CHAPTER 5.3

FREEDOM: CREATING YOUR LIFETIME INCOME PLAN

Lifetime Income Stream Key to Retirement Happiness
—*TIME*, July 30, 2012

I have enough money to retire comfortably for the rest of my life. Problem is, I have to die next week.
—ANONYMOUS

In 1952 Edmund Hillary led the first expedition to successfully climb Mount Everest, a feat once thought to be impossible. The Queen of England promptly knighted him, making him "Sir" Edmund Hillary for his amazing trek.

Despite his accomplishment, many people believe Sir Edmund Hillary may not have been the first person to reach the peak of Everest. In fact, it is widely believed that George Mallory may have been the first person to reach the peak nearly 30 years prior!

So, if George Mallory reached the peak of Mt. Everest in 1924, why did Edmund Hillary receive all the fame—including being knighted by the Queen?

Because Edmund Hillary didn't just make it to the peak, he also successfully made it *back down* the mountain. George Mallory was not so lucky. Like the vast majority of those who have died on Everest, it was coming down that proved fatal.

INVESTING FOR WHAT, EXACTLY?

I often ask people, "What are you investing for?"

The responses are wide and diverse:

"Returns."

"Growth."

"Assets."

"Freedom."

"Fun."

Rarely do I hear the answer that matters most: ***Income!!!!!***

We all need an income that we can count on. Consistent cash flow that shows up in our account every single month, like clockwork. **Can you imagine never worrying again about how you will pay your bills or whether your money will run out?** Or having the joy and freedom of traveling without a care in the world? Not having to worry about opening your monthly statements and praying the market holds up? Having the peace of mind to give generously to your church or favorite charity and not wonder if there will be more where that came from? We all know intuitively: *income is freedom!*

Shout it from the hilltops like Mel Gibson in the movie *Braveheart*: "Income is freedom!!!"

And *lack* of income is stress. Lack of income is struggle. Lack of income is not an acceptable outcome for you and your family. Make this your declaration.

Dr. Jeffrey Brown, retirement expert and advisor to the White House, said it best in a recent *Forbes* article: "[I]ncome is the outcome that matters most for retirement security."

The wealthy know that their assets (stocks, bonds, gold, and so on) will always fluctuate in value. But you can't "spend" assets. You can spend only cash. The year 2008 was a time when there were lots of people with assets (real estate, in particular) that were plummeting in price, and they couldn't sell. They were asset "rich" and cash "poor." This equation often leads to bankruptcy. **Always remember that income is the outcome.**

By the end of this section, you will have the certainty and the tools you need to lock down exactly the income you desire. This is what I call **"income insurance." A guaranteed way to know for certain that you will have a paycheck for life without having to work for it in the future—to be absolutely certain that you will *never* run out of money.** And guess what? You get to decide when you want your income checks to begin.

There are many ways to skin the proverbial cat, so we will review a couple of different methods for getting the income insurance that makes sense for you.

One of the more exciting structures for locking down income has other powerful benefits as well. **It is the *only* financial vehicle on the planet that can give you the following:**

- **100% guarantee on your deposits.[16] (You can't lose your money, and you keep total control.)**
- **Upside without the downside: your account value growth will be tied to the market, so if the market goes up, you get to participate in the gains. But if the market goes down, you *don't lose* a dime.**
- **Tax deferral on your growth.** (Remember the dollar-doubling example? Tax efficiency was the difference between having $28,466 or more than $1 million!)
- **A guaranteed lifetime income stream where *you* have control and get to decide when to turn it on.**
- **Get this: the income payments can be made *tax free* if structured correctly.**
- **No annual management fees.**

You get all of these benefits by using a modern version of a 2000-year-old financial tool! How is this possible? I am sure it sounds too good to be true, but stick with me. It's not! I use this approach, and I am excited to share the details with you.

As we have highlighted throughout the book, the financial future that you envision is very much like climbing Mount Everest. You will work for decades to accumulate your critical mass (climbing to the top), but that's only half the story. **Achieving critical mass, without having a plan and**

[16]Insurance guaranty associations provide protection to insurance policy holders and beneficiaries of policies issued by an insurance company that has become insolvent and is no longer able to meet its obligations. **All states, the District of Columbia, and Puerto Rico have insurance guaranty associations.** Insurance companies are required by law to be members of the guaranty association in states in which they are licensed to do business. Each state has its own maximum amount that you are covered up to, and in most states, that varies per person up to $300,000 to $500,000.

strategy for how to turn it into income that will last the rest of your lifetime will leave you like George Mallory: dead on the back side side of a mountain.

A NEW AGE

We are, without a doubt, in uncharted waters. In the past 30 years, the concept of retirement has transformed radically. Heck, even as recently as the late '80s, over 62% of workers had a pension plan. Remember those? On your last day of work, you got a gold watch and the first of your guaranteed lifetime income checks. Today, unless you work for the government, a pension is a relic; a financial dinosaur. Now, for better or worse, you are captain of your own ship. You are ultimately responsible for whether or not your money will last. That's quite a burden to bear. Throw in market volatility, excessive fees, inflation, medical "surprises," and you quickly start to understand why so many are facing a massive retirement crisis. Many people, including your neighbors and colleagues, are going to face the real likelihood of outliving their money. Especially with the prospect of living longer than ever before.

IS 80 THE NEW 50?

A long, fruitful retirement is a concept that's only a few generations old. If you recall from our discussion earlier, when President Franklin Roosevelt created Social Security in 1935, the average life expectancy was just 62. And the payments wouldn't kick in until age 65, so only a small percentage would actually receive Social Security benefits to begin with.

At the time, the Social Security system made financial sense because there were 40 workers (contributors) for every retiree collecting benefits. That means there were 40 people pulling the wagon, with only 1 sitting in the back. By 2010, the ratio had dropped to only 2.9 wagon pullers for every retiree. The math doesn't pencil out, but since when has that stopped Washington?

Today the average life expectancy for a male is 79, while the average female will live to 81. For a married couple, at least one spouse has a 25% chance of reaching age 97.

BUT WAIT, THERE'S MORE!

