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FINANCIAL ADVISOR

Private Wealth

3RD ANNUAL

Financial Advisor RETIREMENT SYMPOSIUM

Two Top Advisors Discuss Different Approaches To Retirement Withdrawals

PANELISTS

Norm Boone

Founder and President

Mosaic Financial Partners

Ross Levin, CFP

Founding Principal and President

Accredited Investors Inc.

Mosaic's Client Withdrawal Program

How do you determine the "right" withdrawal amount so your client's portfolio can last a lifetime?

Industry Research

- **Bengen—the original 4% rule**
- **Guyton/Klinger—variation of 4% rule**
  - Relevant variables to determining a "Safe Initial Withdrawal Rate"
  - "Guide Rails" to guide annual calculation
- **Kitces—refinements**
  - Starting valuations influence results
  - Adjust for fees

Key Factors

1. **Your possible life expectancy**
   - Guyton limited tests to 30 or 40 years
   - Longer time period = lower withdrawals
2. **Your investment returns**
   - Guyton - 40%, 55% or 70% equity portfolios
   - Lower risk = lower withdrawals
3. **Your desired confidence level**
   - Guyton - 90%, 95% or 99% success rates
   - High confidence needed = lower withdrawals
4. **Market valuation**
   - Kitces used Shiller's PE10—Normal (12-20), High (>20) or Low (<12)
   - Higher market levels = lower future returns = lower withdrawals

Safe *Initial* Withdrawal Rate

- Your Safe Initial Withdrawal Rate (SIWR)
  - Is determined based on the four key factors
  - Is used to determine your 1st year's withdrawal amount
  - Ranges from 3.1% to 6.0%

Withdrawals defined

Net of Investment Fees

Includes:

Amounts needed for Taxes

Does *not* include:

Social Security, Pensions, Annuities or Other Assets

Calculating the First Year's Withdrawal Amount

- SIWR x Portfolio Value = 1st year's amount
- Example: 4 Factors for $2 million portfolio
  - –40 years
  - –95% confidence
  - –55% equity
  - –normal valuation
- Calculated Example SIWR = 4.5% rate
- SIWR x Portfolio Value = 1st year's amount
  - –4.5% x $2,000,000 = $90,000

Subsequent Annual Withdrawals

"Basic Rule"

Each year's amount is based on the prior year's calculated amount, as adjusted

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Last Year's Amount *x* (1 + Inflation Rate) = Current Year's Withdrawal Amount

Example: $90,000 x 1.02% = $91,800

Unless….

Exception Rules

When do you raise or lower the calculated amount? (Guyton's "Guide Rails")

1. Freeze Rule (no inflation adjustment)
2. Capital Preservation Rule (reduction)
3. Prosperity Rule (increase)

Freeze Rule
(*No Inflation Adjustment*)

If:

(1) portfolio has negative return *<u>and</u>*

(2) the new (current year's) withdrawal rate is now greater than the SIWR

Then:

No Inflation Adjustment

Freeze Example

Year 2 Conditions:

Prior year's portfolio returns = -5%

Prior year withdrawal amount = $90,000

Prior year inflation rate = 2%

Normalized Yr 2 withdrawal calculation = $91,800

Rule Application:

$91,800 ÷ $1,900,000 = 4.8% rate

Calculated rate (4.8%) > SIWR (4.5%)

Result:

Withdrawal Amount remains $90,000 (as last year)

Capital Preservation Rule
(Withdrawal Amount Reduced)

If:

Current year's rate > 120% x SIWR

(you would be taking too big a bite from your portfolio)

Then:

Current year's amount is cut 10%,

But….

