BUCKETS FOR BEARS—ANNUITIES CAN HELP

In a rising-rate environment, clients using the bucket strategy may avoid investing the "first bucket" funds as they wait for a better deal. Is there another alternative?

The Time-Based Segmentation method or "buckets" approach has been used in retirement planning for many decades. Initially developed by Harold Evensky in 1985, buckets was a way to reduce sequence-of-returns risk. Over time, the strategy developed into three buckets, each with a clear purpose:

1. **1–5 years: Cash Flow**
   Invest in low-risk vehicles to cover spending needs in the first five years of retirement.
2. **6–15 years: Bonds**
   Medium-risk vehicles provide the opportunity for growth during the middle retirement years.
3. **16+ years: Stocks**
   Equities offer the highest risk with growth as the potential reward.

In today's rising-rate environment, can annuities help with this approach?

Bucket One–Money for Current Expenses

For the first bucket, the retiree needs income and cash flow to meet spending needs for the first five years of retirement. Income annuities, such as a single-premium immediate annuity (SPIA), can help meet those essential expenses. A five-year Period Certain annuity can provide guaranteed cash flow without exposure to bond-market volatility. Here's a tip: Run an illustration to solve for a monthly amount needed to help determine the initial purchase payment.

As rates rise, this type of annuity also may provide income to bridge the gap between retirement and claiming Social Security benefits and ensure the highest Social Security benefit available. Whether delaying claiming Social Security benefits until full retirement age (FRA) or until age 70, this strategy can be a way to manage essential income. This would allow Social Security's delayed retirement credits (DRC) to grow from FRA to age 70.

Bucket Two–Money for the Middle

For the second bucket, the approach is for an intermediate time frame. This bucket allows for limited market participation. However, the emphasis is on moderate growth and income as well as safety of principal. This bucket will replace the first bucket's assets as time progresses.

The shorter time horizon makes this option riskier than some clients might accept. An optional guaranteed minimum accumulation benefit for an additional cost with a variable annuity can reduce these concerns. In simple terms, it is a "walk-away" benefit that ensures if the market did not perform during a specified period, the investor will get all or most of the premium back in a variable annuity contract.

By investing in equities and bonds, the investor can now participate in market growth secure in the knowledge that at the end of the period, all or part of the original investment will be returned.

Bucket Three–Growth for the Future

The third bucket is typically used for long-term investing and is the highest-risk bucket. In nonqualified and qualified accounts, an investment-only variable annuity (IOVA) can be just as simple as that. There are no optional living benefits added, which helps reduce costs. An investor may invest as aggressively as he/she wants using as many (or as few) of the subaccounts offered. In nonqualified accounts, the ability to rebalance investments without recognition of gain, can allow assets to grow more quickly.

In addition, some IOVAs offer a death benefit, typically the return of premium (ROP). As a plus, most annuities allow for a 10% annual withdrawal free of sales charges in case the investor unexpectedly needs to move some funds to bucket one or bucket two.

Putting It Together

There are various investment options to use when using the Time-Based Segmentation method, also called buckets. This strategy can be attractive to retirees because it is easy to understand. The first two buckets use fixed investments to help mitigate risk; however, with rising rates and market volatility, it may be worthwhile to consider alternatives. For a client who retires in a rising-rate environment, using annuities in the bucket strategy may allow someone to retire sooner rather that later.

Clients concerned about sequence-of-returns risk may use the bucket strategy. For those who do (or plan to soon), adding annuities may help. Reach out to your clients to discuss what may work best for their situations.

Additional Resources and Links

[Retirement Income Strategies]

[The Impact of the Sequence of Returns]

[Understanding Sequence of Returns]

For more information about retirement planning, please contact our Retirement Strategies Group at RSG@PacificLife.com or (800) 722-2333, ext. 3939.
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VLC2122-0622W

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