You could be living *way* longer than even these estimates. Think how far we have come in the past 30 years with technology. From the floppy disk to nanotechnology. Today scientists are using 3-D printing to generate new organs out of thin air. Researchers can use human cells, scraped gently from your skin, to "print" an entirely new ear, bladder, or windpipe![17] Science fiction has become reality. Later we'll hear directly from my friend Ray Kurzweil, the Thomas Edison of our age and currently the head of engineering at Google. When asked how advances in life sciences will affect life expectancies, he said:

"During the 2020s, humans will have the means of changing their genes; not just 'designer babies' will be feasible, but designer baby boomers through the rejuvenation of all of one's body's tissues and organs by transforming one's skin cells into youthful versions of every other cell type. People will be able to 'reprogram' their own biochemistry away from disease and aging, radically extending life expectancy."

Those are exciting words for us boomers!!! Wrinkles be damned! We may all soon be drinking from the proverbial fountain of youth.

But the implications to our retirement are clear. Our money has to last even longer that we may think. Can you imagine if Ray is right, and us boomers live until we are 110 or 120? Imagine the type of technology that will alter the lifespan of millennials. What if 110 or 115 is in your future? Nothing will be more important than guaranteed lifetime income. A paycheck that you can't outlive will be the best asset you own.

> When I was young, I thought that money was the most
> important thing in life; now that I am old, I know that it is.
>
> —OSCAR WILDE

[17] Dr. Anthony Atala, director of the Wake Forest Institute for Regenerative Medicine, has been creating and implanting organs like this for more than a decade.

THE 4% RULE IS DEAD

In the early 1990s, a California financial planner came up with what he called **the "4% rule."** The gist is that if you wanted your money to last your entire life, you could take out 4% per year if you had a "balanced portfolio" invested in 60% stocks and 40% bonds. And you could increase the amount each year to account for inflation.

"Well, it was beautiful while it lasted," recounts a 2013 *Wall Street Journal* article entitled "Say Goodbye to the 4% Rule." Why the sudden death? Because when the rule came into existence, government bonds were paying over 4%, and stocks were riding the bull! If you retired in January 2000, and you followed the traditional 4% rule, you would have lost 33% of your money by 2010, and, according to T. Rowe Price Group, you would now have only a 29% chance that your money would last your lifetime. Or spoken in a more direct way, you'd have a 71% chance of living beyond your income. Broke and old are not two things that most of us would like to experience together.

Today we are living in a world of globally suppressed interest rates, which is, in effect, a war on savers. And most certainly a war on seniors. How can one retire safely when interest rates are near 0%? They must venture out into unsafe territory to try to find returns for their money. Like the story of the thirst-stricken wildebeest that must venture down to the crocodile-infested waters to seek out a drink. Danger lurks, and those who need positive returns to live, to pay their bills, become increasingly vulnerable.

CRITICAL MASS DESTRUCTION

No matter what anyone tells you, or sells you, there isn't a single portfolio manager, broker, or financial advisor who can control the primary factor that will determine if our money will last. It's the financial world's dirty little secret that very few professionals know. And of those who do, very few will ever dare bring it up. In my usual direct fashion, I put it smack dab in the middle of the table when I sat down with legend Jack Bogle.

Remember Jack Bogle? He is the founder of the world's largest mutual fund, Vanguard, and about as straightforward as a man could be. When we spoke for four hours in his Pennsylvania office, I brought up the dirty little secret, and he certainly didn't sugarcoat his opinion or thoughts. "Some things don't make me happy to say, but there is a lottery aspect to all of this: when you were born, when you retire, and when your children go to college. And you have no control over that."

What lottery is he talking about?

It's the big luck of the draw: What will the market be doing when *you* retire? **If someone retired in the mid-1990s, he was a "happy camper." If he retired in the mid-2000s, he was a "homeless camper."** Bogle himself said in an early 2013 CNBC interview that, over the next decade, we should prepare for *two* declines of up to 50%. Holy sh*t! But maybe we shouldn't be surprised by his prediction. **In the 2000s, we have already experienced two drawdowns of nearly 50%. And let's not forget that if you lose 50%, you have to make 100% just to get back to even.**

The risk we all face, the dirty little secret, is the devastating concept of ***sequence of returns.*** Sounds complicated, but it's not. In essence, **the earliest years of your retirement will define your later years.** If you suffer investment losses in your early years of retirement, which is entirely a matter of luck, your odds of making it the distance have fallen off the cliff.

You can do everything right: find a fiduciary advisor, reduce your fees, invest tax efficiently, and build up a Freedom Fund.

But when it's time to ski down the backside of the mountain, when it's time for you to take income from your portfolio, if you have one bad year early on, your plan could easily go into a tailspin. A few bad years, and you will find yourself back at work and selling that vacation home. Sound overly dramatic? Let's look at a hypothetical example of how the sequence of returns risk plays out over time.

JOHN BIT THE DOG

John bit the dog. The dog bit John. Same four words but when arranged in a different sequence, they have an entirely different meaning. Especially for John!

John is now 65 and has accumulated $500,000 (far more than the average American) and is ready to retire. Like most Americans nearing retirement, John is in a "balanced" portfolio (60% stocks, 40% bonds), which, as we learned from Ray Dalio, isn't balanced at all! Since interest rates are so low, the 4% rule won't cut it. John decides that he will need to take out 5%, or $25,000, of his nest egg/Freedom Fund each year to meet his income needs for his most basic standard of living. When added to his Social Security payments, he "should" be just fine. And he must also increase his withdrawal each year (by 3%) to adjust for inflation because each year the same amount of money will buy fewer goods and services.

As John's luck would have it, he experiences some market losses early on. In fact, three bad years kick off the beginning of his so-called golden years. Not such a shiny start.

