

## **Your Grandparent's Pension**

Dear Mr. Johnson,

Acme Widget Company would like to thank you for your 35 years of faithful service. As you set sail into your golden years we are pleased to present you with your retirement information package. In addition to your gold watch you and your spouse will receive 65% of your salary for as long as you both shall live. You are currently 65 years old so you will be receiving your full social security benefit and you are fully eligible for Medicare.

Ahhh, the good old days! Your grandfather may have received something very similar to this but times have changed. Gone are the days of defined benefit plans (i.e. monthly check for life). Defined contribution plans (i.e. IRA, 401k, 403b) are in vogue. The responsibility to save and invest has been shifted from the backs of companies and governments, and put squarely on the backs of the individual investor.

Many forces have contributed to this change. Municipalities from California to New Jersey have been reporting that their pensions are insolvent and budgets are underfunded. Pension funds were not immune to the poor investment performance of the past decade and there have been many demographic changes that have and will continue to contribute. When social security was created the average life expectancy was somewhere around age 64. "Mr. Johnson, thank you for your years of service, we would like to provide you with your first social security check however you have been dead for over a year!" The new mortality tables tell a much different story as the average life expectancy of a couple age 65 is now 92\*. That means that a couple that retires today has a better than 50% chance of one spouse living beyond age 92. Advances in healthcare and better education about the importance of nutrition and exercise are contributing to the increased longevity of the U.S. demographic at the same time that we have a baby boomer generation that is preparing for retirement. The "graying" of America is leading to an increased need for sustainable incomes that may have to last for decades.

The word "annuity" has been given a bad rap in the past but annuity products today offer something that few other investments can – guarantees. There are many types of annuities with countless riders and benefits attached to them. The annuity that I employ most frequently offers a rider that guarantees you an income stream for life. Like your great grandfathers pension, these annuities promise to pay you and your spouse income for as long as you both shall live. They do come at a price however, with high expense ratios and long surrender charges they may not be appropriate for everyone. Irrespective of the negatives, if used properly in conjunction with other more conventional investments, they can provide something that no other investment can; stock market exposure without risk to your future income, an income base that grows prior to retirement and a guaranteed income payment for life.

Due to the long time horizon of these products and illiquidity, I rarely recommend using more than 20-30% of your total investments portfolio in an annuity. I would recommend only buying annuities from an insurance company that has strong ratings so that it will be there when you need it most and speak with a professional before deciding on what works best for yourself. As always I welcome your questions and comments.

Best Wishes,

Stephen Littenberg CFP®  
President Scholar Wealth Management

\*Based on Annuity 2000 Mortality Table assuming relatively good health

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