



Pre-meeting preparation

- 1) Writing tools
- 2) Optional: Know what you need MFS # IRAE-BUDGET-FLY-5/09
(if approved at firm)



A common sense approach to retirement

Presenter Name

Title
MFS Investment Management®

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- Thank you for joining me today.
- A recent survey of retirees found out what I consider to be great news. Retirees with a comprehensive income plan felt more financially secure, more confident in their future and more in control.* This makes sense to me because a written plan gives you a better idea of your retirement income situation.
- Think about it this way: A friend of mine is a pilot. He's flown literally hundreds of flights but every time he flies he completes a preflight checklist and a flight plan. Ok- I'm flying from San Francisco to LA- I need x gallons of fuel, check, Nav system works, check, Etc.. In addition he flies with an emergency manual that's tabbed with various events. If a warning light comes on, he flips to page 5 and sees step one, step two etc. If he has a loss of power he flips to page 8. He's not unique, all pilots follow the same procedure because they know that if you fly long enough you will encounter a problem.
- Let's do an exercise- Visualize yourself flying and you're almost to your destination. You flip the switch to lower the landing gear on nothing happens. Now is not the time to turn to your copilot and say "What an interesting problem, let's think about what to do." You want to open the manual to page 11 and see exactly what steps fix the problem.
- This is what we'll talk about today. What can we do now to develop a "procedure manual" for retirement. We know certain events, both positive and negative, are likely to happen. Work with an advisor, a "flight instructor" if you will, to figure out what steps worked in the past to successfully handle the situation and write these down.
- It just makes sense that for something as important as your income in retirement you'd want a written plan. That's why I call today's presentation "A common sense approach to retirement."

*MFS and Northstar Research Partners, 2009 (based on data gathered in 8/2008 and 10/2008)

Retirement exercise



My concerns

Healthcare

Running out of money

Inflation

My lifestyle

Golf

Eating out

Travel

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- To develop an income guide we need to know two things- what are the concerns we need to address and what is the lifestyle you want in retirement.
- Under MY CONCERNS I want you to list your personal fears upon entering retirement. Many retirees tell us that healthcare costs, running out of money, and inflation are near the top, but your fears may be different. They may include the economy, war, upcoming elections, global warming, recession, a stock market crash. Whatever they are, please write them down.
- Now, under MY LIFESTYLE, write down the things that you *know* you are going to do in retirement — play golf every day, go out for dinner and I also want you to write down the things that you *want* to do — travel, go back to school, etc. — be as specific as you like. Note to speaker: you might add in a few of your own dreams to make it fun/interactive.
- Let's keep these materials handy. I'll refer back to this piece throughout today's discussion.

Income plan



- Income goals
- An asset allocation plan
- Guidelines for handling market ups and downs



No investment strategy, including asset allocation, can guarantee a profit or protect against a loss. MFS nor any of its subsidiaries are affiliated with Guyton/Klinger.

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- Developing a retirement income plan involves three major components:
 - Identifying what annual income you'll need or want,
 - How to best structure or invest your portfolio to provide for this need,
 - and how you will adjust your income in retirement to accommodate changes to the investment markets.
- **Income needs-** What is the total amount of annual income you need to support your lifestyle? Both the necessities and the "nice to haves." Once you have that, we compare your income needs to your sources of income, such as social security and pensions. The difference between these two is the income we need to generate from your assets.
 - One important part of your retirement income plan is your *initial withdrawal rate (IWR)*. We calculate your IWR by dividing your income target by your total portfolio value. So if you're taking \$50,000 in annual retirement income and your portfolio is worth \$1,000,000, your IWR is 5%: \$50,000 divided by \$1 million is 5%. Studies* suggest that sustainable IWRs vary by individual circumstances, and are very much affected by how one adjusts to or responds to varying market conditions, but are generally between 4% and 6%. We'll come back to this later.
- **An asset allocation plan-** Your asset allocation is a very *personal* issue and needs to be developed or customized to each of your *unique* situations: your concerns, goals, needs, risk tolerances, assets accumulated to date... It's outside of the scope of this seminar. All I'll say today is that you may need to find a balance between being too conservative and too aggressive. In retirement, a portfolio that goes to either extreme may not last throughout retirement.
- **Guidelines for handling different market conditions.** This is what we'll talk about today.