JOHN

Age	Hypothetical stock market gains or losses	Withdrawal at start of year	Nest Egg at Start of year
64			$500,000
65	-10.14%	$25,000	$500,000
66	-13.04%	$25,750	$426,839
67	-23.37%	$26,523	$348,766
68	14.62%	$27,318	$246,956
69	2.03%	$28,318	$251,750
70	12.40%	$28,982	$228,146
71	27.25%	$29,851	$223.862
72	-6.56%	$30,747	$246,879
73	26.31%	$31,669	$201,956
74	4.46%	$32,619	$215,084
75	7.06%	$33,598	$190,084
76	-1.54%	$34,606	$168,090
77	34.11%	$35,644	$131,429
78	20.26%	$36,713	$128,458
79	31.01%	$37,815	$110,335
80	26.67%	$38,949	$95,008
81	19.53%	$40,118	$71,009
82	26.38%	$36,923	$36,923
83	-38.49%	$0	$0
84	3.00%		
85	13.62%		
86	3.53%		
87	26.38%		
88	23.45%		
89	12.78%		
	Average return 8.03%		Total Withdrawal $580,963

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In five short years, John's $500,000 has been cut in half. And withdrawing money when the market is down makes it worse, as there is less in the account to grow if or when the market comes back. But life goes on, and bills must be paid.

From age 70 onward, John has many solid positive/up years in the market, but the damage has already been done. The road to recovery is just too steep. By his late 70s, he sees the writing on the wall and knows that he will run out. By age 83, his account value has collapsed. In the end, he can withdraw just $580,963 from his original $500,000 retirement account. In other words, **after 18 years of continued investing during retirement, he has just an additional $80,000 to show for it.**

But here is the crazy thing: **during John's tumble down the mountain, the market averaged over 8% annual growth.** That's a pretty great return, by anyone's standards!

Here's the problem: the market doesn't give you *average* annual returns each year. It gives you *actual* returns that work out to an average. (Remember our discussions about the difference between real and average returns in chapter 2.3, "Myth 3: 'Our Returns? What You See Is What You Get' "?) And "hoping" you don't suffer losses in years in which you can't afford them is *not* an effective strategy for securing your financial future.

FLIP-FLOP

Susan is also age 65, and she too has $500,000. And like John, she will withdraw 5%, or $25,000 per year, for her income, and she too will increase her withdrawal slightly each year to adjust for inflation. And to truly illustrate the concept, we used the exact same investment returns, but we simply **flipped the sequence of those returns.** We reversed the order so that the first year becomes the last year and vice versa.

By merely reversing the order of the returns, Susan has an entirely different retirement experience. In fact, **by the time she is 89, she has withdrawn over $900,000 in income payments and still has an additional $1,677,975 left in her account! She never had a care in the world.**

Two folks, same amount for retirement, same withdrawal strategy: one is destitute, while the other is absolutely free financially.

SUSAN

Age	Hypothetical stock market gains or losses	Withdrawal at start of year	Nest Egg at Start of year
64			$500,000
65	12.78%	$25,000	$500,000
66	23.45%	$25,750	$535,716
67	26.38%	$26,523	$629,575
68	3.53%	$27,318	$762,140
69	13.62%	$28,318	$760,755
70	3.00%	$28,982	$832,396
71	-38.49%	$29,851	$827,524
72	26.38%	$30,747	$490,684
73	19.53%	$31,669	$581,270
74	26.67%	$32,619	$656,916
75	31.01%	$33,598	$790,788
76	20.26%	$34,606	$991,981
77	34.11%	$35,644	$1,151,375
78	-1.54%	$36,713	$1,496,314
79	7.06%	$37,815	$1,437,133
80	4.46%	$38,949	$1,498,042
81	26.31%	$40,118	$1,524,231
82	-6.56%	$41,321	$1,874,535
83	27.25%	$42,561	$1,712,970
84	12.40%	$48,383	$2,125,604
85	2.03%	$45,153	$2,339,923
86	14.62%	$46,507	$2,341,297
87	-23.37%	$47,903	$2,630,297
88	-13.04%	$49,340	$1,978,993
89	-10.14%	$50,820	$1,677,975
	Average return 8.03%		Total Withdrawal $911,482

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And what's even more mind boggling: **they both had the same average return (8.03% annually) over the 25-year period!**

How is this possible? Because the "average" is the total returns divided by the number of years.

Nobody can predict what will happen around the next corner. Nobody knows when the market will be up and when it will be down.

Now, imagine if John and Susan both had income insurance. John would have avoided an ulcer, knowing that as his account dwindled, he had a guaranteed income check at the end of the rainbow. Susan would have simply had more money to do with as she pleases. Maybe take an extra vacation, give more to her grandkids, or contribute to her favorite charity. The value of income insurance cannot be overstated! And when coupled with the All Seasons portfolio, you have quite a powerful combination.

6 DEGREES OF SEPARATION

You might recall from earlier in the book when I introduced Wharton professor Dr. David Babbel. He is not only one of the most well-educated men I have ever met but also a gentle and caring soul with a grounding faith. And he prefers David over "Doctor" or "Professor."

Here is a quick refresher on David's accomplished background. He has six degrees! A degree in economics, an MBA in international finance, a PhD in finance, a PhD minor in food and resource economics, a PhD certificate on tropical agriculture, and a PhD certificate in Latin American studies. He has taught investment at Berkeley and the Wharton School for over 30 years. He was the director of research in the pension and insurance division for Goldman Sachs. He has worked for the World Bank and consulted for the US Treasury, the Federal Reserve, and the Department of Labor. To say he knows his stuff is to say Michael Jordan knows how to play basketball.

David is also the author of a polarizing report in which he lays out his own personal retirement plan. When it came time for David to retire, he wanted a strategy that would give him peace of mind and a guaranteed income for life. He remembered that *income is the outcome*. And he also wisely took into consideration other factors such as not wanting to make complex investment decisions in his older years. He considered all his options and drew upon his vast knowledge of risk and markets. He even consulted with his friends and former colleagues on Wall Street to compare strategies. In the end, David decided that the best place for his hard-earned retirement money was *annuities*!

Whoa! Wait a second.

How could Babbel commit what his Wall Street buddies call "annuicide"? *Annuicide* being the term that brokers first coined for a client who withdraws money from the stock market and uses age-old insurance companies to guarantee a lifetime income. Brokers see it as an irreversible decision that no longer allows them to generate revenues from your investment. The death of *their* profits.

Come to think of it, **when was the last time your broker talked to you about creating a lifetime income plan?** Probably never. Wall Street typically has no interest in promoting concepts related to withdrawal. To them, *withdrawal* is a four-letter word. Here is the irony: you represent a lifetime of income for the broker so long as you never leave.

