



DEFINITIVE GUIDE TO RETIREMENT INCOME

Definitive Guide to Retirement Income: Seven Things You Need to Know

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When it comes to retirement, you need to have enough money coming in to cover your expenses and meet your goals without running the risk of depleting your nest egg. However, not all forms of retirement income are the same in the eyes of the IRS. Some can be partially or even fully taxable, and some can impact the way your Social Security benefits are taxed. And that's just for starters. In this report, we'll discuss the following:

1. What is retirement income?
2. What is a fixed-income investment?
3. Understanding fixed-income investments
4. What is an example of a fixed-income investment?
5. Types of fixed-income investments
6. What is the average retirement income?
7. What is a good monthly retirement income?

What is Retirement Income?

As many Americans are enjoying 20 to 30 years in retirement, it has become imperative for anyone close to retirement age to establish their own streams of income that they can count on to cover their living expenses and meet their goals in retirement. That's basically what retirement income is all about: having enough money coming in each month so that you don't have to tap into the principal balance of your retirement savings.

Retirement income can come from a wide range of sources, including:

- Social Security benefits
- Annuity payouts
- Retirement or profit-sharing plans
- Insurance contracts
- Pension plans
- IRAs, 401(k)s, and 403(b)s

As noted earlier, some forms of income in retirement can be fully or partially taxable. That's why it is important to work with a financial advisor who specializes in helping you identify the best ways to generate lasting income for your retirement—while also helping you minimize the amount of tax you'll have to pay on that income.

What is a Fixed Income Investment?

Fixed-income investing is an investment approach focused on helping you preserve your capital and generate income in the form of interest or dividends. Fixed-income investments can offer a steady stream of income, often with less risk than stock market investments geared toward capital gains.

Fixed-income investments are typically ideal for more conservative savers who feel more comfortable knowing exactly what their investments will provide for them in the future. This way, they can know what they have to work with and help avoid unnecessary stress. These mostly conservative investors tend to focus mainly on generating income through interest using fixed-income options such as bank Certificates of Deposit (CDs), individual corporate and government bonds, annuities, and other contractual bond-like instruments.

Understanding Fixed Income Investments

Fixed-Income investments are debt instruments that have a fixed interest payment and a fixed amount that must be repaid at maturity, known as the par value. The fixed interest payments are made to investors in the form of coupon payments. The coupon payment is paid to investors while the par value is returned to the investor at maturity, assuming there have been no defaults.

The par value is another feature that makes fixed-income investing a good option for investors at or near retirement age. Take the par value on an individual bond, for example. It means that if the market value of an individual bond happens to drop below the par value, bondholders still receive the par value at maturity. So, for bondholders who plan on holding their bond until maturity, a loss in value is just a paper loss, since they will still get their par value back at maturity if the issuer does not default.

What is an Example of a Fixed-Income Investment?

As we mentioned, individual bonds are one of the most common types of fixed-income investments, but there are many others. The universe of fixed-income investments is much bigger than the universe of growth-based stock market investments.

One of the first things that comes to mind when people hear the term fixed income investing is government bonds. Government bonds are debt securities issued by a government to fund government spending. Government bonds that are issued by national governments can be considered lower risk since they are backed by the government.

For example, debt securities issued by the United States and backed by the U.S. Treasury Department include US Treasury Bills, Notes, and Bonds. The main difference between Bills, Notes, and Bonds comes down to the length of their term:

- U.S. Treasury Bills (T-bills) are short-term debt obligations backed by the U.S. Treasury Department with terms of one year or less.
- U.S. Treasury Notes (T-notes) have stated interest rates that are paid semi-annually until maturity. US Treasury notes are issued in two-, three-, five-, seven-, and 10-year terms.
- U.S. Treasury Bonds are debt obligations backed by the U.S. Treasury Department that have maturities of 10 years or longer.