*Decision Rules and portfolio management for retirees; journal of financial planning, 2004

*Decision Rules and Maximum Initial Withdrawal Rates; Guyton and Klinger, Journal of Financial Planning, 2006

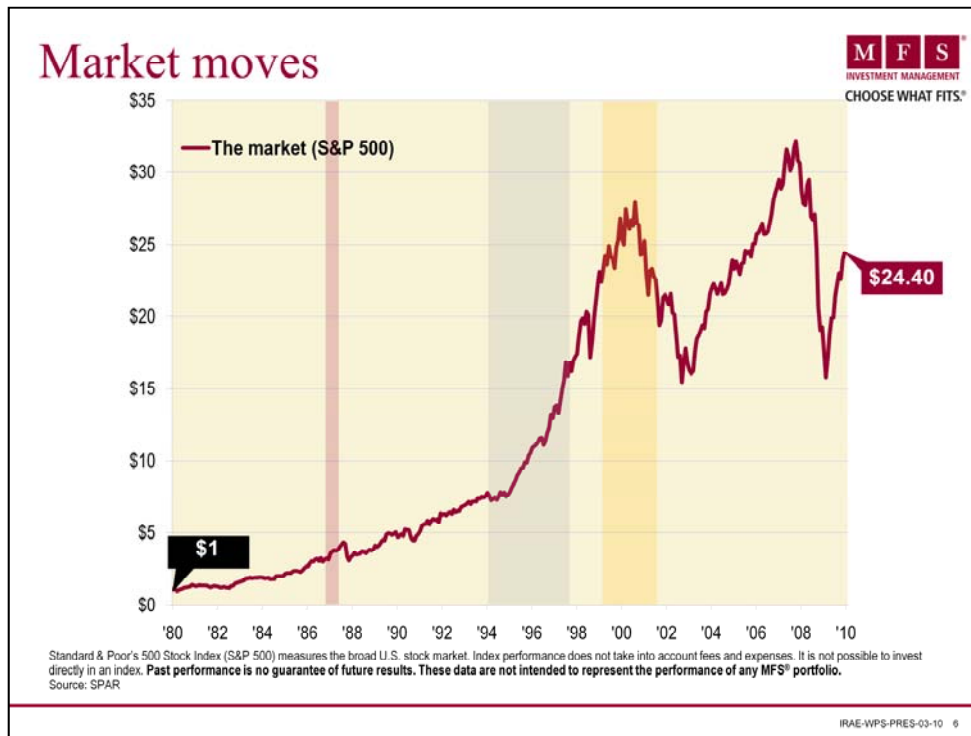
Lessons from the past



- Several bear markets
- Many market corrections
- 7 presidential election cycles
- Wars
- Catastrophic weather events
- Political upheavals around the world
- Rising energy prices



- One way to prepare for your retirement is to look at the past. I like to go back about 30 years because the life expectancy of a 62 year old couple is 29 years* (statistics predict that for 50% of couples, at least one person will live at least 29 years). So think about the concerns we talked about earlier. Many people worry that there MAY be a bear market or correction during their retirement. If history is any guide, it's not a question of if, it's a question of when and how many, not a question of if. Let's take a minute to compare our concerns to what's happened in the last 30 years.
- Over the last 30 years, for example, you have witnessed [click - READ LIST]
- We can't predict exactly what will happen but it's likely that the next 30 years will include similar events.
- You'll notice that many of the things we are concerned about have happened in the not so distant past. So our question becomes how do we structure a retirement income plan that would have weathered the negative events of the past. This doesn't guarantee success but gives us a really good place to start.
- *IRS Publication 590