> Americans should convert at least half of their
> retirement savings into an annuity.
> —US TREASURY DEPARTMENT

Dr. Jeffrey Brown knows a thing or two when it comes to creating a lifetime income plan. He is an advisor to the US Treasury and the World Bank, and is one of the people called on by China to help evaluate its future Social Security strategy. He was also one of only seven individuals appointed by the president of the United States to the Social Security Advisory Board.

Jeff has spent most of his professional career studying how to provide people an income for life. **What did he resolve? That annuities are one of the most important investment vehicles we have.**

Jeff and I had a fascinating three-hour interview around income planning and how baffling it is to him that income is omitted from most financial planning conversations. How is it possible that income insurance is barely discussed in the offices of most financial planners, nor is it included as an option inside 401(k) plans, the primary retirement vehicle for Americans?

I asked him, "How do people find a way to protect themselves so they really have an income for life when they are living longer than ever before? They're retiring at sixty-five, and today they've got twenty or thirty years of retirement income needs ahead of them, but their financial plan won't last that long. What's the solution?"

"The good news, Tony, is we actually do know how to address this problem," he said. "We've just got to get people to change the way they are thinking about funding their retirement. There are products out there in 'economist land' that we call annuities, which basically allow you to go to an insurance company and say, 'You know what? I am going to take my money and put it with you, you're going to manage it, grow it, and you're going to pay me back income every month for as long as I live.' **The easiest way to understand this is, it's exactly what Social Security does. With Social Security, you know, you're paying in over your lifetime while you're working, and then when you retire, you get paid back income every month for as long as you live.** You don't have to be limited by Social Security; you can expand your lifetime income by doing this on your own as well."

Jeff and his team performed a study where they compared how annuities were described, or "framed," and how the shaping of that conversation completely changed people's perceptions of their need or desire for an annuity.

First, they portrayed them the way stockbrokers do: as a "savings" account or investment with relatively low levels of return. Not surprisingly, only 20% of people found them attractive. Sound familiar? You can hear the broker saying, "Annuities are a bad investment!"

But when they changed just a handful of words and described the *actual* and *real* benefits of an annuity, the tide changed. By describing the annuity as a tool that gives you a guaranteed income for the rest of your life, more than 70% found them attractive! Who doesn't want income insurance that kicks in if you have burned through your savings? Maybe your cost of living was greater than you expected. Maybe you had an unexpected medical emergency. Or maybe the market didn't cooperate with its timing of returns. What a gift to know that your future income checks are just a phone call away.

And today a revolutionized financial industry has created a whole new set of annuity opportunities. Many of these pay you returns that mimic the performance of the stock market but carry none of its downside losses. Annuities aren't just for your grandpa anymore. **Turn the page, and let me show you the five types of annuities that could change your life.**

CHAPTER 5.4

TIME TO WIN: YOUR INCOME IS THE OUTCOME

The question isn't at what age I want to retire, it's at what income.

—GEORGE FOREMAN

Annuities have long been the whipping boy of the financial industry. When I first heard the concept of using an annuity a few years ago, I scoffed. I had been conditioned to believe that annuities are bad news. But when challenged, I didn't really have a solid reason why I thought they were bad. I was simply picking up my torch and pitchfork like the rest of the mob.

But the conversation has been shifting. Imagine my surprise when I was handed a 2011 issue of *Barron's* with this cover line:

"Best Annuities—Special Report—Retirement: With Their Steady Income Payments, Annuities Are Suddenly Hot."

Barron's? The classic investment magazine with an annuity cover story! Is the sky falling? I flipped open the pages, and there it was in black and white:

"Now, as baby boomers approach retirement with fresh memories of big market losses, many sharp financial advisors are recommending an annuity as an important part of an income plan."

Wow. Annuities have been given quite the promotion lately. From your grandpa's annuity stuffed away in a dusty drawer to the hottest product recommended by sharp financial advisors. But guess what? **Annuities are not just for retirees any longer. More often, younger individuals are starting to use annuities, specifically those where the growth is tied to a market index (such as the S&P 500), as a "safe-money" alternative.**

To be clear, they are *not* an alternative to investing in the stock market or a way to try to beat the market. We already made it quite clear that nobody beats the market over time, and as Jack Bogle and so many others have echoed, using a low-cost index fund is the best approach to investing in the markets. But certain annuities, specifically those "linked" to market returns, can replace other safe-money alternatives such as CDs, bonds, Treasuries, and so on—and **offer superior returns.**

But I am getting ahead of myself! Let's take a moment to do a quick overview as to what's available today and what's coming soon.

First, let's be clear: there are really only two general categories of annuities: *immediate annuities* and *deferred annuities.*

IMMEDIATE ANNUITIES

Immediate annuities are best used for those at retirement age or beyond. If you aren't there yet, you can skip over this page and go right to deferred annuities, or you can keep reading because this might be applicable for some special people in your life, such as your parents or grandparents.

Simply put, **immediate annuities beat every other potential vehicle for providing a guaranteed lifetime income** for one reason: a concept called *mortality credits.* I know it sounds gruesome, but it's really not. Remember how annuities got their start 2000 years ago in the time of Caesar? For hundreds of years, insurance companies have successfully guaranteed lifetime incomes for millions of people because when a bunch of people buy an immediate annuity, some people will die early, while others will live a long time. By "pooling" the risk, **the annuity buyer who lives a long time gets the benefit,** while those who die early leave some money on the table. But before we shun the potential of leaving some money on the table, let's look at the power of annuities when wielded appropriately.

2,750% MORE INCOME

My son Josh has been in the financial services industry his entire adult life. He was telling me a story about a client of his who came to him ready to retire. He had just turned 65, and over his lifetime he had managed to sock away about $500,000. He needed a secure income stream, and he felt taking risks in the market was not an option. Sadly, his former broker had him allocated to a very aggressive portfolio, which resulted in a near 50% drawdown in the 2008 crash. It wiped out hundreds of thousands of dollars that took him a full decade of hard work to sock away. And like so many other people, he'd barely gotten back to even, and now he was more afraid than ever of running out of money.

He wanted his income checks to start immediately. So Josh began to walk him through his limited options.

