How Do We Ensure That Our Clients Don’t Outlive Their Money?

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As we weather the world’s greatest economic crisis since our grandparents’ days, many of our clients are fighting a palpable level of panic that is permeating all aspects of their lives. Clients who ordinarily are oblivious to day-to-day market fluctuations are tuning into television and the media’s sensationalism morning, noon, and night, giving up the tranquility of their normal lives. Many feel deserted by government officials and financial institutions; that no one cares that their retirements and the values of their personal portfolios have been decimated.

But it’s not like most Americans went into this storm from a position of strength. Nearly half the participants in MetLife’s 2006 Employee Benefits Trends study1 ranked “outliving their savings” as their greatest retirement fear; 48 percent said they worried about needing a full- or part-time job to make ends meet. Many have used their homes as ATM machines, and now that home values have crashed they have little or no equity or owe more than their homes are worth. Others recently took on huge mortgages as investment opportunities and are no longer able to pay them. Most clients also are pinched by hidden inflation. On top of all this, people are living longer thanks to medical advances, so they have to make their money last longer, too.

How can we help clients address their fears of outliving their money and provide them with best practices appropriate for different stages of their lives?

First, let’s be aware that high-net-worth clients tend to overspend and anticipate more income than their portfolios can produce. For these reasons, we need to be conservative as we guide clients (for example, we should include the effect of taxes and inflation on the actual rate of return). In many cases, being conservative also means reshaping client expectations to accommodate a long-term spending rate of 3–5 percent. Accomplishing this shift in expectations helps ensure clients that they won’t outlive their money and/or protects their principal for gifting to their children or other beneficiaries.

Second, we need to approach clients with investment strategies and choices that are adaptable to the volatile times we live in. Market changes are painful, and clients look to us for ways to protect themselves.

Finally, we must address the fear and even panic that nearly all clients wrestle with during periods of economic turbulence. Clients need our support and expertise as they evaluate whether they should postpone retirement, cut costs, or reallocate portfolios. With an astute financial professional alongside, clients should be able to embrace life—even during a financial tsunami—because they have well-diversified portfolios and accurate spending plans.

Wealth Management Strategies

Let’s take a look at some wealth management best practices that can be applied successfully—even in volatile markets. As always, there’s no one-size-fits-all approach, so the onus is on you to assess each client’s financial situation and tailor recommendations accordingly. Consider multiple strategies to ensure that clients have the appropriate income they need.

First, develop a stock, bond, and liquidity portfolio with an equity income focus and design a precise monthly distribution and spending strategy. While traditional income—which comes from interest and dividend payments—is useful, it often falls short of providing sufficient income. Many high-quality companies are either growth companies or lower-paying blue chip companies, both of which traditionally produce a modest dividend stream. In addition, inflation can devastate dividend-based strategies if you fail to use a total-return design. An effective total-return approach takes into account the dividends, interest, and growth of a client’s income stream, as well as the capital appreciation of the equities, minus an assumed level.
of inflation. This calculation helps you determine a reasonable income level for a client.

By exercising prudence in these assumptions and re-evaluating the success of the strategy annually, you can help clients ensure they don’t outlive their money. For example, when designing the total-return strategy, allow for higher inflation than what we’ve seen over the past 100 years. In the past decade, we’ve experienced exponential increases in energy, food, and health care costs, and current trends indicate that we should expect more of the same. Fortunately, more and more private planning and consulting firms are studying best-of-breed endowment funds, such as the Yale and Harvard endowments, to model effective payout strategies.

Within the total-return approach, you can consider a number of investment strategies for each client’s income needs.

**Strategy 1: Implement a diverse equity portfolio**

Investors need to develop portfolios of equities that consistently provide dividends that increase over time. During periods of market volatility, find opportunities for clients to purchase high-dividend-paying stocks at bargain-basement prices. In other words, help them purchase equities at low prices and realize high dividend payouts, resulting in a superior total return.

The challenge, of course, is to identify dividend-paying stocks in companies with track records of 10 or more years that are making consistent payouts. Ideally, you want companies that have a history of steady dividend increases, because this helps offset the effects of inflation. In portfolios of modest size, mutual fund or exchanged-traded fund (ETF) alternatives can be useful in complementing your equity implementation strategy because they provide low-cost and simplified entry and exit of equity markets.

**Strategy 2: Diversify preferred stocks with high-quality companies beaten down by lack of market confidence**

Look for companies that offer a high-dividend quarterly payout and buy their stocks during a period of significant dislocation of the markets. Over time, you will assemble a solid base of high dividend payers at significant discounts to their call or maturity values.

**Strategy 3: Ladder government, corporate, or municipal bonds to provide predictable income**

High quality tax-free or taxable bonds can be a great source of the predictable income needed to support clients and ensure they don’t outlive their money. By laddering a semi-annual stream of interest payments, you can give clients the regular distributions that they crave and depend on.

