MassMutual

Taming a Bear Market in Retirement

Adding flexibility to your retirement income portfolio with whole life insurance

Market Volatility and Retirement

If you're saving for retirement, you're probably used to seeing the value of your retirement accounts go up and down with the financial markets. However, once you retire, this may be a greater concern.

Taking withdrawals from your retirement accounts during market downturns can significantly reduce their value over the long term. This is why it's important to have alternate sources of retirement income that are not directly impacted by market conditions. To better understand this problem and how you can prepare for it, consider the following example.

The decision to purchase life insurance should be based on long-term financial goals and the need for a death benefit. Life insurance is not an appropriate vehicle for short-term savings or short-term investment strategies. While the policy allows for loans, you should know that there may be little to no cash value available for loans in the policy's early years.

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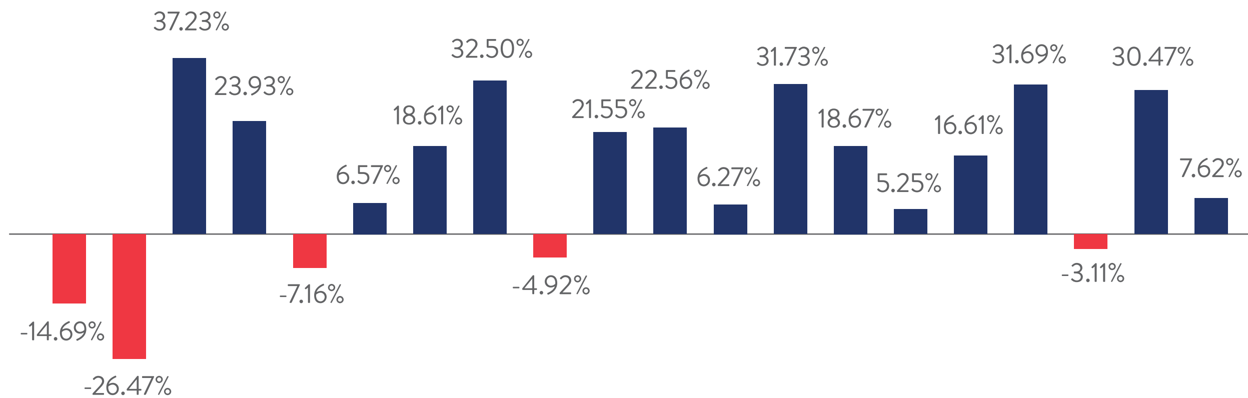
Meet Sandra

Sandra is 65 and planning to retire. She has a substantial portion of her retirement savings in a traditional individual retirement account (IRA) with a pre-tax balance of $2,000,000. Assume that the investment results for this account over the next 20 years of Sandra's retirement will mirror the annual returns of the S&P 500 Index[1] from 1973 to 1992.