- He could go to a bank, and a CD would pay him 0.23% (or 23 basis points) per year. This arrangement would give him $95.80 per month in fully taxable income for a $500,000 deposit. That's a whopping **$1,149 a year**—before taxes. Don't spend it all in one place!
- Bonds would pay him closer to 3% per year, or about **$15,000 a year** before taxes, but the risk that option would entail would be if interest rates rise. This would cause the value of his bonds (his principal) to shrink.
- Josh showed him that a $500,000 deposit into an immediate lifetime income annuity, as of today would pay him $2,725 per month or **$32,700 per year,** guaranteed for life![18] That's a 2,750% increase over CDs and an 118% increase over bonds, without their risk.

At today's life expectancies, this man has at least 14 more years to live, and if Ray Kurzweil is right, he could live well beyond that! When he added this guaranteed income to his Social Security payments, he had more than enough to maintain his standard of living and could spend his time focused on what mattered most to him: his grandchildren and fishing.

Do you see the power here? When compared with any other type of "sure thing" investment, he will certainly run out of money. But with an immediate annuity, which is really a form of income insurance, he has protection for life.

Critics will say, "Yes, but if you die early, they keep your money! You will have left that money on the table." When I asked David Babbel about this concern, his response was swift and blunt: **"If you are dead, who cares?! What's painful is if you live too long with no income—that's when you'll really suffer."** And if you are really worried about premature

[18]The effective tax on income from immediate annuities is dependent on what the IRS calls the *exclusion ratio*. A portion of your income payments are deemed a return of your principal and thus "excluded" from tax.

death, you can select an option where the insurance company will refund your heirs the same amount you put in. (This arrangement, however, will decrease the size of your income payments, so there is a trade-off.) Or as David recommends, use an inexpensive term life insurance policy. So if you live a long fruitful life, you win because you have income insurance. Or God forbid, if you pass early, with a life insurance policy, your heirs win as well.

CONTROL IS AN ILLUSION

We all love control. But control is often an illusion. We think we have control over our health, our finances, our kids—Okay, maybe not our kids. But we all know that things can change in the blink of an eye. A storm can cause your house to flood (as it did to my brand-new home in Florida after a torrential rain had my wife and I wading through 12 inches of water at three in the morning). Or you could get a callback from the doctor after a supposed routine checkup. The point is, control is often more of an illusion than a reality.

Stockbrokers will tell you that by handing your money to an insurance company in exchange for a lifetime income, you are "losing control" of your principal. Let's look at this a little more thoughtfully. Say you are 60 years old and have accumulated a $1 million nest egg. Your broker advises the traditional approach of stocks and bonds, and you apply the 4% rule for your income (which means you'll be able to take out $40,000 per year). The reality is you will need every bit of that $40,000 to pay your bills. You know your money needs to be invested, so you really can't afford to touch your principal. **And what happens if the market drops?** You don't want to sell at the bottom, but at the same time, you may also feel that you can't afford more losses at this stage of life. You are between a rock and a hard place. **This so-called control is an illusion. Floating with the whims of the market waves and hoping the tide turns in your favor can be a recipe for disaster.**

Remember, our focus is not just on asset growth. Our theme is: **guaranteed income for life!**

It is better to have a permanent income than to be fascinating.

—OSCAR WILDE

DEFERRED ANNUITIES

Okay, so we said there are two general types of annuities. You now know what an immediate annuity is: you give your money to an insurance company, and it immediately starts to provide you with an income for life.

The other type of annuity is called a deferred annuity. This simply means you give the insurance company money either in one lump sum or over a period of years, and instead of receiving an immediate income, your returns are reinvested in a tax-deferred environment so that when you're ready you can, at will, turn on the income stream you want for the rest of your life. You literally have a schedule for what your income will be when you're 40, 50, 60—for every year of your life.

While there are many different versions of immediate annuities, with different terms and rewards that vary by the company that puts them out, similarly there are a variety of types of deferred annuities. **Here's the good news, though: there are roughly only three primary types of deferred annuities.** Once you know these three different types, along with your understanding of immediate annuities, you will fundamentally understand what your options are and you will be able to **tap into the power of this safe-money vehicle.**

So let's make it as simple as 1, 2, 3. There are three types of deferred annuities. They are:

1. **Fixed annuity**: This is where you get a fixed, guaranteed rate of return every year (independent of any stock market ups or downs), very much like you would receive with a CD or bond, but the rates are different.
2. **Indexed annuity:** This is where your rate of return is tied to how the stock market does, but you get a percentage of the upside of the market (not all) with no downside and no possibility of loss.
3. **Hybrid "indexed" annuity:** This is where you get the benefits of an indexed annuity with the addition of a "lifetime income" rider. **This lifetime income feature gives you the ability to turn on a paycheck for life!** (Note: technically speaking, there isn't a product called a "hybrid." However, it has become a common name among professionals to describe the category, which includes the lifetime income features.)

HOW SAFE ARE ANNUITIES? THE POWER OF INCOME INSURANCE

A guarantee is only as good as the insurance company that issues it, so highly rated insurance companies are key. Many of the top companies have over 100 years in the business, succeeding in spite of depressions, recessions, and world wars. But with over 1,000 insurance companies in the United States, it's really only a handful that command the top ratings. I asked Dr. Jeffrey Brown about the safety of annuities and people's concern that the insurance company could go under.

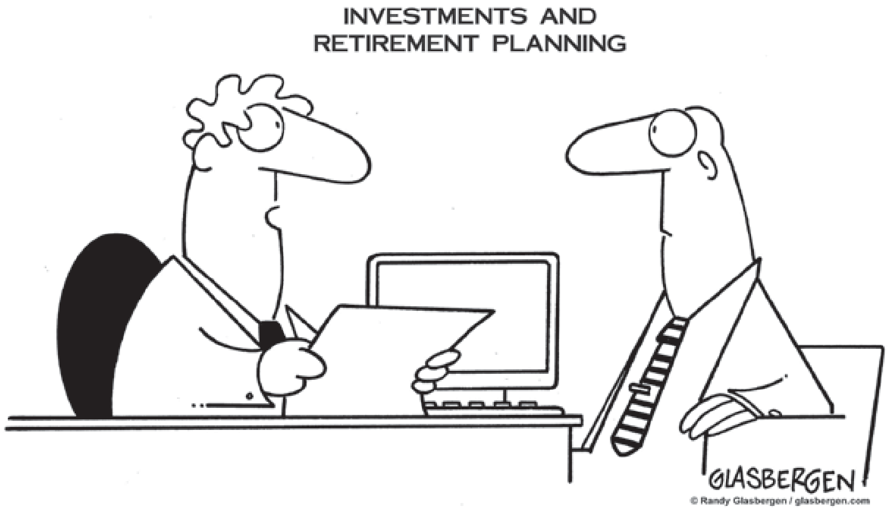
"Yes, this is a concern that a lot of people have," he acknowledged. "I start by reassuring the people that to my knowledge—and I've been studying this for, you know, fifteen years or more—I don't know of anyone who's ever actually lost money in an annuity product, and there are a lot of reasons for that. Depending on what state you're in, there are **insurance guaranty associations** run by the state insurance departments that will guarantee up to a certain amount/deposit of the product you buy. And the way these work is essentially every insurance company that operates in that state is basically agreeing to insure all the other ones."