The key is to tailor investments to each client’s unique situation and take bracket—and then pick winning companies that will withstand the test of time, even during economic downturns. For higher-tax-bracket clients, consider using tax-free municipal bonds to augment government and high-quality corporate bonds. In addition, as noted in strategy one, adding mutual funds and ETFs can provide an excellent, low-cost approach to diversifying bond-based strategies.

**Strategy 4: Make a lump-sum purchase of an immediate annuity with a lifetime payout**

Annuities are perhaps the fastest, easiest way to address a client’s financial worries. By negotiating written contracts with high-quality life insurance companies, you can provide clients with steady, predictable income streams that they can’t outlive. These contracts can be written over a single life or multiple lives, which further ensures that clients don’t run out of money. Payouts may be lower compared with other financial vehicles, but the predictability of annuities can mitigate the psychological costs of economic downturns.

The challenge for you is to identify highly rated, stable insurance companies that offer substantial payouts—and then negotiate the highest possible distribution levels from among the best companies for your clients.

**Strategy 5: Invest in a diversified portfolio of real estate investment trusts (REITs) and ladder the quarterly distributions to provide steady monthly income**

Search for REITs that invest in actual bricks and mortar—not mortgages—and have a history of steady if not increasing dividends. REITs that invest in actual real estate typically can provide the long-term payouts needed to achieve client goals. As with bonds, you can ladder interest payments to provide regular distributions.

**Strategy 6: Invest in oil and gas trusts or limited partnerships predominately domiciled in Canada or the United States**

Oil- and gas-focused trusts historically have strong income flows and offer clients a modest tax shelter. In a world with increasing energy demand and...
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Strategy 1: Reduce any and all consumer debt to zero
Eliminate a client’s out-of-pocket costs associated with credit cards or other forms of bank borrowing at high interest rates. A client’s motto should be, “I pay off my bills at the end of month or I don’t use the cards,” because there is no tax deductibility in paying finance charges on a traditional credit card.

Strategy 2: Develop a realistic spending plan
During economic downturns, most people need to rethink how they manage income and manage their lifestyles to align expenses with incomes. They need to develop a realistic budget to ensure that they will not run out of money. Asset-liability analysis gives you the insight to better understand client lifestyles, identify what is causing the client to overspend, and help the client make more informed spending decisions.

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Strategy 3: Pair active incomes with passive incomes
Passive incomes include pensions, Social Security, annuity distributions, inheritances, and reverse mortgage income streams. In many cases, when you add active and passive income streams you will find that clients have excess income. This presents new opportunities for clients to use this income to design more fun into their lives, help family members, and develop charitable pursuits.

Liability Management Strategies
As we help clients shift to more-conservative return payout expectations, it is more important than ever to balance financial strategies with liability and spending management strategies. It’s all about getting back to basics.

For example, before any wealth advisory work can begin, you need to answer a fundamental question: Is the client living at, above, or below his or her income needs? The answer requires a comprehensive asset-liability study that examines all sources and uses of income relevant to the client’s life—both business and personal. Using sophisticated software, this task is a straightforward, efficient process. What is crucial is that every area of the client’s spending is made transparent and all parties involved determine which spending is essential and which is nonessential. Once the relationship between income and expenses is fully understood, you can begin the income and spending redesign process—which may involve prioritizing which expenses have to go. This can be a hot potato with couples because priorities often vary between spouses.

For clients living at or above their income needs, the following strategies for managing liabilities can play a critical role in ensuring that they don’t outlive their money.

Life Planning Strategies
After you complete the tactical side of money management that ensures clients don’t outlive their money, clients are free from financial stress and worry. The next step is to challenge them to step into a richer, fuller life with a greater sense of purpose. Today’s retirees don’t want to play croquet in Florida. Increasingly they want the mental stimulation, professional challenge, and human interaction that can come with professional or volunteer work to complement their retirement plans. Moreover, working part time—even in a new field—can help them keep their lives vital, defray the cost of living, and extend their nest eggs many years into the future. As a result, they need to rely less and less during early retirement on portfolio distributions.

Putting Timeless Strategies into Practice
Taken together, the timeless wealth-management, liability-management, and life-planning strategies described here provide you with a solid foundation for ensuring that your clients don’t outlive their money. Used well, they will help you deal with the uncertainties that we face in working with clients—and enable you to meet their income and lifestyle needs in a more comprehensive, effective way.

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Endnote
1 For the past six years, MetLife has surveyed employers and employees on pressing issues facing the U.S. benefits industry today and compiled the results in its annual Study of Employee Benefits Trends. For more information, visit http://www.whymetlife.com/trends.