



CORNERSTONE
Investment Services, LLC

Cornerstone Investment Services LLC Money Managers

RETIREMENT PLANNING

Be Prepared, Not Surprised!

If you were told you need \$1 million for a comfortable retirement, what would you say? How about if you were told you needed \$10 million?

Retirement is inevitable. Planning won't change it. You either have a plan or not and it is either going to work or not and it may have nothing to do with the plan.



You may have a plan that shows you need to save \$2,000/month for the next 20 years to have enough to retire on. What if you can't do that? What if all you can save is \$200/month? Then that is what you do. Saving something is better than saving nothing.

We look at retirement differently than most financial planners. Many plans view the retirement period as the distribution phase of your retirement. They set up your assets so that a fixed amount is distributed annually. And many times, the income distribution includes a dispersal of principal. They design the plans so that your assets run out by age 85, 90 or 95.

I don't know about you, but I have yet to meet a retiree that wants to spend their principal. In fact, that is usually the first thing they ask, "we won't be dipping into the principal will we?" This is because they know that they are going to need it at some time in the future. Maybe they are going to need an extra \$25,000 one year to buy a new car, or an extra \$15,000 for a new roof or \$10,000 to bail the rotten son-in-law out of jail. Something always comes up. So the last thing a retiree should do is be involved in any investment scheme that produces a fixed income with no access to the principal.

But that is getting ahead of ourselves. We "back into" our calculations for a retiree. First we want to know their expenses. (All of them, the gifts to the grandkids, the Friday night parties with the neighbors, the lunches out with the girls...) Then we look at the sources of income. Maybe Social Security will generate \$25,000 annually. Maybe they have dividend income from their investments of \$5,000.

If their expenses come to \$60,000, they need \$30,000 more, not counting taxes. Include taxes and you can bump the income needed up to maybe \$45,000. This income is going to have to come from their investments. Since the \$5,000 dividend income also comes from the investments, they have a total of \$50,000 coming from investment income.

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C o r n e r s t o n e I n v e s t m e n t S e r v i c e s L L C M o n e y M a n a g e r s

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We use current interest rates to determine what is a “safe” investment income return. Today, we believe 5% is relatively safe. Go for more and you can hurt future income and principal growth. Once interest rates are higher, and then declining, the amount of income that can be earned safely rises. Maybe 7%, 8%. It all depends on the environment.

Since we feel 5% is the current “safe” income number, and the retiree in question needs \$50,000 of income, we can easily see that the investor needs \$1,000,000 of assets. (\$1,000,000 times 5% equals \$50,000) That is today. Tomorrow is a different story.

Lets say you currently are 30 years old. You have \$75,000 in annual expenses. You calculate that when you are retired, you won't have certain expenses like a mortgage. Maybe your expenses will drop to \$60,000 annually, in today's dollars.

Now lets apply inflation to this number, over the next 35 years. At 4% annual inflation, your income need grows to \$227,000. At 5% it grows to \$315,000 annually. I don't know about you, but when I see numbers like those I at first don't believe them and then don't believe it will really happen. (Check with history, according to government statistics, 4% average annual inflation is a good estimate.)

But you haven't seen anything yet. In order to generate that kind of income, you are going to need \$10 million to generate \$500,000 of income at 5% (pre-tax) After tax, you will have somewhere around \$300,000, depending on the brackets in 35 years.

We don't even think about Social Security for a 30 year old. If it is there – great, but we aren't planning on it!

So if you are 30 and want to give up, we don't blame you. It looks too big. There is no way you are going to have \$10 million in 35 years. At least it doesn't look that way today.

Regardless of what the future income need is, regardless of

what the future principal projection is, the most anybody can do is save the most they can. It could be \$200/month or \$2,000/month. You do what you can.

A simple planning technique is to take your expenses away from your after tax income and invest the difference. Is it possible to invest any more than that? No - so regardless of what some crazy projection says, that is what you do. (And max out your company 401k, especially if they match.)

What you invest in is the most important variable. You can save all you want, but if your investments stink, you won't hit your target. This is where you need to talk to a professional. Money management isn't just about making money, it is also about keeping losses minimized. Good management manages risk first. A good investment strategy will take care of the upside.

We are not downplaying the importance of going through the exercise of retirement planning. It is an important step for a successful investment portfolio. But we don't believe in getting so wound up about the numbers that you either bury your head or deny yourself everything to save every penny you can.

Diversification does not ensure a profit or guarantee against a loss. There is no assurance that any investment strategy will be successful. Investing involves risk and you may incur a profit or a loss.

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