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WEALTH MANAGEMENT

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Retirement income management

Timing is more important than many realize.

Investor truism: Time in the market is more important than timing the market.

For those with a long-term time horizon, volatility in the financial markets is relatively unimportant. Imagine that a portfolio has an average 10-year return of a modest 5%, but the yearly returns are 25%, 18%, 3%, -4%, -28%, -2%, 8%, 10%, 12%, and 8%. Does it matter when the bad years occur?

It does not.

The table below shows what would happen to $500,000 over ten years. On the left, the bear market comes early, pushing the portfolio into loss territory, from which it recovers only after eight years. Putting the bull market first, as on the right, causes the portfolio to soar, but when the inevitable bear market ensues, the losses apply to a much higher base. After ten years, the portfolios arrive at the same final total.

For savers, the sequence of returns makes no difference at all. During the accumulation years of the financial life cycle, the important factor is being invested for as long as possible, to be confident of participating when the markets enjoy good years. Although one might hope to move the portfolio to cash at the top of the market, to avoid the bear market losses, very few investors have been able to do that successfully. Studies have shown that the most important market moves happen on just a very few days. The risk of market timing is being out of the market when another major uptick occurs.

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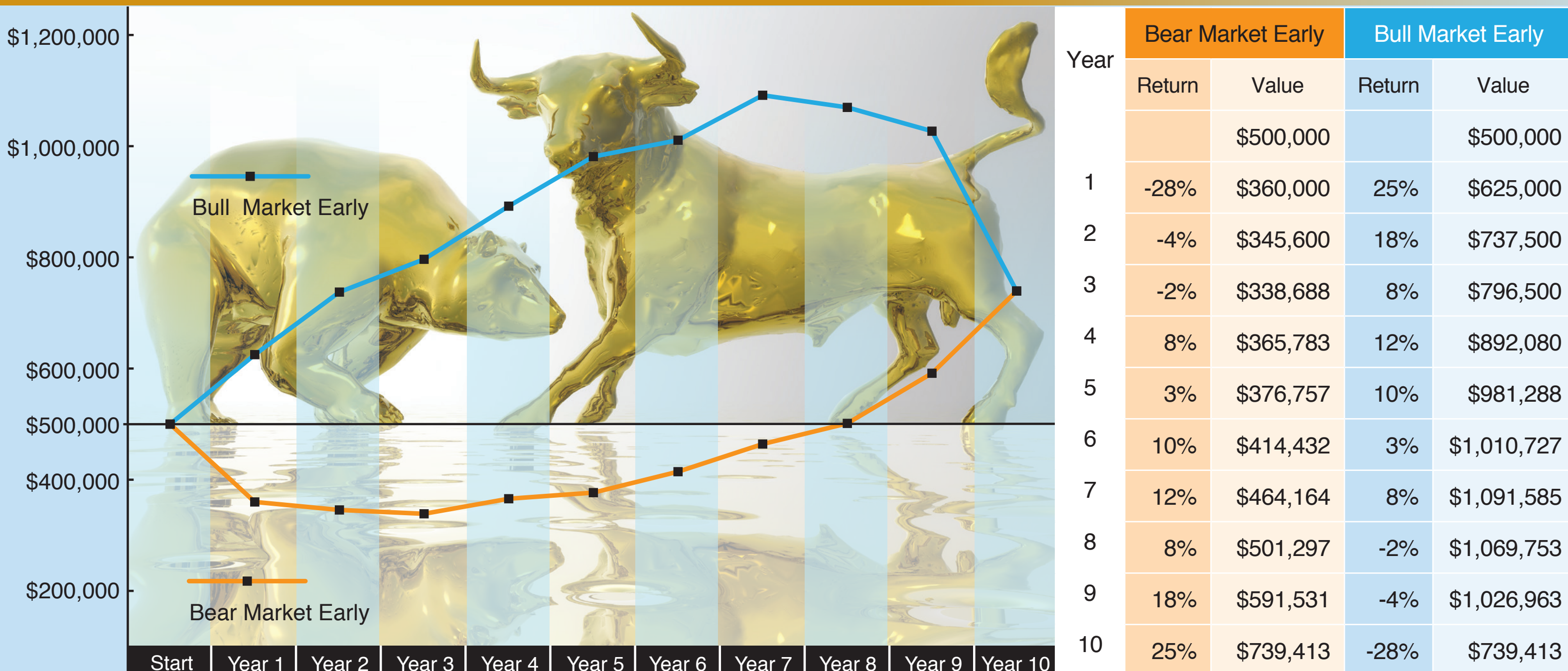
Two Paths



Year	Bear Market Early		Bull Market Early	
	Return	Value	Return	Value
		$500,000		$500,000
1	-28%	$360,000	25%	$625,000
2	-4%	$345,600	18%	$737,500
3	-2%	$338,688	8%	$796,500
4	8%	$365,783	12%	$892,080
5	3%	$376,757	10%	$981,288
6	10%	$414,432	3%	$1,010,727
7	12%	$464,164	8%	$1,091,585
8	8%	$501,297	-2%	$1,069,753
9	18%	$591,531	-4%	$1,026,963
10	25%	$739,413	-28%	$739,413

A very different story for retirees

Retirees are concerned about outliving their financial resources, and with good reason. There are not many options for a retired person to boost his or her income other than selling assets. What is a sustainable withdrawal rate for a retiree?