No cut if within last 15 yrs of withdrawal period

Capital Preservation Rule Example

Conditions:

Portfolio value dropped to $1,670,000

Current normalized rate = $91,800÷$1,670,000 = 5.5%

120% x SIWR of 4.5% = 5.4%

Rule Application:

Current rate (5.5%) > 120% x SIWR (5.4%)

Result:

Withdrawal Amount cut 10% to $82,620

($91,800 x 90% = $82,620)

Prosperity Rule
(Withdrawal Amount Increased)

If:

Current year's rate < 80% x SIWR

(you could easily take a larger bite from your portfolio)

Then:

Current year's amount is raised 10%

Prosperity Rule Example

Conditions:

Portfolio value has risen 30% to $2,600,000

Normalized rate = $91,800 ÷ $2,600,000 = 3.5%

80% x SIWR of 4.5% = 3.6%

Rule Application:

Current rate (3.5%) < 80% x SIWR (3.6%)

Result:

Withdrawal Amount raised 10% to $100,980

($91,800 x 110%)

Operations

- SIWR calculation done using spreadsheet with built-in entries, as provided by the research
- Each client has own signed Withdrawal Policy Statement
- Rules are applied at beginning of each year
- Client gets new calculation amount in standardized letter or in meeting
- Upon client approval, cash raised once for the full year
- Monthly transfer to client's bank account

What if client needs more?

– "Emergency funds" – initial set aside account. Draw down as needed, until exhausted. It reduces the initial withdrawal amount. Can use to provide planned "extra" expenses, also.

– "Surplus account" – initial set aside amount plus funds arising from prior year unspent amounts from client's annual "allowance" (alternatively, can be held in portfolio to raise the calculated withdrawal amount).

Disclosures

- It is impossible to predict the future with certainty.
- This program is intended to provide rational guidelines and a structured approach to managing personal retirement spending with a level of confidence.
- The success of this program will depend heavily on the client's ability to spend within the program's guidelines.
- Based on research by Jonathan Guyton & William Klinger (Journal of Financial Planning, October 2004 and March 2006) and Michael Kitces (The Kitces Report, May 2008)
- Future research may render this model obsolete.

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Emotions v Reality

- Ranges of Spending
- Treatment of Outside Accounts

Disability and Income Protection 20%

What are the income and lifestyle needs and wants of your family currently and prospectively? – 35 percent	
211	Review current cash flow and budget needs – 30 percent (2.1 percent)
213	Determine purpose and costs of one-time large expenditures including education, vacation homes, or assistance for family members – 10 percent (0.7 percent)
214	Establish you financial independence goals and the price to be paid to achieve them – 30 percent (2.1 percent)
215	Review your annual charitable giving objectives and how they should be funded – 10 percent (0.7 percent)

Disability and Income Protection 20%

Have you evaluated all current sources of income and potential changes to these sources? – 25 percent	
223	Review the cost/benefits of various pension pay-out options – 15 percent (0.75 percent)
224	Analyze social security income options including those for children under 18 – 15 percent (0.75 percent)
225	Understand required minimum distributions from retirement – 10 percent (0.5 percent)
226	Determine the amount of portfolio withdrawals to fund expected three-year cash flow shortages – 10 percent (0.5 percent)
227	Objectively consider any expected gifts or inheritances – 10 percent (0.5 percent)

Disability and Income Protection 20%

Are you proactively engaged in tax planning for you and your dependents? – 25 percent	
241	Determine appropriate levels of withholding and estimated tax payments – 15 percent (0.75 percent)
242	Determine whether tax-loss harvesting is possible and appropriate – 15 percent (0.75 percent)
243	Review gifting opportunities and strategies – 20 percent (1 percent)
244	Determine whether to accelerate or defer income and/or deductions for tax bracket or AMT reasons – 30 percent (1.5 percent)
245	Evaluate the re-characterization or conversions of IRAs to/ from Roth IRAs – 20 percent (1 percent)

Investment Planning 25%

Have you developed an investment philosophy? – 60%	
411	Define your attitude toward investment risk – 10 percent (1.5 percent)
412	Determine whether the portfolio return objectives are consistent with these attitudes – 10 percent (1.5 percent)
413	Define the various time horizons for which you are saving – 10 percent (1.5 percent)
414	Determine legal, investment, regulatory restrictions or unique circumstances impacting your portfolio – 10 percent (1.5 percent)
415	Determine a suitable asset allocation – 60 percent (9 percent)

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Investment Planning 25%

Have you determined the mechanics for managing your portfolio and the evaluation of what success looks like? – 40 percent	
421	Decide accounts to consolidate, transfer, or maintain separately and how they will be handled for policy and advice – 55 percent (5.5 percent)

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Portfolio Values

Asset Allocation Decisions

- More Bonds = ↑ Starting Rate
  ↓ Lifetime Income

Legacy Decisions

- Who Gets What
- Not Included or Included Later

ross@accredited.com

Adjustments are based on portfolio values, not inflation.