- Before we look at the chart please note that while I'm using the S&P 500 index to represent "the market" you can't actually invest directly in the index and I would never suggest that a retiree invest all their money in stocks - or any single asset class. When you build your actual retirement income portfolio, you'll want to consider mixing a variety of investments and carefully consider the fees, risk characteristics and potential returns associated with each one. Your financial professional can also help you understand the appropriate investment strategy for your unique circumstances, such as your financial needs, goals, and risk factors.
- With that said, here's what the past 30 years of the market looks like. You can see different periods of terrible market performance, great market performance, bad market performance and good market performance.
- One of the keys to a retirement income plan is to understand that you don't know what the market will do after you retire. Picture two hypothetical retirement dates. If you retired in 1988, you had many years of generally favorable market conditions. You would have been pretty happy with your timing and your chances of running out of money would be lower than usual because of lucky timing. Now picture retiring in late 1999 or early in 2000. You were immediately subjected to very negative market performance. Your chance of running out of money is much higher than someone who retired in 1988. All else being equal, you're much better off if you experience good market returns early in retirement and are much worse off if you experience poor markets early.
- So which will it be for you? Unfortunately, I can't tell you, no one can. So we need to look at what strategies would have helped past retirees. It's just like the pilot example from before - the right procedure doesn't guarantee a positive outcome but drawing on other's experience makes a positive outcome more likely.*
- *Source for the increased survivability of a retirement portfolio is: Decision Rules and Maximum Initial Withdrawal Rates; Guyton and Klingler, Journal of Financial Planning, 2006

Key planning questions

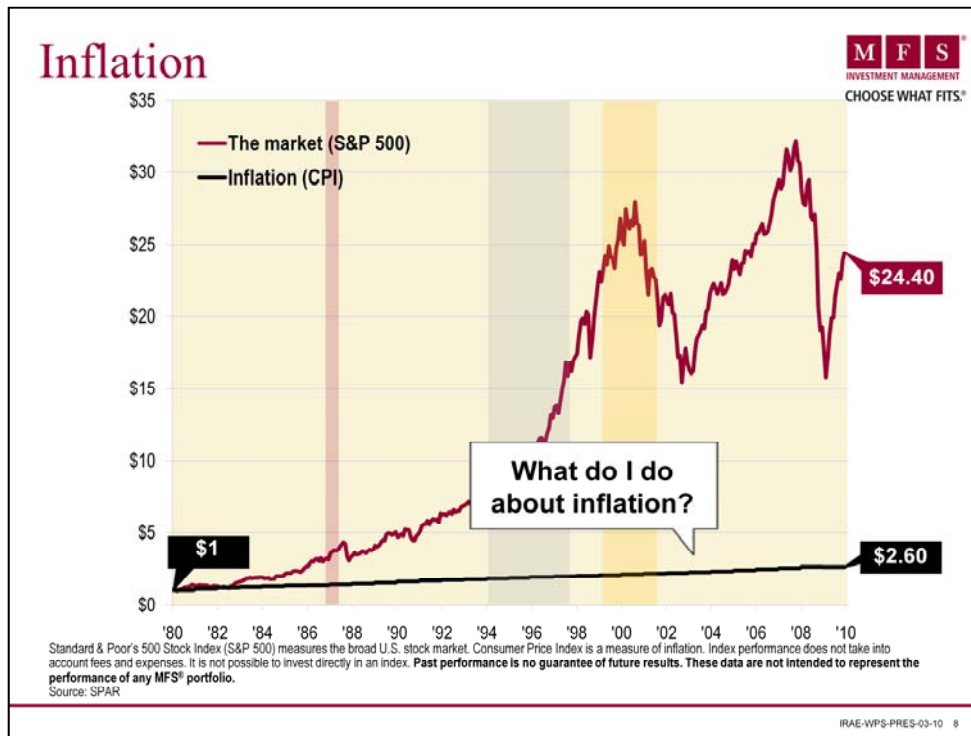


- What do I do about inflation?
- What happens if the market has a bad year?
- What happens if the market keeps going down?
- What happens when the market rallies?