Each state has its own limits, but **the guarantee can be as high as $500,000,** for which you are insured against loss, in the rare event of an insurance company failure. How rare? According to the FDIC (Federal Deposit Insurance Corporation), there were 140 bank closures in 2009 alone, yet not a single major insurance company went under.

VARIABLE ANNUITIES

There is one type of deferred annuity I deliberately didn't mention above, and that is the variable annuity. The reason for that is, **nearly every expert I interviewed for this book agreed that variable annuities should be avoided.** They are extremely expensive, and the underlying deposits are invested in mutual funds (also known as sub accounts).

So not only are you paying fees for stock-picking mutual funds (which don't beat the market and can average upward of 3% in annual fees), you are also paying the insurance company (between 1% and 2% annually). These



"If you work hard and invest wisely, you can afford to turn 65 on your 80th birthday."

products can be toxic, and yet brokers manage to sell about $150 billion in new deposits each year. I spent more time addressing variable annuities in chapter 2.7, "Myth 7: 'I Hate Annuities, and You Should Too.' " Feel free to flip back for a refresher.

So let's take a few moments and go a little deeper with each of these three options.

FIXED ANNUITIES

A *fixed deferred annuity* offers a specific guaranteed rate of return (for instance, 3% or 4%) for a specific period of time (such as five or ten years). The money grows tax deferred, and at the end of the term, you have a few options. You can walk away with your money, you can "roll your money" into a new annuity and keep the tax protection, or you can convert your account balance into a guaranteed lifetime income. There are no annual fees in a fixed deferred annuity. You will know in advance what your growth will be at the end of the term.

Pretty simple, right? These rates of return might not be terribly exciting in today's market, but they change with interest rates. And at least this type of annuity has tax efficiency, so handled properly, this can increase your net rate of return significantly.

But let me share with you something quite a bit more interesting:

THE LONGER YOU WAIT, THE MORE YOU GET

What if you're young and just getting started building your financial future, or you're at a stage of life where you don't need income today but you're concerned that your investment income may not last as long as you live? Remember, if someone retires today at 65, he or she may have 20 or 30 years of income needs. Trying to figure out how to make your money last that long is a fairly daunting task. So a new approach called *longevity insurance* has become increasingly popular. These products allow you to create income insurance so that you have guaranteed rates of income from, for example, age 80 or 85 until your passing. Knowing you have an income starting at that later stage gives you the freedom to have to plan for only 15 years of retirement instead of 20 or 30. Let me give you an example:

In a 2012 *Wall Street Journal* article titled "How to Create a Pension (with a Few Catches)," writer Anne Tergesen highlights the benefits of putting away $100,000 today (for a male age 65) into a *deferred fixed-income annuity*. This man has other savings and investments, which he thinks will last him to age 85 and get him down the mountain safely. *But* if he lives past 85, his income insurance payments will begin, and the amounts he receives will be staggeringly large compared with how much he put in.

"Currently, a 65-year-old man paying $100,000 for an immediate fixed annuity can get about $7,600 a year for life . . . But with a longevity policy [a long-term deferred fixed-income annuity—I know the language is long] that starts issuing payments at age 85, his annual payout will be $63,990, New York Life says."

Wow. **At age 65, if he makes a onetime deposit of just $100,000, his payments at age 85 are close to $64,000 per year! Why is this so valuable? Because at age 85, if he lives another ten or 15 years, he will get $64,000 *every* year, dwarfing his initial investment.** But the best part is that he has to make his initial savings and investments last only 20 years, not 30 or 35. And with the volatility of markets and the inevitable challenge of sequence of returns, this task can be challenging for almost anyone.

I ran these numbers myself, and since I am only 54, my payments at age 85 would be $83,000 per year for the same onetime $100,000 deposit today! (And you don't have to have a $100,000 lump-sum payment. It can be sizeably smaller, which would also provide a smaller income.) That means if I live until I am 95, I would receive $830,000 in payments (10 years × $83,000) for my $100,000 deposit. And I don't have to wait until age 85 to turn on the income. The day I make the deposit, I'm given a schedule of what the annual income payments will be at any age I want to begin taking income. If I felt I needed or wanted money at age 65 or 75, I know exactly how much that's worth to me.[19]

Income insurance, when structured correctly and as part of an overall plan, is an incredible tool that reverses or eliminates the risk of living too long and becoming a burden on your family members. When I met with Alicia Munnell, director of the Center for Retirement Research at Boston College, she echoed my enthusiasm: "So many people that I work with are very excited about and positive about the advanced life deferred annuity, which is essentially longevity insurance."

At my annual financial event in Sun Valley, Idaho, I interviewed famed publisher Steve Forbes. I asked him about his own approach to personal finance, and even he said that he has longevity insurance in place!

One more very cool thing? The IRS looks very favorably on these deferred income annuities, so you don't have to pay tax on the entire income payment (because a good chunk of the payment is considered a return of your original deposit).

THE ULTIMATE INCOME SOLUTION

It's been said that if you give a man a hammer, everything becomes a nail. This is to say that the solution outlined below, as exciting as it is, is not the be-all and end-all solution, nor is it for everyone or every situation. It's part of an overall asset allocation. My objective here is to outline a powerful financial product, a hybrid annuity, that gives us great upside potential during its growth phase but also provides a guaranteed lifetime income down the road, when we crest the top of the mountain and begin the "second act" of our lives. It's called a **fixed indexed annuity (FIA).**

[19]Obviously, if I start the annuity income sooner, at 65 or 70, the income I receive will be less than at 85.

