PACIFIC LIFE

# A PROTECTED APPROACH TO RETIREMENT SPENDING

A Summary of the White Paper by Michael Finke, PhD[1]

Without a pension, today's retirees must use their own savings to pay for spending in retirement. This white paper provides a simple overview of the retirement income choices faced when using investments to create a lifestyle. Three basic approaches are considered:

1. Using safe investments to pursue a stable income over a specific number of years
2. Investing in a riskier investment portfolio that offers potential for gains and increased spending
3. Using a financial product that blends investment risk with a lifetime income guarantee

## Conservative Investors Could Run Out of Money

Turning savings into income would be easy if a retiree knew exactly what investment returns they would receive and how many years of spending they needed to fund. A retiree could increase investment certainty by taking less risk, but then faces the choice of either spending as they wish and possibly outliving savings or spending little to spread savings out over a greater number of years. Taking greater risk does increase expected investment returns to enable higher spending, however, a poor sequence of returns can seriously jeopardize spending ability later in retirement.

## Riskier Investing Increases Potential for Sequence of Returns Risk

What if a retiree takes greater investment risk? Historically, risky assets have provided a higher average return than safe assets like bonds. On average, higher investment returns allow a retiree to spend more each year. In many historical periods, taking risk would have resulted in greater wealth later in retirement and the ability to meet more ambitious spending and legacy goals. However, taking investment risk means accepting that low or negative returns early in retirement could erode savings too quickly to sustain a desired lifestyle.

## Spending Worries Prevent Many Retirees from Enjoying Their Retirement

A retiree who faces investment risk without a safety net to protect the ability to spend later in retirement may be less inclined to enjoy the benefit of spending more at a time when they can get the greatest enjoyment from their savings, in their 60s and 70s. Spending early in retirement is also more volatile. As retirees reach their 80s, they spend less and the amount of spending is less volatile.



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By spending very little, a retiree is less likely to run out of money if they live a long time or don't get the investment returns they expect. However, spending too little when the money can provide the greatest enjoyment is itself a risk. A retiree who fears spending freely early in retirement will sacrifice the opportunity to benefit from the nest egg they so carefully built during their working years.

## Insurance Strategies Combine Growth Potential with Income Certainty

A third approach incorporates insurance against outliving savings through an investment portfolio that offers greater expected returns than safe assets like bonds.

A protected approach can provide retirees with both the possibility of more investment growth and the freedom to spend more earlier in retirement knowing they have a source of income that's protected for life. The value of insurance is protection against risk. Decreasing risk through the use of investment protection provides a solution for retirees who are focused on maximizing lifestyle without the risk that they might ultimately sacrifice spending in the future by living well today.

Be sure to read the full white paper by Michael Finke, PhD, "A Protected Approach to Retirement Spending."



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