coaster rides. To be sure, you must calibrate your allocations according to existing conditions as well as projected future trends, but you should also ignore ephemeral market blips.

As 2016 unfolds, you should consider “rebalancing” your portfolio to accommodate the likely economic, business and market trends of the coming new year.

Portfolio Calibration

Now that you’ve set the right portfolio allocations, how do you adjust your portfolio from growth to a more balanced approach that generates the income you’ll need for living expenses in retirement?

For starters, once you've made a plan that you believe thoroughly addresses your retirement needs, stick to it.

A lot of people nearing retirement were heavily invested in stocks during the late 1990s, and they delayed making the transition to lower-risk investments because they believed the market would continue to climb.

These hapless investors got caught in the sharp downturn of 2000-02, and they ended up with a lot less for retirement than they expected.

This cycle was repeated not long afterwards, as too many investors approaching retirement in the 2003-07 period again didn't make that necessary change to protect their nest eggs. The damage that time was even worse because of the financial crisis and terrible bear market of 2008-09.

It's important to have a specific date in mind for when you plan to retire. This should be based on multiple factors, not just your investment portfolio.

If you enjoy your job, would you prefer to keep working (and saving) a little longer? It's tough to get back into the working world once you've left it behind.

Are you slated to get a defined-benefit pension from your job? Are you fully vested already? If so, you may not need to make significant changes in your investments.

When are you eligible for full Social Security benefits? This varies depending on when you were born. If it was in 1960 or later, you will have to wait until age 67. If you start to collect your benefits earlier, your monthly payments will always be lower than if you had waited.

Then make an honest assessment of your future spending needs. Will you sell your current home and move to a lower-cost area? What are the tax consequences of this? After you have a specific target in mind, you can start formulating your strategy for getting there.

Most people in their 50s are earning the biggest incomes of their careers. If this situation applies to you, resist the temptation to rush out and buy a sports car.

Instead, consider increasing your automatic investments in your retirement plans, especially if your employer offers matching contributions to a 401(k) plan.

Adjusting your portfolio as you near retirement isn't all that different from the re-balancing you may have been doing all along, as certain asset classes perform better than others, resulting in an allocation that is different from what you set out to have.

But there's no exact formula for determining how much you should have in different types of investments. It really depends on your projected future income needs, your comfort level and investment-market conditions.

Also keep another important factor in mind: If you are in good health, you should assume you'll live another 25-30 years or more. That means you need to think long term with a large portion of your wealth. In turn, that means some growth, which leads to equities.

Reducing Risk

When you're about five to seven years from your target retirement date, it's essential that you start to gradually reduce the risk in your portfolio.

You can do some of this as part of your usual adjustments. If a stock, exchange-traded fund or mutual fund that you've been holding has been a disappointment and you've decided to sell, shift that money towards other, lower-risk investments.

If you plan ahead, you can sell or buy strictly on an investment's merits, not because of a sudden need for more income or less risk.

If your retirement picture is bright – you're sure to get a generous pension, or your nest egg has grown even faster than you expected – feel free to keep your stock allocation relatively high. But remember what happened to those investors in 2008.

The usual approach is to reduce your stake in stocks and increase it in bonds. But you likely need to go beyond that now, given the potential for rising interest rates.

One proven approach is to focus more on less volatile securities of conservative companies that pay good income. Seek out companies that have consistently raised their dividends over time, or mutual funds that invest in such companies.

When you find yourself just three years or so away from your retirement target date, it's time for another thorough evaluation of where you are and where you're going.

You may want to further reduce your stock allocation, holding onto only the most rock-solid equities. Use the money to beef up bond and cash equivalents.

If you find you're falling short of your goals, don't panic. It's not a great idea to expand the risky side of your portfolio to deal with the shortfall.

The more prudent course of action is to cut day-to-day spending and increase your savings as well as contributions to 401(k)s, IRAs, etc.

You've reached the age where protecting what you've earned becomes more important than continuing to pursue growth. Everyone deserves a financially secure retirement; a few proactive strategies can help you get there.