Higher Start = Lower Increases

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Clients want to spend less when they are afraid.

- Fixed v Discretionary
- Buckets

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Client and Co-Client

Portfolio Composition

March 13, 2012

Total Assets as of 3/13/12: $9,349,009

70/30 Portfolio

Cash	$57,448
Equity	$5,098,422
Alternatives	$629,512
Fixed Income	$1,800,265
Total	$7,585,647

Cash for taxes

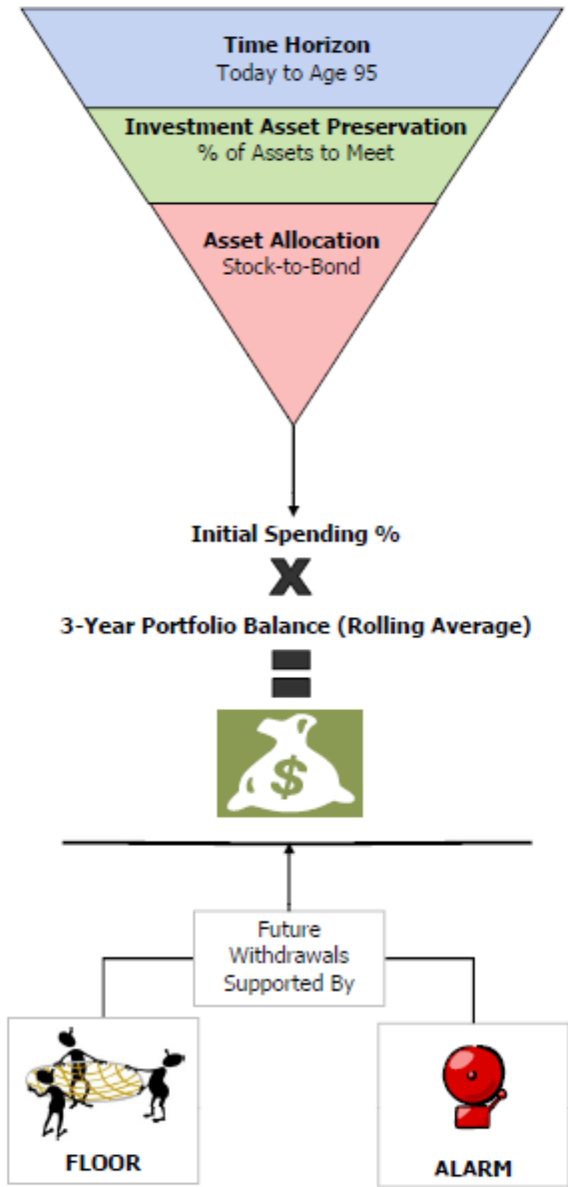
Cash	$100,000
Total	$7,685,647

Lifestyle

Cash	$458,709
Stonebridge	$712,623
Bond Ladder	$492,029
Total	$1,663,361

Client & Co-Client

Determining Annual Spending Amount



Client & Co-Client

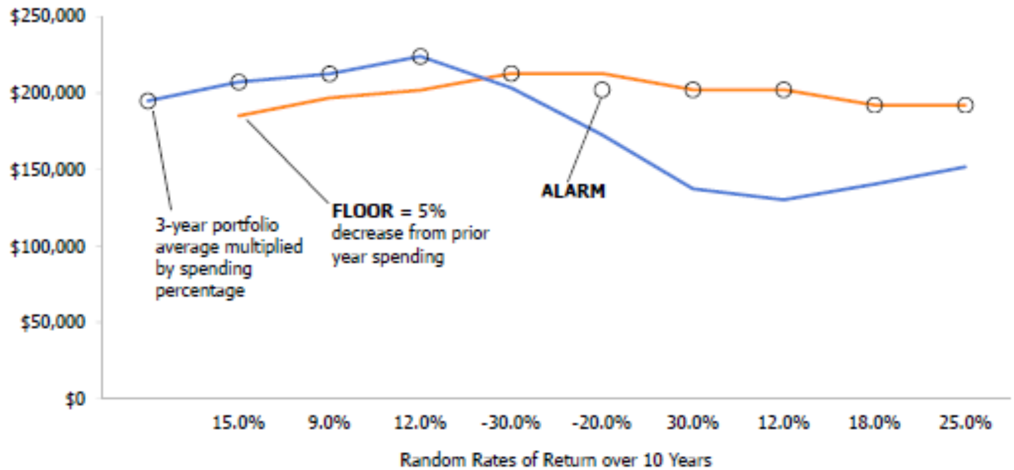
Spending Policy Illustration - Several Large Negative Years