Types of Fixed-Income Investments

Besides government and agency bonds, there are many other types of fixed-income investments. Here are a few examples:

- Savings Bonds: a type of bond issued by a government that offers a fixed rate of interest over a fixed period.
- Municipal Bonds: debt securities issued by state and local governments to fund public works such as parks, roads, libraries, and other infrastructure.
- Corporate Bonds: debt securities issued by corporations.
- Preferred Stock: a class of equities that have a fixed dividend and a par value. So, if the market value of the share drops below the par value, investors will still receive the fixed dividend payment. Also, if that company ever wants to redeem or call those shares, those shares get called back at par value or above.
- Business Development Corporations (BDCs): although BDCs do not have a par value, they do have loans to businesses inside their portfolios, and those loans have a par value.
- Certificates of Deposit: many people forget that CDs are another type of fixed-income investment. They pay a fixed rate of interest and once the term of that CD is up, the investor receives all their principal back.
- Money Market Accounts: sometimes called money market deposit accounts or money market retirement savings accounts, these types of accounts also fall into the category of fixed-income investments. They generally offer a higher rate of interest than a traditional retirement savings account and offer account holders the benefit of occasional withdrawals

When it comes to managing a portfolio of individual fixed-income investments, there is a wide range of strategies that investors and their advisors can use to help maximize the income generated by their investments. For example, one such strategy is a “laddered” portfolio of bonds. A laddered portfolio is one in which an investor’s allocation is split up among different bonds with varying maturities. An investor might choose a laddered strategy to try to maximize the interest generated by their bonds while helping to minimize their exposure to interest rate fluctuations.

What is the Average Retirement Income?

According to 2021 data, the average retirement income for Americans over the age of 65 was \$3,946 per month or \$47,357 per year.¹ In January 2022, the average monthly retirement income from Social Security (for all retired workers) was \$1,657 per month or \$19,886 per year.²

As you can see, there’s quite a difference between the average income from Social Security and the average overall retirement income for Americans over the age of 65. That’s because Social Security was never intended to be the sole provider of income for retirees; it was intended to serve as part of the three-legged stool comprised of Social Security, a pension, and individual retirement savings.

With pensions increasingly rare these days, it means that Americans must take it upon themselves to make sure they maximize their retirement savings and the benefits available to them through Social Security. That's where fixed-income investing can play a valuable role.

However, to get it right, you need to work with a financial advisor who specializes in retirement income and has the knowledge and experience to help you make the most of your Social Security benefits. Understanding the best time and method to claim your Social Security can be complex. But it's important to get it right because the difference between the first and the second-best method of claiming your benefits can mean a difference in receiving or not receiving hundreds of thousands of dollars over the course of your lifetime.

What is a Good Monthly Retirement Income?

The plain and simple truth is that when it comes to planning and saving for retirement, there is no "one-size-fits-all" solution. The same is true when it comes to the amount of income you will need to enjoy the lifestyle you've always envisioned for your retirement. For example, a certain amount of income might be right for someone who likes to stay close to home and enjoys spending their time gardening. That same amount might not be right for someone who likes to travel and eat out quite often.

But when it comes to making sure you have the right amount of monthly retirement income for your needs, as a rule, you should be able to satisfy your day-to-day expenses with the interest and dividends from your portfolio without having to tap into your principal. That's because if you end up having to liquidate shares of your investments to pay for things, especially during a downturn in the market, you could end up cannibalizing your retirement fund.

The worst example of this happens when an investor must sell shares from a mutual fund to cover expenses during a stock market downturn. Since the value of the shares of that fund will most likely be down, it means the investor will have to sell more shares to get the same amount they need to cover their expenses—thus eating away at a greater percentage of their retirement savings.

This is known as reverse dollar-cost averaging, and it's what many consider to be one of the biggest financial mistakes a retiree could make. The good news is that you can avoid these types of situations by working with an advisor who understands the best ways to invest for income.

Sources:

1. <https://www.annuity.org/retirement/planning/average-retirement-income/>
2. <https://www.ssa.gov/news/press/factsheets/colafacts2022.pdf>

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