To be clear, there are two relatively new types of deferred annuities that have surged in popularity since they were introduced in the early 1990s:

1. the indexed annuity, where the rate of your return is tied to a stock index, and . . .
2. **the even more popular hybrid version, where you get both a fixed rate of return and the option of a return tied to the growth of the stock market index as well as a guaranteed lifetime income feature.** These hybrid annuities are more commonly known as fixed indexed annuities, with a lifetime income rider or a guaranteed minimum withdrawal benefit. (I told you we'd make sense of this alphabet soup of financial terms.)

In 2013 alone, these annuities collected over $35 billion in deposits. In fact, as we were wrapping up this book, fixed indexed annuity deposits were at record levels through the first half of 2014, with over $24 billion in new deposits, a 41% growth over 2013. **Why this record growth?**

- **In a fixed indexed annuity, your deposits remain entirely in your control. You are *not* giving up access to your cash.**
- **It offers the potential for significantly higher annual returns than other safe-money solutions such as CDs or bonds.**
- **It provides a 100% guarantee[20] of your principal—you can't lose money.**
- **The growth is tax deferred, providing maximum compounded growth for the expansion of your Freedom Fund.**
- **It provides income insurance, or a guaranteed income for life, when you select an optional income rider.**

As I alluded to earlier, these structures offer upside without the downside. Gains with no losses. In many ways, they are an antidote to the problem of sequence of returns.

How do they work?

First of all, a fixed indexed annuity is **fixed, which means your account is guaranteed never to go down. No matter what happens, you will not**

[20]Remember, there are state insurance guarantees as well as corporate guarantees.

lose your original deposit. That's half the battle! However, instead of getting a small guaranteed rate of return like a traditional fixed annuity, your "base account" growth is determined by tracking the gains of a stock market index such as the S&P 500. As an example, if the S&P 500 goes up 8% in a given year, you would get to keep (or "participate in") in a certain **percentage of that gain, which is typically subject to a cap. For example, if your cap was 5%, you would receive a 5% credit to your base account value.**[21] In other words, there is a "cap" or a "ceiling" in most annuities on how much of the gain you get to keep. **But conversely, if the market goes down in that year, you don't lose a dime!**

In recent years, there have been a few unique products that allow you to keep 100% of the market/index gains and, yes, still avoid the down years! There is no cap on your upside. What's the catch? Instead of putting a cap on your annual gains, the insurance company will share in a small portion of your gains (1.5%, in many cases). So let's say the index/market was up 8% in a given year; you would receive 6.5% added to your account, and the insurance company keeps 1.5%. Or if the market has a stronger year with gains of 14%, you get to keep 12.5%. Many experts I spoke with anticipate that these uncapped annuities may be the future.

Okay, but what happens if the market goes down?

If the market index drops, even if it's one of those nasty 20%, 30%, or 50% drawdown years, you don't lose a dime. You get to avoid all the bad years and only participate in the up years of the market index.

Now, I know what you are thinking. It's exactly what I was thinking when I first heard of these products: **"How in the world can insurance companies give you the upside with no downside?"**

"There is no magic here," said Dr. Babbel when I asked him the same question. He explained that the insurance company parks your money safely in its cash reserves, never actually investing it in the stock market. This is how it guarantees your principal. The remainder is used to buy "options" on the stock market index and to cover expenses. So if the market is up, it gives you your portion of that gain. If it goes down, the options "expire," but you don't lose—and neither does the insurance company. Win, win.

[21] Participation rates and caps will depend on the individual products.

LOCK IN YOUR GAINS

In addition to having the upside without the downside, these FIAs have another special benefit. Look, we all love opening our stock account statements and seeing our account balance on the rise. But we never *really* know if those dollars will truly be ours to spend one day or if another market drop could wash away those gains. **One of the huge benefits of an FIA is that each and every year, any gains or upside are locked in,** and now this becomes our new floor. For example, if I earn 6.5% on my $100,000 account, I now have $106,500 locked in. Never can I lose that $6,500 in growth. Each and every year, the account will be either flat, because I am guaranteed not to partake in market losses, or the account will be up. Like an elevator that only goes up, this unique feature of locking in gains each year is a powerful tool for our safe money.

INCOME! INCOME! INCOME!

As powerful a tool as these FIAs can be for a safe-money return, **it's their ability to simultaneously provide you a guaranteed lifetime income stream** that makes make them so darn attractive. And while I *like* fixed indexed annuities for the reasons above (principal guarantees, tax efficiency, upside without downside), I have come to *love* them for the guaranteed income aspects. This is what happens when we elect to add a *guaranteed lifetime income rider*. Let me translate into English.

No matter how your account performs, even if it is flat or up moderately over many years, the addition of a guaranteed lifetime income rider ensures that you will receive a guaranteed annual income stream when you decide to turn it on, regardless of what happens to your base account.

Get this: **I have an annuity in which the income account is *guaranteed* to grow at 7% per year for 20 years with no market risk.** The day I went to buy it, I received an income schedule, so that whenever I decide to turn it on, **I will know exactly how much income I am guaranteed for the rest of my life (no matter how long I live).** And the longer I wait, the more my income account will grow, and thus, the higher the income payments will be. This account has become an important part of my Security

Bucket. Again, sounds too good to be true, right? I had my fiduciary advisor dig beneath the surface, and he discovered that not only was it legit, but also it was attracting billions in annual deposits from baby boomers like me.

After all, who wouldn't want a product with a 7% guaranteed return in their income account while simultaneously avoiding market risk, sequence-of-returns risk, and so on? Remember, this was early 2009, when the market was melting down. There was seemingly no such thing as a safe place. And other guaranteed vehicles like CDs came with tiny returns. As you probably recall, there was a panic in the air, and people were scouring the world for financial safety. I found out later that this specific product became the fastest selling annuity on the planet at the time.

After I made the investment, my next thought was, "How do I set this up for my kids and grandkids? This is too good to be true."