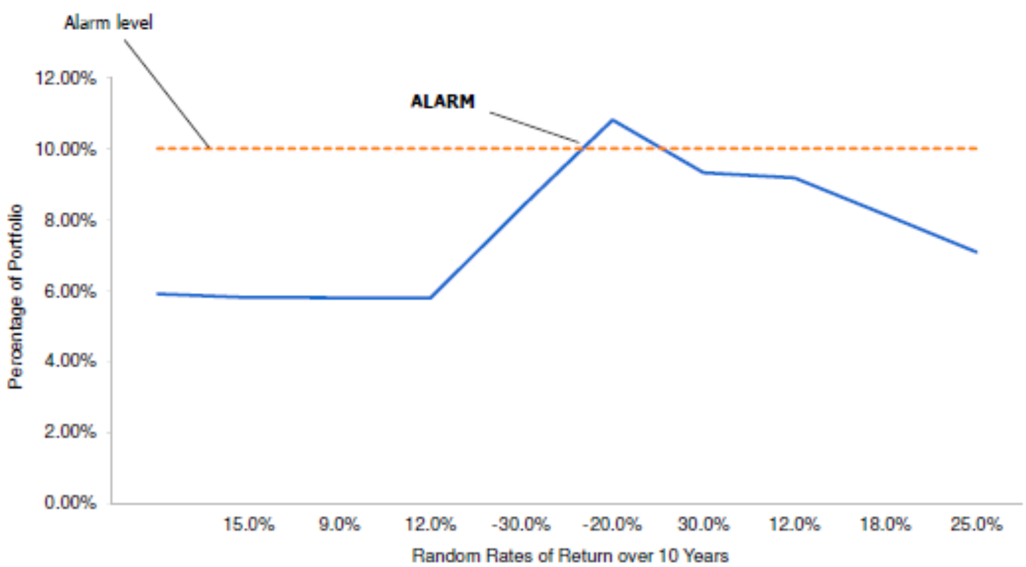
April 2, 2012

Greater of floor or 3-year average, unless alarm

Annual Spending Amount

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
$194,818	$207,173	$212,506	$223,971	$212,772	$202,134	$202,134	$202,134	$192,027	$192,027

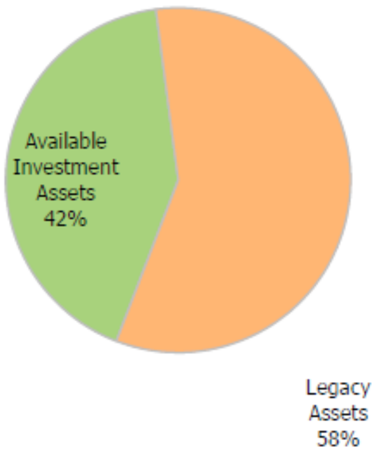




Client & Co-Client

Asset Summary

April 2, 2012



Assets Considered in Spending Policy:

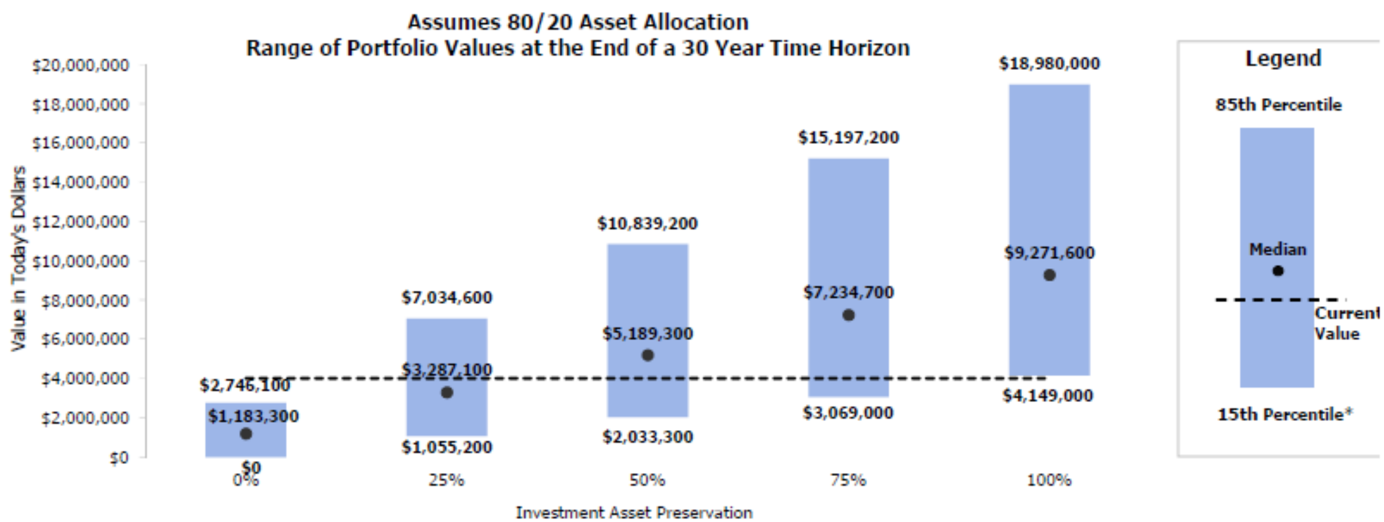
Description	Beginning of Year Value
Personal Accounts	$2,000,000
Tax Deferred Accounts	$2,000,000
Total	**$4,000,000**

50% of Investment Assets Preserved

Assets Excluded from the Analysis:

Description	Current Value
MN Home (equity)	$700,000
Timeshares	$50,000
Total	**$750,000**

