

Will your clients outlive their money?

If they live a long life and are too conservative when it comes to investing, they might

By Jeff Benjamin

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In a world of increasing uncertainty in which not everyone has amassed a nest egg big enough for retirement, financial advisers are doing a delicate dance: helping elderly clients embrace more investment risk while advising them to try to get by on less.

"You're not old at 75 anymore, and investors should not be overly conservative, because the biggest threat is going to be inflation," said Jerry Miccolis, a principal and chief investment officer at Brinton Eaton Wealth Advisors Inc.

Mr. Miccolis, whose firm manages \$600 million, said our natural tendency to become more conservative as we age has its limits, especially if the retirement account is running low.

"Unless someone is independently wealthy, they won't be living just off their investment income; they're going to be living off income and principal," he said. "And they won't run into trouble at age 76 — they'll run into trouble at 94, when it's too late to do anything about it."

With that in mind, advisers such as Mr. Miccolis recommend starting with a basic cash flow analysis, factoring in annual expenses, inflation and estimated investment performance.

"There's really no substitute for that kind of exercise," he said. "It doesn't have to be all that complicated, but it will help determine what makes sense."


A key aspect of these retirement assessments is revisiting the formulas regularly, according to Jim Heitman, president of Compass Financial Planning.

"If somebody is running near the edge, it's important to have that conversation of what retirement is going to look like," he said.

Mr. Heitman, who has \$22 million under advisement, said he avoids the "standard go-to response" of buying an annuity and accepting whatever the annuity can pay.

"There needs to be some equity exposure, regardless of a client's age, because perfect safety is not always realistic," he said. "I still operate under the assumption that we can provide a better return than an annuity."

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He added that one of the biggest mistakes an adviser can make is to assume a client's lifespan is 90 and then never revisit that assumption.

"If somebody lives to be 75, there's a good chance they're going to live past 90," he said. "That's why there needs to be some equity exposure all the way to the end, even if it's just 15% in stocks."

Once a person reaches the mid-70s age range, lifestyles are fairly established and often quite modest, advisers said.

"Based on some of the tax returns I do, I'm amazed at what people can learn to live on," said Bedda D'Angelo, president of Fiduciary Solutions, which has \$110 million under management and advisement.

At 63, Ms. D'Angelo said her personal experiences help her to appreciate the perspectives of some of her elderly clients.

"Most people at 75 really have their spending under control," she said. "They don't care if they have a widescreen TV."

That means the biggest adjustment for a lot of elderly clients will be in the area of accepting levels of risk that they might not otherwise have considered.

"The more conservative you get, the faster you will run out of money," said Robbie Cannon, president and chief executive of Horizon Investments LLC.

At his firm, which manages \$3 billion in separate-account assets, the "lifetime-income strategy" involves keeping three years' living expenses in liquid assets and the rest in the equity markets.

"It's a paradigm shift to move out of the old style boxes that force you to buy high and sell low," Mr. Cannon said.

The basic idea of allocating near-term living expenses to secure cash equivalents such as certificates of deposit is that the money can be withdrawn either from the equity investments (if the market is up) or from cash reserves (if the market is down).

The strategy, which is a variation on the kind of liability-driven investing used by pension funds, is gaining popularity among advisers.

Asset Dedication LLC employs a similar model on its \$80 million managed-account platform, using individual bonds to guarantee an income stream while equity market allocations keep investors exposed to potential investment gains.

"For a 75-year-old, we do a sophisticated bond ladder that would keep 40% of the portfolio immunized [from market volatility]," said Brent Burns, Asset Dedication's president.

"The bond portfolio is like a buttress that allows them to take on the equity risk," he added.

The primary distinction between this kind of strategy and an annuity that offers a guaranteed income stream is that the annuity route can lag inflation and eliminate the opportunity to participate in market performance.

"If you don't have a lot of money and you annuitize it all, you won't have any savings left," Ms.

D'Angelo said.

Mr. Niccolis believes in tweaking the traditional formula of subtracting your age from 100 to determine equity exposure; he advises subtracting your age from 110.

"Inflation will be like a death by thousand cuts if you just use annuities," he said. "Once clients understand the impact of inflation, they realize getting more conservative is the riskiest thing they can do."

One of the advantages of living off a lower income is that tax consequences become less of an issue when making investment decisions.

"A lot of investing literature is geared toward high incomes, but if you're in the two lowest tax brackets, you can sell off an investment for living expenses and not incur any tax," said David Blain, president and chief investment officer at D.L. Blain & Co. LLC, which has \$60 million under advisement.

Mr. Blain is advising a 68-year-old widow who is down to her last \$100,000 after spending all her savings caring for her husband, who had Alzheimer's.

Mr. Blain said he is building a fixed-income ladder for income, but also keeping the client exposed to equities for added performance.

"I explain to people that if they're not going to make it doing what they're doing now, they've got to change something," he said. "That usually gets a person thinking if they're going to run out of money investing conservatively, they might as well take some more risk for more yield."

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