FUTURE ANNUAL RETURNS FOR SANDRA'S IRA



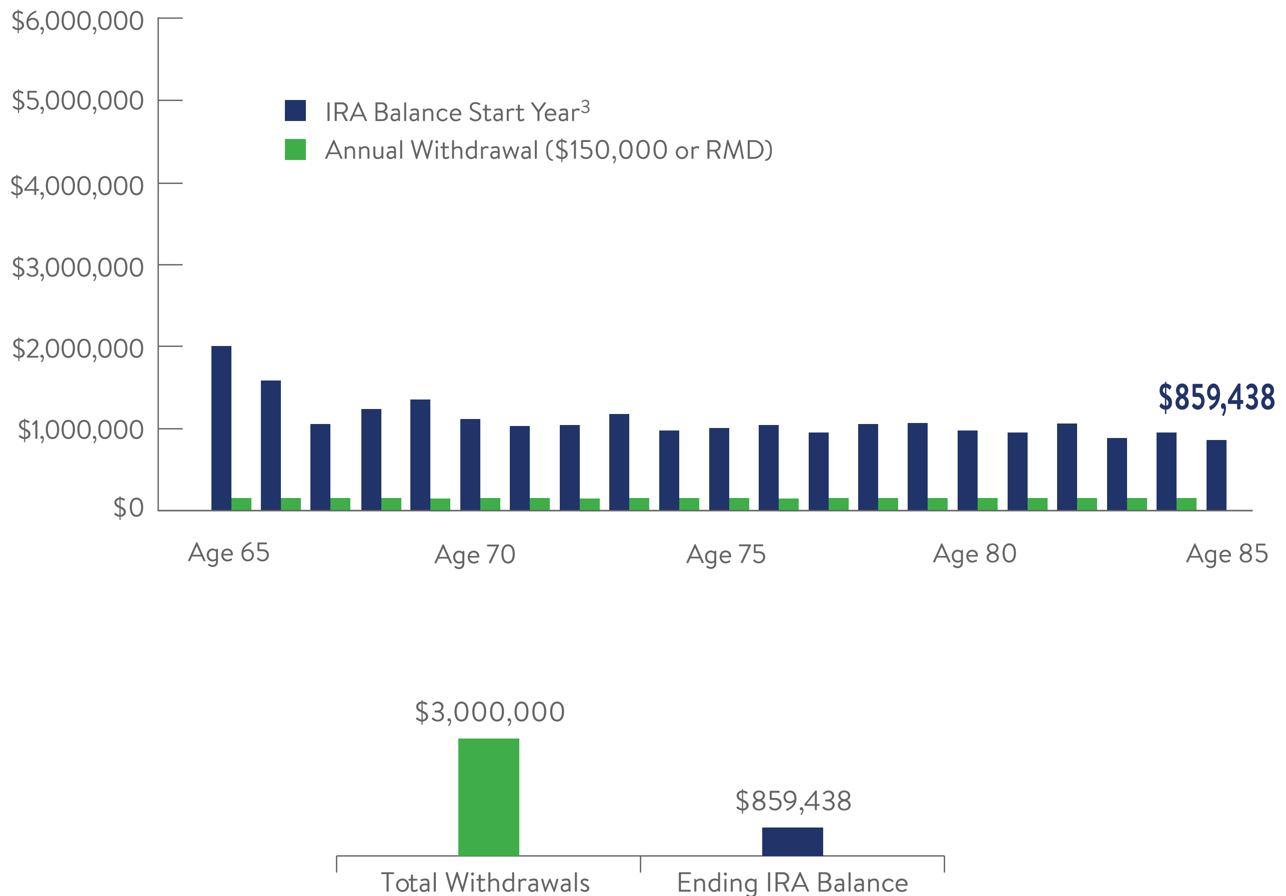
This return pattern was selected to illustrate the long-term impact that negative returns can have on a retirement account:

- The average annual return over this 20-year period was 12.75%.
- There were five years with negative returns.
- The index declined significantly over the first two years.

[1] The S&P 500 price index is a measure of common stock market performance in the U.S. It is an unmanaged index and does not reflect the fees or expenses associated with an actual investment. Individuals cannot invest directly in an index.

Sandra's Plan

Sandra plans to withdraw $150,000 from this account at the start of each year, or the required minimum distribution (RMD),[2] if greater. This will be taxed as ordinary income to Sandra. The chart below illustrates her annual withdrawals and the IRA balance over the first 20 years of her retirement.[3]



Based on our assumptions, Sandra will withdraw a total of $3,000,000 from her IRA over the 20-year period. Her account will have an ending balance of $859,438.

[2] The Required Minimum Distribution (RMD) is the minimum amount that must be withdrawn annually from a traditional IRA once the account owner reaches age 73 (age 70 ½ if you were born before July 1, 1949, age 72 if you were born after June 30, 1949 and before January 1, 1951. The RMD age will increase in 2033 to age 75). If the full RMD is not taken as required, the shortfall will be subject to an excise tax.