Total Wealth	**$4,750,000**
Total Wealth % Preserved	**58%**



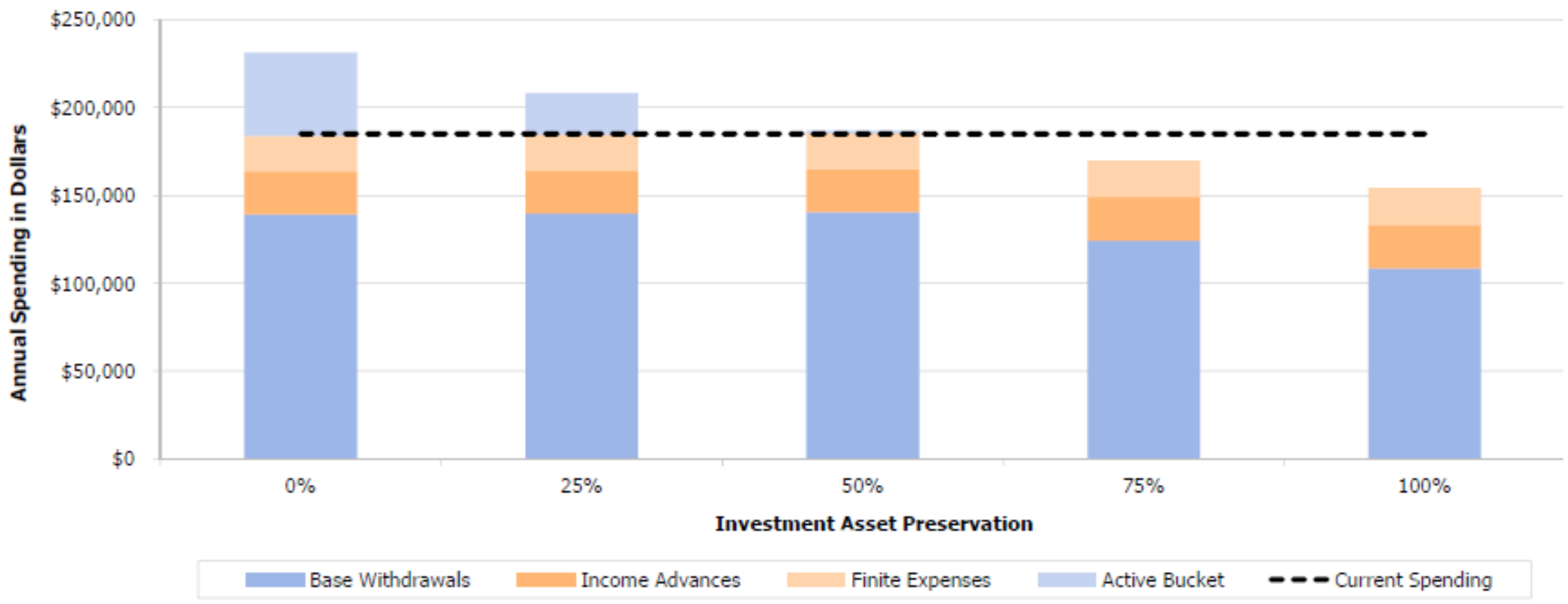
Client & Co-Client

TOTAL Spending Based on Legacy Goals

April 2, 2012

Investment Asset Preservation	0%	25%	50%	75%	100%
Income from Portfolio					
Social Security Advance	$30,000	$30,000	$30,000	$30,000	$30,000
Mortgage	$25,000	$25,000	$25,000	$25,000	$25,000