Timing is everything, in trying to answer this question. If retirement commences during good economic times, the nest egg has a good chance of lasting decades.

Let's begin with the $739,413 that was saved in the earlier example. Assume that the retiree will need to draw down $50,000 annually, less than 7% of the account's value. If there is a bull market when the withdrawals begin, the account will continue to grow despite the partial consumption, as shown in the table at the right.

After taking $500,000 out of the account over ten years, a retiree who begins taking distributions during a bull market still has $667,639 to work with for the balance of the retirement.

Divergence

Year	Bear Market Early			Bull Market Early		
	Return	Withdrawal	Value	Return	Withdrawal	Value
			$739,413			$739,413
1	-28%	$50,000	$482,378	25%	$50,000	$874,267
2	-4%	$50,000	$413,082	18%	$50,000	$981,635
3	-2%	$50,000	$354,821	8%	$50,000	$1,010,165
4	8%	$50,000	$333,207	12%	$50,000	$1,081,385
5	3%	$50,000	$293,203	10%	$50,000	$1,139,524
6	10%	$50,000	$272,523	3%	$50,000	$1,123,710
7	12%	$50,000	$255,226	8%	$50,000	$1,163,606
8	8%	$50,000	$225,644	-2%	$50,000	$1,090,334
9	18%	$50,000	$216,260	-4%	$50,000	$996,721
10	25%	$50,000	$220,325	-28%	$50,000	$667,639

However, a colleague who retires during a down market is not so fortunate. At the 10-year mark, this retiree's portfolio is just one-third the value of that of one who retired during a bull market. The years of high returns are applied to a much lower account balance.

What can one do?

The choice of a start date for one's retirement will be influenced by many personal factors. The health of the financial markets is typically low on the list of concerns, but these tables suggest that perhaps it shouldn't be. There are steps that can be taken to protect against market vagaries.

- ***Augment capital.*** Sell the house; move to smaller quarters; pocket $250,000 worth of capital gains tax free ($500,000 for couples) to supplement retirement capital.
- ***Reduce spending.*** Someone who already has retired doesn't have the luxury of becoming "unretired." Unpleasant though it may be, when the markets head south, some spending plans may have to be deferred or eliminated.
- ***Smooth portfolio volatility through sound asset allocation.*** By balancing portfolio assets among a variety of investment classes—large stocks, small stocks, short-term bonds, long-term bonds, and so on—expected returns may fall within a narrower range. The lowest lows will be avoided—along with the highest highs—and the risk of outliving one's money may be reduced.

We can help you

Unbiased investment management is an integral part of our service as trustee. But you don't need to fund a trust to be able to call upon our professional expertise. We manage investment portfolios for a fee for individuals and families in a wide variety of situations.

This month, why not schedule a meeting with us to learn more? ☐

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Roald Dahl

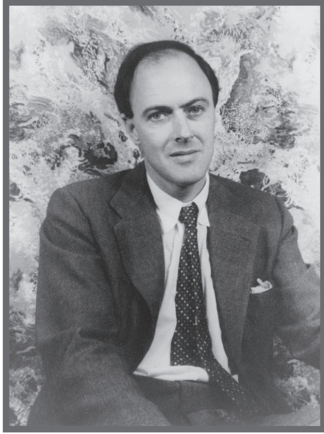


Photo by Carl Van Vechten

The writer of many beloved stories for children, Roald Dahl did little to manage his legacy. Dahl's charitable commitments during his life were focused on the fields of neurology, hematology, and literacy. His interest in advancing the field of medicine may have been influenced by the medical calamities of his personal life—when he was three years old, his older sister died of appendicitis; his daughter Olivia died of measles encephalitis at age seven; his first wife, actress Patricia Neal, suffered three ruptured brain aneurysms while pregnant with their fourth child. A desire to promote literacy would be a natural for a writer, especially one whose target audience was children.

Nevertheless, at Dahl's death in 1990 his estate passed almost entirely to his widow, Felicity Crosland. The task of making a social impact with Dahl's fortune fell to her. The estate was then worth some £2.8 million. However, it also had an asset with great potential value—the future royalties from sales of Dahl's books and the movie rights to those stories.

A charity is born

Soon after Dahl's death, Felicity established the Roald Dahl Foundation. Consistent with Dahl's lifetime interests, the Foundation targeted its help to children with specific brain and blood disorders, as well as children's literacy. In 2010 the Foundation was rebranded as Roald Dahl's Marvelous Children's Charity. The mission has since broadened to include all serious illnesses in children.

Key milestones for the charity include:

- creating the first Pediatric Epilepsy Nurse Specialist Post in the United Kingdom;
- creating 54 Roald Dahl nursing healthcare professional posts around the U.K.;
- awarding grants of over £2.5 million to 400 grassroots projects and charities, reaching an estimated 600,000 seriously ill children and young people.