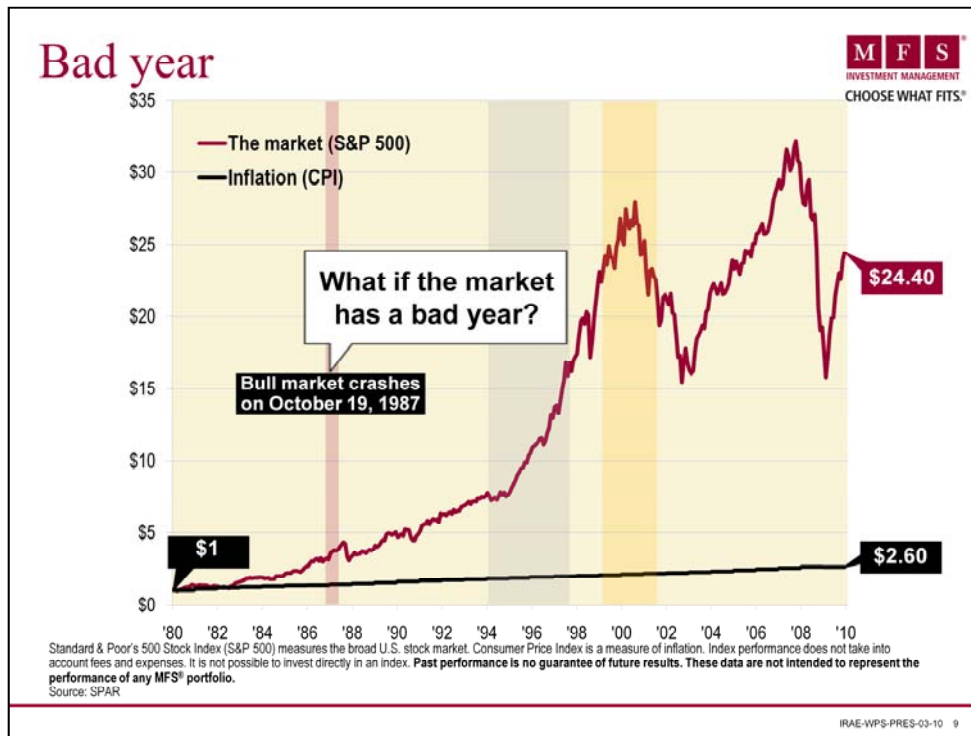
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- What do we need to prepare for in our plan?
[READ LIST]
- After you look at these questions I want you to think about your working life. If your company or business had a good year and you got a good bonus, you might spend a bit more. If the company had an average year, you just may get enough of an increase to meet inflation.
- Prolonged periods of difficulties would bring bigger adjustments to your family budget, and perhaps your income, and so on. What I am suggesting is to put that same structure in place for your retirement investments; that's all.
- We'll develop simple guidelines to address each of these questions.

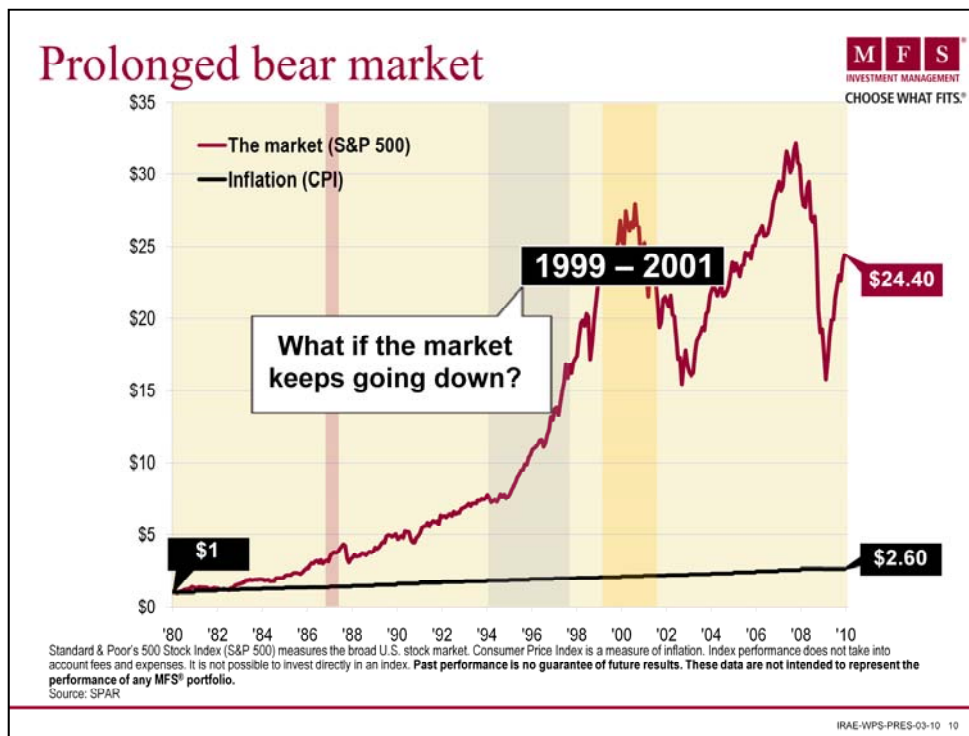


[FOCUS ATTENTION ON HANDOUT AND USE THE CHART TO EXPLAIN EACH SITUATION]