Other Withdrawals to Meet Base Spending	$171,100	$171,100	$171,100	$150,800	$130,800
Active Spending Bucket	$58,100	$28,900	$1,400	$0	$0
Less: Expenses					
Projected Taxes	($53,100)	($46,800)	($40,800)	($36,100)	($31,700)
TOTAL Spending (Net of Taxes)	**$231,100**	**$208,200**	**$186,700**	**$169,700**	**$154,100**

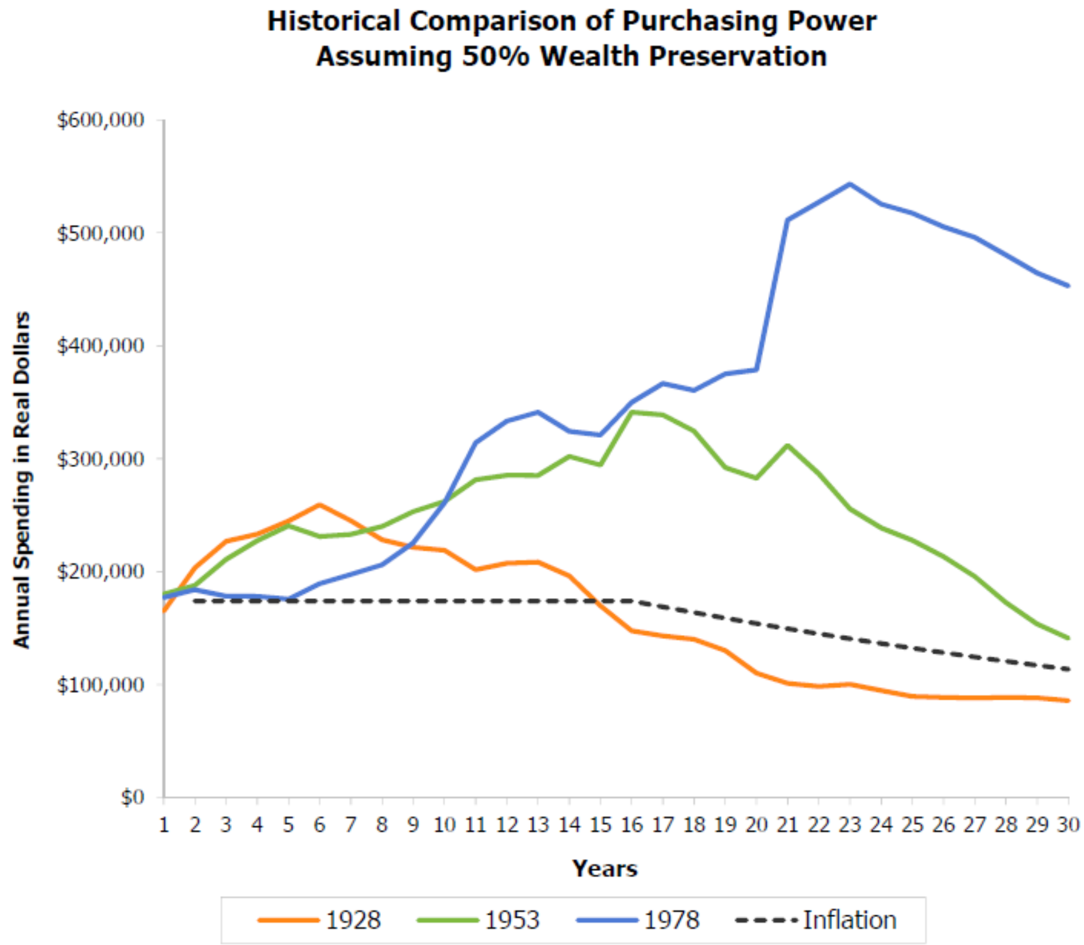
Assumes 80/20 Asset Allocation and 30 Year Time Horizon