So what's the catch? I came to find out that the insurance companies offer this product only if you are in your mid-50s or older. They can't offer 7% forever, so they give a maximum of 20 years. If you are younger, the insurance company obviously can't afford to give you a 7% return in your income account forever. Also, this annuity requires a sizeable lump-sum deposit up front. I was baffled and frustrated. If this product is this powerful for someone my age, it would be even more powerful for someone in his 20s, 30s, or 40s who has so much time to allow his deposits to compound. **That day, I made it my mission to create an affordable solution for younger people.** Where else could they build a secure lifetime income plan that would allow them to carve a clear path to financial freedom without all the stress and volatility of the market?

TOOLS OF THE .001%

We've come a long way! Not only do we have the mind-set of an insider we have the tools of the insiders! In this section alone, we have learned a powerful portfolio model from icon Ray Dalio that has proven resilient throughout every economic season since 1925. And most people have to invest $100 million to get his insights! We can be confident that his portfolio model survives, and over the long term thrive in all environments.

We have also learned how correctly structured income insurance, an annuity, can give us a paycheck for life without having to work for it. And not only that but with the right fixed indexed annuity, our deposits can participate in 100% of the upside of the market/index but avoid losses when the market goes down! A Security Bucket with some excitement. Although there are many approaches to achieve financial freedom, the one-two punch of an All Seasons portfolio and the certainty of a guaranteed lifetime income stream is a powerful combination for peace of mind.

But once you build your wealth, you also must protect it for you and your children. The ultrawealthy protect their wealth with an entourage of extremely sophisticated advisors. So who or what do they protect it from? **Let's find out the secrets of the ultrawealthy in chapter 5.5!**

FREQUENTLY ASKED QUESTIONS

Here are a handful of common questions that seem to come up when people learn about fixed indexed annuities:

What happens if I die "early"?

If you die before turning on your income stream, your entire account balance is left to your heirs. This is a *huge* benefit over a traditional income annuity. When you do decide to eventually turn on your lifetime income stream (with a simple phone call), you *do not* forfeit your entire account to the insurance company. Your heirs would still get your account balance minus any income payments you had taken to that point.

Can I take out money in case of an emergency?

Most FIAs allow you to withdraw up to 10% to 15% of your account without any penalty or surrender charge. Keep in mind, if you make this withdrawal prior to age 59½, you will be charged a 10% penalty by the IRS, which is standard for any investment that gives you tax deferral on the growth. If you need all your money back, you can surrender your annuity and get your money out (plus any growth). However, this withdrawal may incur a surrender charge, depending on how long you have owned the annuity. A surrender charge is really a self-imposed penalty because you are taking back your money early. The typical schedule will start at 10% and go down by 1% per year until you reach 0%. So if you have held the annuity for five years, you would have a 5% charge if you surrender the contract and get back all your money. Any money invested in this vehicle should be considered money invested for the longterm.

What are the fees within an FIA?

There are no annual management fees withdrawn from your account. However, if you select the guaranteed lifetime income rider, the annual fee for this ranges between 0.75% and 1.25% annually, depending on each company's individual offerings.

Can I put my IRA money into an annuity?

Yes, you can use money from your IRA (or Roth IRA), or you can also use after-tax dollars (money you have already paid tax on) to fund an annuity. This scenario is also known as qualified or nonqualified dollars, both of which can be used.

What is the cap on my account growth, and how is it determined?

The cap, the ceiling on how much of the market growth you get to keep, is typically tied to interest rates. If interest rates are higher, the cap is high (and vice versa). Some newer products offer 100% upside with no cap, *but* they take a small spread, which is a share of your upside/profits. If the market is up 10%, you might get 8.75% credited to your account (which means the insurer kept a 1.25% spread). But if the market goes down, it doesn't take anything, and you don't lose a dime. I like these uncapped strategies because they give the highest upside potential in a given year.

To what underlying markets will my account be "linked"?

The most popular index is the S&P 500. But newer indexes are being added quite frequently. For example, some accounts can be linked to the Barclays Dynamic Balanced Index (a mix of stocks and bonds) or the Morgan Stanley Dynamic Allocation Index (a mix of 12 different sectors). Some indexes are even tied to commodities.

What factors will determine how much income I get?

The amount that you contribute to the annuity, the length of time before you decide to access your income stream, and your age at the time your income begins are the primary factors that will ultimately contribute to the amount of income you'll receive. However, the biggest factor is the product you select. Every annuity contract is different in the amount of contractually guaranteed income it will provide, so it's important you understand this before you pull the trigger.

What is the tax treatment of an FIA?

The growth within your FIA is tax deferred. When you turn on the income stream, you will be paying ordinary income tax rates on the lifetime income payments. Because the government is giving you tax deferral, it will penalize you if you take money out before you reach age 59. If you own the FIA within a Roth IRA, there no will be no tax on either the gains or the lifetime income stream.

Here's what you can avoid with a fixed index annuity: the benefits of getting the upside without the downside becomes incredibly powerful when you look back at the history of Wall Street crashes. What's astonishing is just how long it took for the market to recover—for investors to get back to breakeven. Just for fun, take a look at some of the history of the stock market crashes—and remember, with this type of investment, you can avoid all of these.

1901–1903

- The Dow fell 46 percent.
- Recovered by July 1905.
- Total time to recovery: two years.

1906–1907

- The Dow fell 49 percent.
- Recovered by September 1916.
- Total time to recovery: nine years.

1916–1917

- The Dow fell 40 percent.
- Recovered by November 1919.
- Total time to recovery: two years.

1919–1921

- The Dow fell 47 percent.
- Recovered by November 1924.
- Total time to recovery: three years.

1929–1932

- The Dow fell 89 percent.
- Recovered by November 1954.
- Total time to recovery: 22 years.

1939–1942

- The Dow fell 40 percent.
- Recovered by January 1945.
- Total time to recovery: three years.

1973–1974

- The Dow fell 45 percent.
- Recovered by December 1982.
- Total time to recovery: eight years.

2000–2002

- The Dow fell 36 percent.
- Recovered by September 2006.
- Total time to recovery: four years.

2008–2009

- The Dow fell 52 percent.
- Recovered by April 2011.
- Total time to recovery: two years.