Drawing Living Expenses

When you draw on your investment portfolio for living expenses in retirement, keeping your tax bill down will give you more to spend. A tax dollar saved is as good, maybe better, than an investment dollar earned.

It's usually best to let your wealth compound tax-free for as long as possible. The greater variety of accounts you have, the more opportunities you'll enjoy to diversify your tax savings. This can help you keep your tax bracket down in retirement.

As a general rule, you should withdraw cash from taxable accounts first. Later on, focus on tax-deferred accounts such as traditional IRAs and annuities.

Leave accounts with tax-free withdrawals for last. An example of such an account is the Roth IRA, which allows taxpayers, subject to certain income limits, to save for retirement while allowing the savings to grow tax-free. Taxes are paid on contributions, but withdrawals, subject to certain rules, are not taxed at all.

Early in your retirement, converting currently taxable assets to spending money makes sense because little or no additional tax likely will be due.

First, take dividend income and any mutual-fund distributions in cash instead of reinvesting them. You pay tax on these payouts even if you reinvest them, so this step won't cost you anything.

Next, sell investments with no cost basis or the highest basis and therefore no or low taxable gain.

Assets with no cost basis include money funds and bank CDs as well as Treasury bills and various types of bonds held to maturity. Bond funds likely carry a high basis compared with your sale price, and therefore low tax liability.

Ideally, you'll be more passive in taking long-term gains and more active in "harvesting" your tax losses.

Continuing to hold profitable, long-term investments in a regular account is, in effect, a form of tax deferral. If you sell losing investments, you offset your tax liability on any gains you've taken with other investments.

Don't Sacrifice Growth

In addition, plan ahead for your cash needs. Then you can make gradual changes, instead of selling good investments because of a sudden need for income. Unplanned sales can needlessly boost your tax liability while causing you to sacrifice growth opportunities.

In general, you should keep your tax-deferred retirement plans intact as long as possible. Plan distributions are taxed at ordinary rates. When you leave those assets untouched in the early years of retirement, they can continue to grow unhindered by taxes.

Later, you can tap your retirement accounts, which will have enjoyed extra years of tax-deferred growth potential.

Starting at no later than age 70-1/2, you have to start making required minimum distributions (RMDs) from your IRA or other tax-deferred accounts.

In this situation, be sure to take your annual RMD before drawing on the assets in your regular accounts. The RMD may be enough to cover all or most of your cash needs, when combined with Social Security benefits and income from other sources.

If you're a retiree who's younger than 70-1/2, it may pay to start IRA distributions early if you're in a low tax bracket now and have a relatively large IRA.

For example, you may be able to take enough from the IRA to bring you only to the top of the 10% or 15% federal tax brackets.

If you need more cash than that, withdrawals from taxable accounts may increase your tax bill little or not at all, as we explain above.

What if you also own a variable annuity that you purchased with after-tax money? Lump-sum annuity withdrawals are taxed on a last-in, first-out basis.

This means that the annuity earnings come out first, taxed as ordinary income. Then the amounts taken from principal are nontaxable.

However, withdrawals are taxed differently if you set up a series of payouts over your lifetime or a specific time period.

In that situation, a portion of each payment is considered a return of principal and isn't subject to ordinary income tax. The percentages of each payment that are taxable and excluded from tax are determined when you elect to annuitize the policy.

Withdrawals from a Roth IRA will qualify for tax-free treatment if at least five years have passed since you first contributed to the plan. Note that you also usually must be at least 59-1/2 to avoid a penalty for early withdrawal.

But distributions you take because you're disabled, or that are made to a beneficiary or to your estate after death also qualify for tax-free treatment.

Planning for tax-wise portfolio distributions for living expenses is essential. But prudent asset allocation, diversification and investment selection are more important. Don't let tax savings dominate your investment decisions.

For more guidance on the right investments to choose for retirement, and to gain access to the same proprietary stock-picking system used by thousands of successful individual investors today, be sure to visit www.pfnewsletter.com now.