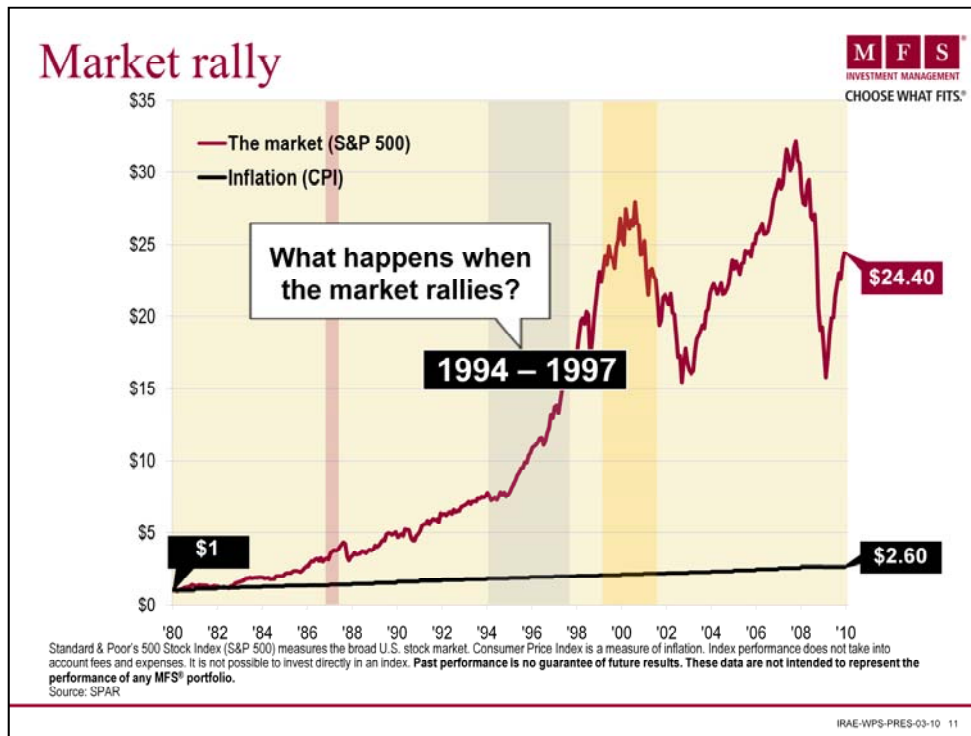
- Now let's look at the inflation line. As you can see, over the last 30 years, Inflation increased our costs - or the prices we paid for the things we need . So if your income doesn't increase, your real spending power is gradually going down.
- One way to handle inflation is to plan to increase your retirement income by the rate of inflation each year. So if your income is \$100,000 and inflation is 3% for the year, you would take \$103,000 in income for the next year.
- This leads to two more points:
 1. Investing too conservatively may mean less risk but also could make it difficult to keep up with inflation. The proper balance in your portfolio is something you need to work out with your financial professional.
 2. Increasing your income at the same time the market is going down may cause problems which leads us to.... (CLICK to next slide)



- What happens when your portfolio goes down? If we just mechanically increase withdrawals by inflation, you get a double hit in down years. Money coming out of the portfolio goes up at the same time that the portfolio goes down. This increases the likelihood that the portfolio will run out of money down the road – later in your retirement.
- One way to handle this is to “freeze” your income in years when the portfolio has a negative return. So if you took out \$100,000 this year and your portfolio went down, you’d take out \$100,000 next year as well.
- This may work well enough for the periodic “corrections” we have in the market. The periods when the market is down but recovers relatively quickly. But what do we do if the market keeps going down?



