3 Safer Income-Oriented Asset Classes for Retirees in 2016

By Stephen Vita | January 24, 2016

The Federal Reserve's unprecedented easy money policy since the financial meltdown in 2008 created horror for many retirees used to rolling over certificates of deposit (CDs) when their terms concluded. Prior to 2008, this was a low-risk tactic that produced returns that beat inflation and kept retirees' stress levels to a minimum.

In December 2015, Janet Yellen finally took the step of raising the federal funds rate by 0.25%. This is so minuscule, however, that it will have little effect on fixed income investments. Finding a safe place for retirement money in 2016 will still not be easy, but there are several alternatives to consider.

Immediate Annuities

An immediate annuity is created when a retiree deposits a lump sum of cash with an insurance company, creating an income stream that will continue for a period of time based on the retiree's choice. For example, this could be for the retiree's lifetime with payments terminating on his death. Secondly, the period could be payments for the lifetime of the retiree and his spouse as long as one of them is alive. Moreover, the period of payments can be chosen to last for a "period certain," a specified period of years when payment will continue until expiration. These annuities are constructed in the same manner as a life insurance policy, based on the retiree's gender and date of birth.

The highest immediate annuity income stream is received by a retiree who selects a lifetime option ("life-only") with no beneficiary to receive further payments after his death. The risk, of course, is that the retiree will die well before the actuarial tables' prediction. The income stream ends before the lump sum is ever paid out, and the insurance company wins. Each income payment includes both interest and return of premium, so only the interest component is taxed.

Insurance companies and brokerage companies such as Fidelity Investments offer immediate annuities. With Fidelity, a 2015 estimate for a 70-year-old male with a $100,000 deposit offered life-only monthly income of $659. If the retiree lives well beyond the prediction of actuarial tables, he will win. With a choice of a life payment including a guaranteed 10-year period certain, the monthly payment is $622. Here, the retiree is guaranteed at least 10 years of payment no matter when his death occurs.

There are many other payment options available depending on the issuer. As with any interest rate product, market yields will govern payout amounts.

Certificates of Deposit

CDs are one of the safest savings options, though rates of return have been skimpy for the last several years. If a CD is bought through a Federal Deposit Insurance Corporation (FDIC)-insured bank, the holder is covered for up to $250,000 at that particular bank in total, but not for each individual CD if he owns more than one. An investor should also know how interest is paid, whether semi-annually or monthly, and when the CD matures. The investor must also understand the severity of withdrawal penalties if he cashes in the CD early.

Banks are the primary distributor of CDs, but stock brokerage firms are also involved heavily, particularly for jumbo CDs that require deposits of $100,000 or more. Jumbo CDs pay higher rates of interest than those denominated in smaller amounts.

Interest earned on a CD of any size is fully taxable in the year when it accrues. In December 2015, one of the better rates was a five-year 2.25% annual percentage yield (APY) CD offered by Synchrony Bank. The minimum deposit is $25,000, and early withdrawal charges apply.

Staged Withdrawals From Investment Portfolios

If a retiree accumulates a diversified portfolio consisting of equities and bonds, a plan for staged withdrawals can create a stream that helps fills retirement income needs without destroying principal. This assumes that a financial Armageddon capable of destroying every asset class, especially equities, doesn't take hold.

Fidelity Investments conducted a study examining a hypothetical retired couple, aged 63, with a $1,500 income gap to fill, the shortfall from pensions and Social Security Income. In this hypothetical case, Social Security started early, before the couple reached 65 years of age.

Using a hypothetical $600,00 portfolio, the retirees could fill the income gap by withdrawing 4% per year, assuming average market conditions. The portfolio would continue to grow, but assuming a 0% return on their invested assets, things look bleak. The couple would run out of money early and deplete their assets in about 20 years.

Assumptions about future returns on asset classes are a guess, and it may be best to look at the glass as more half-empty than half-full to protect downside for a retiree.

Retirees Struggle Not to Outlive Their Incomes

In 2016, the chase for safe retirement income will continue. Market yields are still historically low, even with the Federal Reserve's first tightening move in many years. Burned recently in junk bonds and other high-risk paper, retirees must choose alternatives carefully to preserve capital required in the future.

http://www.investopedia.com/articles/personal-finance/012416/3-safer-incomeoriented-asset-classes-retirees-2016.asp?partner=YahooSA