The foundation's primary funding source is a gift of 10% of gross royalties received each year by Dahl's literary estate.

The Imaginourmous Challenge

Another avenue of remembrance is Roald Dahl's Imaginourmous Challenge, a contest managed by Dahl's literary estate. The contest is open to children aged 5-12, and more than 20,000 story ideas were submitted for the first year of the contest in 2017. Five golden tickets were awarded, and those children will be able to work with industry professionals to see their proposals become reality. A list of the winners and their story ideas may be found at https://www.imaginormouschallenge.com/2017-winners/.

What about your legacy?

Roald Dahl had good and bad fortune in his life, but to cement his legacy Dahl was most fortunate that his widow was blessed with rare vision of the potential for his estate assets. The better course is to build such a plan during life. If philanthropy is to be a part of one's legacy, a variety of charitable trust strategies are available for implementation.

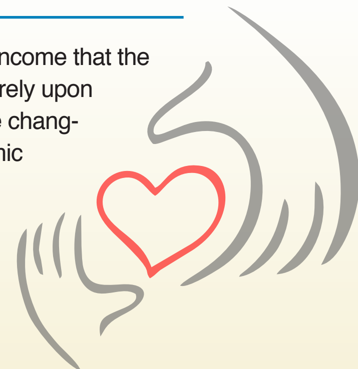
We can help with that. Management of charitable trusts is a core part of our business. Should you have questions in this area, please consider us a resource. We will be pleased to share our expertise with you. ☐

Primer on charitable trusts

Any trust may provide benefits to a charity. However, to secure income, estate or gift tax benefits, such a trust must be irrevocable, and it must meet certain other tax code requirements.

Charitable trusts are often "split interest" trusts; that is, they have both charitable and private beneficiaries. In a *charitable lead trust*, for example, the income from the trust goes to a designated charity for a set period of time. When the trust ends, the remaining trust assets pass to private beneficiaries. A federal gift tax will be assessed when such a trust is funded, but it will be discounted to reflect the income interest given to the charity and the delay for the transfer to the private beneficiaries. The transfer tax cost of keeping assets in the family is thus reduced.

A *charitable remainder trust* is the mirror image of the charitable lead trust. Here, the private beneficiary or beneficiaries receive the trust income, either for life or for a set number of years. The income interest must be expressed as either a fixed dollar amount (annuity interest) or a fixed percentage of the value of the trust assets, determined annually (unitrust interest). With a unitrust approach, the income received by the private beneficiary may rise over time, as the value of the trust assets grows. However, the income may fall should the economy falter. The annuity interest, in contrast, provides a specific income that the beneficiary may rely upon regardless of the changes in the economic weather. When the trust ends, the remaining assets pass to a designated charity.



Charitable remainder trusts often are used to reduce the tax cost of diversifying concentrated holdings or converting non-income-producing property to holdings that will provide an income stream.

Directed trusts

A trust can be a powerful tool for wealth management. The remarkable power held by the trustee of a trust is kept in check by the concept of *fiduciary duty*, which means that in practice the trustee must put the interests of the trust's beneficiaries first. No conflicts of interest are allowed.

Nevertheless, some trust creators have chosen to divide up the trustee's duties among several parties or organizations. That results in a *directed trust,* in which some of those managing the trust are taking directions from others.

There is no single pattern for a directed trust, but it may include these elements.

- ***Administrative trustee.*** Owns the trust assets, prepares tax filings, provides statements, receives contributions, and makes distributions.
- ***Investment committee.*** Provides direction to the administrative trustee regarding the management of trust assets. May include family members.
- ***Distribution committee.*** Provides direction for the distribution of trust income and trust assets. An independent trustee is required for tax-sensitive distributions, and there may be a family committee for situations that don't have tax implications.
- ***Trust protector.*** The power to terminate the trust or reform it may reside in a trust protector. Other decisions within the protector's purview include changing the situs of the trust, adding or removing beneficiaries, vetoing trust distributions, replacing trustees, and finding successor trustees.

State laws vary on directed trusts. One critical issue concerns how the various participants may be relieved of their fiduciary duties regarding aspects of trust administration beyond the scope of their responsibility. To provide consistency in state laws, from time to time the Uniform Law Commission proposes models for the states to follow. One recent project, the Uniform Directed Trust Act, came to completion this year. As a result, we may be hearing more and more about directed trusts in the future.

Having multiple managers for a trust almost certainly will increase the administrative costs. Accordingly, *Barron's* has reported that directed trusts tend to be considered by those with $10 million or more for management, especially those with an unusual asset, such as a closely held business. The trend of having multiple advisors for larger trusts accelerated after the financial crisis, when some trustees were stretched too thin.

Barron's also warned that state income tax laws in this area vary widely. Some states may try to tax the income of an outstate trust—or a portion of the income—if one of the trust managers is located within the state. Handling all the tax nuances of a directed trust is just one more job for the professionals. ☐

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