- Look at the 1999- 2001 period. This was a difficult time for all investors but it is even worse for retirees because they are taking money out of the portfolio at the same time the market is dropping. But they can't just stop withdrawals since they have bills to pay. Is there a way to maintain the portfolio while also paying the bills?
- Many people have "lean years" at some point in their working lives. For whatever reason their income goes down. What do most of us do? (wait for ideas) Right, most of us tighten our belts, spend a little less and ride it out. Studies show that the same strategy works for your retirement portfolio. Decreasing your withdrawals in multi-year downturns increases what we call "portfolio survivability" a fancy term for the probability that your income lasts as long as you need it.*
- Let's get a little more detailed and technical now because this is a very important topic. In situations like this many retirees ask "How do I know if I'm ok?" It's a reasonable question and deserves a good answer. Earlier we talked about your *Initial Withdrawal Rate* (IWR). It turns out that comparing your current withdrawal rate to your initial withdrawal rate is a good barometer of your portfolio's health.
- Let's assume that you and your financial professional had decided a 5% initial withdrawal rate met your needs and was sustainable based on your situation. Now your Financial Professional can calculate your current withdrawal rate (CWR) - if it is at or below your IWR, your portfolio is still statistically "healthy," meaning it has a good chance of lasting. Looking at market simulations and market history, a portfolio starts to run into trouble when the CWR is more than 20% above the IWR (as an example: 20% above a 5% IWR is 6%). So in a prolonged market downturn, one strategy is to cut this year's target income by 10% whenever your CWR is 20% above your IWR.
- Example: (note to presenter- you may want to walk through the calculation of IWR and CWR on a whiteboard or flipchart using sample income and portfolio value numbers- consider using numbers that are close to your audiences average income/asset levels to make it more tangible.)
 - IWR of 5%
 - CWR of 6.1%
 - This year's target withdrawal would normally increase to \$100,000 because of inflation
 - This year's withdrawal would be cut to \$90,000 because the CWR is too high
- **One thing I need to stress** - all the rules I'm using as examples are just that - examples. Since each investor is unique, I recommend that you meet with your financial professional one-on-one to develop a personalized plan. There is no such thing as a one size fits all retirement income plan. The withdrawal guidelines you and your financial professional decide to use could very well be different than my examples. Secondly, even the best retirement income plan is just that - a plan. If the plan indicates that \$100,000 is the appropriate withdrawal for this year and we end up taking out more, the risk of running out of money goes up
- Source: Decision Rules and portfolio management for retirees; journal of financial planning, 2004
- Source for the increased survivability of a retirement portfolio is: Decision Rules and Maximum Initial Withdrawal Rates; Guyton and Klinger, Journal of Financial Planning, 2006



- Our last market situation is a prolonged period of above average market performance. Research shows that a long period of good performance allows us to increase withdrawals by more than inflation. Whether you actually increase your withdrawals is an important decision to make with your financial professional. Some people consider *when* the outperformance happens when making the decision:
 - Let's assume it happens early in your retirement. You may want to just stay on track with regular inflation adjustments and forgo the "extra" increases. After all, if you only needed to take a certain amount, why increase it just because the market's going up.
 - On the other hand, let's assume the market has this period of outperformance after a nasty bear market that forced you to decrease your withdrawals. In this case you may want to increase your withdrawals by a little more than inflation to get closer to your initial target.

*“Am I ok?
What do I do now?”*



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- Am I ok? What do I do now?
- Let's go back to my pilot analogy. Once you have a written “procedure manual” you always have a place to turn if the market gets bumpy, or turbulent.... While you may not need to know how to recover from an airplane stall (if you're interested - you point the nose of the aircraft down until your angle of attack passes the critical angle- or at least that's what they tell me) you do need to know what to do when the market had a bad year. Especially since we know that in a typical retirement you'll face not one but at least several bad markets.
- Whether the market is up, down or sideways or inflation is high or low, the first step is to look at the plan. See what you and your financial professional decided would be an appropriate response. Many retirees find that this gives them a sense of relief. Knowing that we knew there would be market turmoil and thought through a response before anything happened gives them control: puts them in the pilot's seat, not the passenger's seat.
- **One thing I need to stress-** no matter how good your plan- a plan can not guarantee that your portfolio will last as long as you need it. That's one of the reasons I recommend an annual review of your income needs, your portfolio, and your plan. That allows you and your financial professional an opportunity to adjust your plan to current conditions.

A common sense approach to retirement



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- Thank you very much for your time.