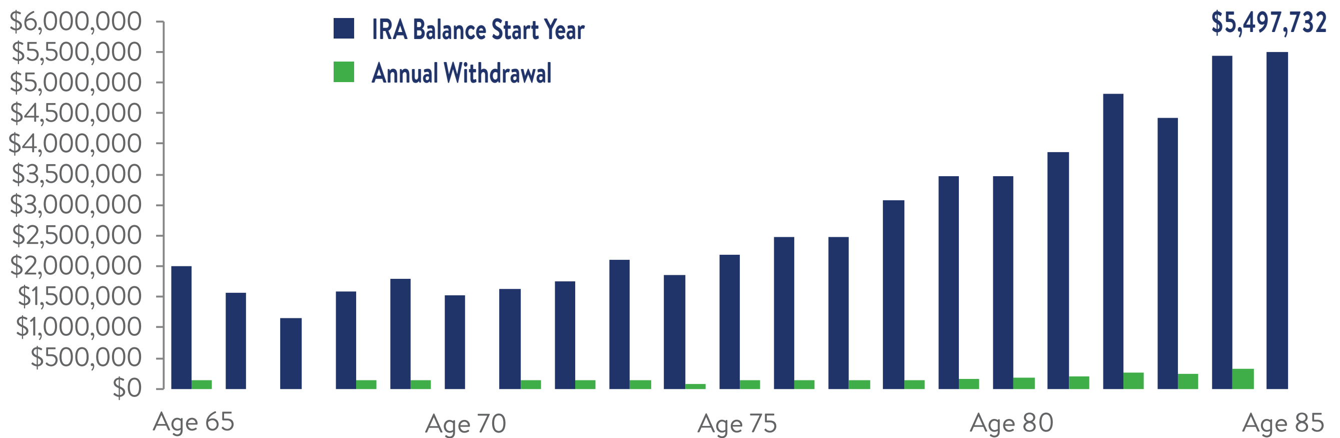
[3] Returns and account values are hypothetical and do not reflect the fees and charges associated with an actual investment.

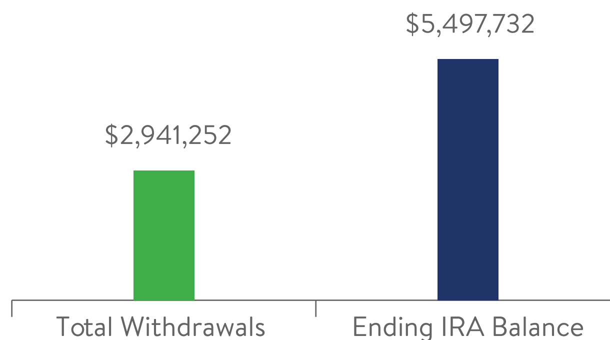
A Different Approach

Assume that Sandra takes an alternate approach. Instead of automatically taking $150,000 out of her account each year, she will avoid taking a distribution in any year that follows a negative annual return. However, she will still need to withdraw at least the annual RMD[2] once she turns 73.

The year-by-year results under Sandra's modified withdrawal strategy are as follows:

SANDRA'S IRA — MODIFIED WITHDRAWAL STRATEGY





Under this approach, Sandra will skip or reduce her withdrawals in four of the 20 years. She will withdraw a total of $2,941,252. This is more than under the prior approach because the higher account balances result in required minimum distributions that exceed $150,000 in each of the last seven years. Even though Sandra will take more out of her IRA under the modified withdrawal scenario, her ending IRA balance increases from $859,438 to $5,497,732 — well over six times as much.

While the modified withdrawal strategy offers some clear advantages, there are still four years when Sandra will need to replace the forgone withdrawals from her IRA.

Alternate Sources of Income

There are a number of ways to create sources of income that you can depend on during down markets. Bank products such as certificates of deposit and savings accounts are obvious choices. Investments such as money market funds and short term government bond funds are also options. These and other near-cash investments should be part of every retiree's safe income sources. However, while they are low-risk investments, they also provide lower returns.

Another option to consider is participating whole life insurance. In addition to providing permanent life insurance protection, whole life accumulates guaranteed cash value that increases each year on a tax-deferred basis and never decreases in value due to market conditions. So it can be a reliable alternate source of funds during financial downturns.[4] Whole life insurance also offers some attractive income-tax advantages that allow the policyowners to access the cash value on a tax-advantaged basis. Overall, it can be an important part of your retirement income strategy.

[4] Distributions under the policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy (cost basis). If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of gain and are subject to a 10% tax penalty if the policyowner is under age 59½.

Access to cash values through borrowing or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

You can't predict when market downturns will occur. But you can be prepared, so you can reduce the impact they will have on your retirement.

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