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Annuities can help money last

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By SCOTT BURNS / The Dallas Morning News

It's an extension of the old joke – too much month at the end of the money.

But in retirement, when you have too many years at the end of the money, it's not a joke. It's a serious problem. Some new research indicates an unexpected solution. Annuities.

Yes, you read that right. Convert some of your retirement savings into a lifetime income and you'll increase the odds you'll be able to pay your phone, cable and Visa bills forever. The new evidence is a study published in the December *Journal of Financial Planning*. A shared project by John Ameriks, Robert Veres and Mark J. Warshawsky, "Making Retirement Income Last a Lifetime," extends previous work by others. It examines the relationship between how we invest our money, how much we withdraw, and how long the money will last.

But this time the researchers did something different. Instead of substituting other asset classes – such as real estate investment trusts or international equity investments – that may grow or shrink in value, they examined how long portfolios would last if 25 to 50 percent of the assets were turned into lifetime annuity incomes.

Lasting power

The result? The odds of financial survival improve. Here's an example: A conservative portfolio that is 20 percent stocks, 50 percent bonds and 30 percent cash has only a 32.6 percent chance of lasting 30 years if you ask it to provide a 4.5 percent initial withdrawal rate followed by annual adjustments for inflation. Annuitize 50 percent of the portfolio, however, and the odds of portfolio survival jump to 81.3 percent.

Indeed, the prime ingredients appear to be a combination of an aggressive portfolio (defined as 85 percent equities, 15 percent bonds, 0 percent cash) and a hefty annuitization. Annuitize 50 percent of such a portfolio and survival odds increase to 97.5 percent. (You can see how the odds shift in the table.)

Average Success Rate For Making Withdrawals Last 30 Years			
Portfolio Type	**No annuity**	**25% Annuity**	**50% Annuity**
Conservative (20/50/30)	32.6%	53.3%	81.3%
Balanced (40/40/20)	76.3	85.1	94.5
Growth (60/30/10)	87.4	92.2	96.7
Aggressive (85/15/0)	91.6	94.6	97.5
Source: TIAA-CREF Institute Quarterly, winter 2002; portfolios are (stocks/bonds/cash)			

Does this mean we should trade in a portion of our portfolios for annuities when we retire?

Maybe. Maybe not.

While there is much to be said for having a variety of income flows and for increasing our assured income in retirement, obtaining an attractive annuity payout isn't easy. Poor execution of a sound idea could defeat the purpose of annuitizing.

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There is another reason to approach annuitizing with caution. The benefits diminish as the equity portion of the original portfolio increases. A conservative portfolio's survival rate will more than double. The improvement for a 60 percent equity portfolio is much smaller – from 87.4 percent to 96.7 percent.

Another option

Related work by retired engineer Robert Greaney shows that substituting TIPS (Treasury Inflation Protected Securities) for conventional fixed income securities works to increase portfolio survival. TIPS with a 3.4 percent current coupon, for instance, will give an aggressive portfolio a 96.2 percent chance of survival for 30 years. A 60 percent equity, 40 percent TIPS portfolio will have a 99.2 percent chance of survival.

Readers who would like to experiment with different portfolios and possible withdrawal rates have two choices. They can download Mr. Greaney's Excel spreadsheet, free, by visiting his website, **www.retireearlyhomepage.com** or they can use an online version at **capn-bill.com/fire**.

It should be noted that there are some differences in method here. Mr. Greaney uses Yale economist Robert Schiller's data in his model and tests against historical return patterns. The annuity study used Monte Carlo simulation and Ibbotson Associates data. While the results are similar, they are not identical.

What's the message for you and me? Simple. More equity, not less, increases portfolio survival odds. More current income, not less, also increases portfolio survival odds. The hard part is that the two positives are mutually exclusive.

Questions of general interest will be answered in future columns. Write Scott Burns, The Dallas Morning News*, P.O. Box 655237, Dallas, 75265, or send an e-mail. Check the website: www.scottburns.com.*

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