Client & Co-Client

Spending Examples

April 2, 2012

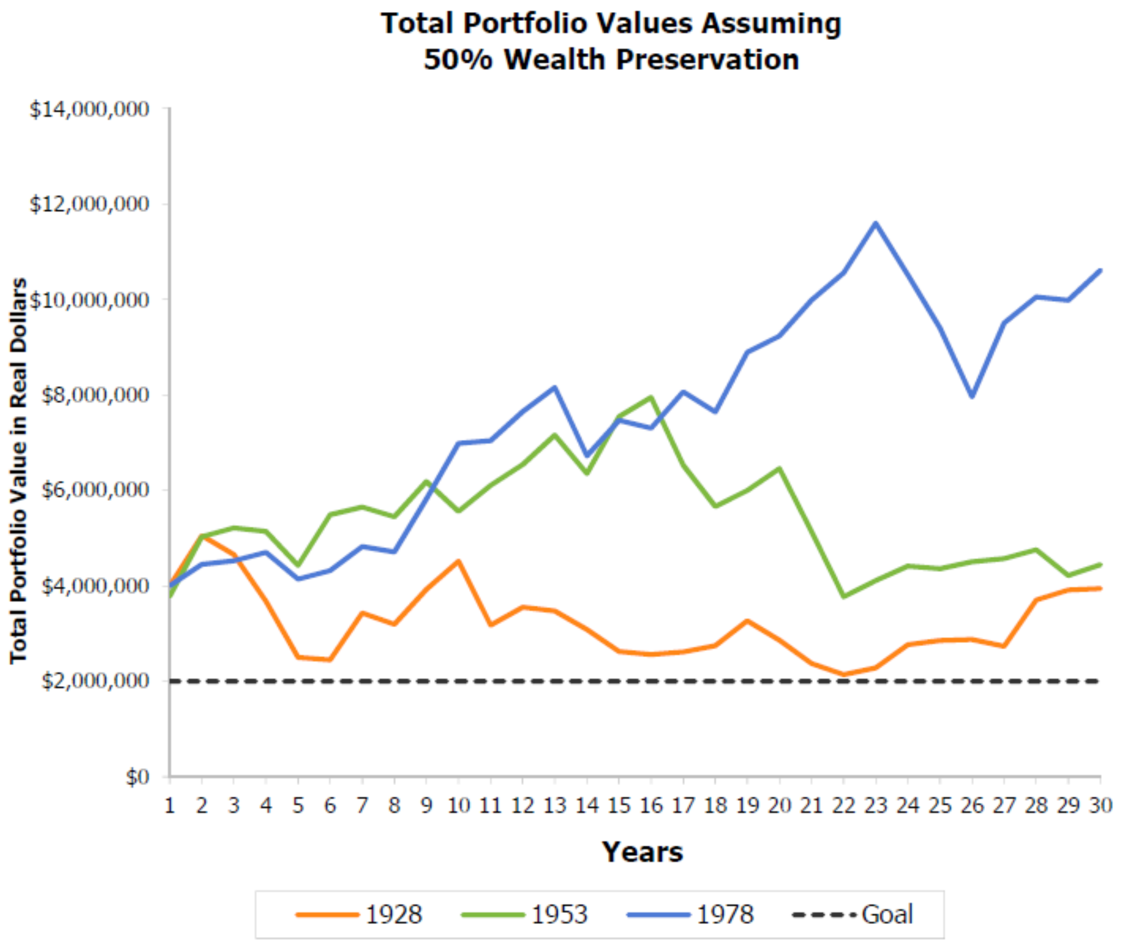


DISCLAIMER: Information is based historical rates of return from 1928 - 1957, 1953 - 1982, & 1978 - 2007

Client & Co-Client

Spending Examples

April 2, 2012



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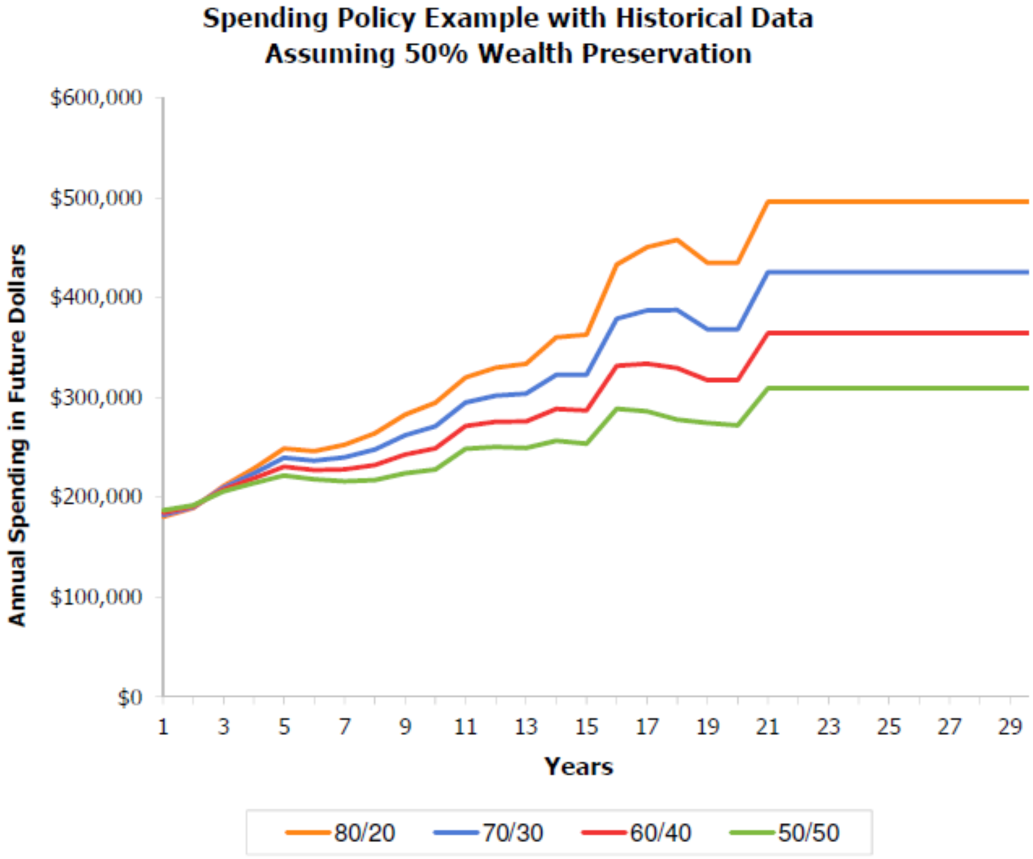
Client & Co-Client

Impact of Asset Allocation on Spending Policy

April 2, 2012

Asset Allocation	80/20	70/30	60/40	50/50
Initial Base Spending %	6.05%	6.30%	6.40%	6.35%
Net Present Value	$6,824,700	$6,118,300	$5,504,400	$4,943,100



DISCLAIMER: Information is based historical rates of return from 1953 - 1982

Monte Carlo

- Failure Rate
- Standard Deviation

ross@accredited.com

Questions?

Be Our Guest

Monday, October 29th

ross@accredited.com