ADVISOR CONSULTING

Meeting Retirement Income Needs:

In Defense of More Growth

MEEDER

4.1 MILLION

There are 11,200 Americans who will turn 65 every day—over 4.1 million every year—from 2024 through 2027. They represent the first generation to rely on private savings versus pensions for retirement income.

SOURCE: Retirement Income Institute at the Alliance for Lifetime Income

The Search for More Income

The Baby Boom peaked in 1960, meaning millions of Americans will turn 65 before 2030. The recent economy has not been kind to pre-retirees and Boomers who have already retired. Traditional retirement investment models have been distorted by stock market volatility, growing debt, and rising inflation. The three-legged retirement stool—Social Security benefits, private pensions, and savings accounts—is no longer sturdy, wobbling investor confidence in the "comfortable American retirement dream."

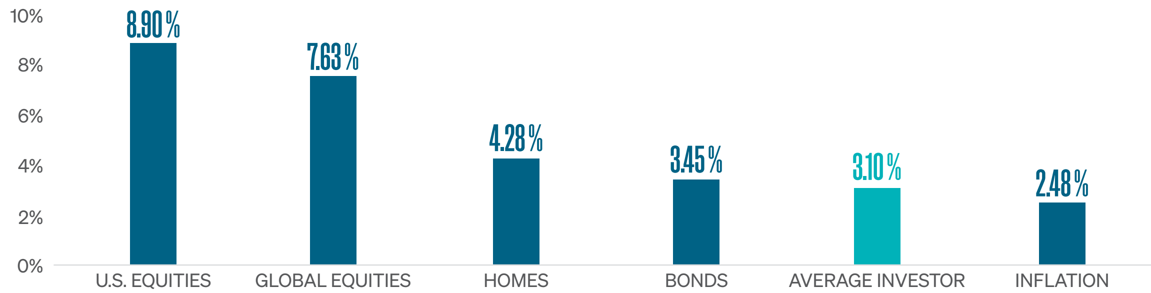
Baby Boomers are now seeking different ways to secure more income in retirement from what they had originally planned. The "mad scramble is on" as advisors look for new creative ways to help these clients find sustainable retirement income-generation options.

Panicked investors lost approximately one-fifth of their account balances during 2022. Equity investors lost 21.17% during the year against an S&P 500 equity index that lost 18.11%, representing an investor gap of 3.06%.[1] Seeking to avoid further losses in weakened markets, investors pulled investments from their traditional and retirement accounts in various forms of poorly executed market timing. Had they only recognized that markets generally reward longer-term investors, they could have participated in the 2023 recovery. They missed out—sold low and bought high.

EXHIBIT 1

AVERAGE INVESTOR – PAST 20 YEARS

2003–2022 Annualized Returns



SOURCE: MORNINGSTAR DIRECT; BLOOMBERG; INFORMA INVESTMENT SOLUTIONS; DALBAR. A CORRELATION OF 10 REPRESENTS A PERFECT CORRELATION WITH THE INDEX.

Past performance is no guarantee of future results. It is not possible to directly invest in an index. U.S. Equities are represented by the S&P 500 Index TR. Global Equities are represented by the MSCI ACW Index. Bonds are represented by the Bloomberg Barclays Aggregate Bond Index. Homes are represented by S&P CoreLogic Case-Shiller US National Home Price Index. Average Investor is represented by Dalbar's average asset allocation investor return, which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/21 to match Dalbar's most recent analysis. Inflation is represented by the Consumer Price Index NSA.

Compared to the returns of major asset classes, the average investor does not fare so well, primarily due to being led by emotions. In fact, over the 20-year period from 2003–2022, the average asset allocation investor had returns of 3.10%—barely keeping pace with inflation.

Interestingly, investors continue to use the same old risk and investment allocation models for retirement that have been employed for years, even with the realization that these models have been damaged by the hailstorm of recent economic and market events. Today's retirees are living longer than prior generations and require a sustainable income stream that will last as long as they do. This factor does not sync with traditional models of the typical retirement timeline. A new way of looking at investment risk and longevity is needed to meet their expectations.

Fortunately for investors and their advisors, there are updated and nuanced models for retirement income that require more of the expertise that professional investment advisors bring to the client relationship and are difficult to emulate using Do-It-Yourself (DIY) models and tools. These newer strategies require active investment monitoring and dynamic, tactical shifts in asset allocation. Baby Boomers who made classic market-timing mistakes in recent years could benefit from engaging advisors who offer steady assurance during times of market turbulence and who demonstrate more positive outcomes by holding equities longer into the retirement timeline than traditionally believed prudent.

[1] Quantitative Analysis of Investor Behavior Report (QAIB), DALBAR, March 2023

The Need for More Financial Advice

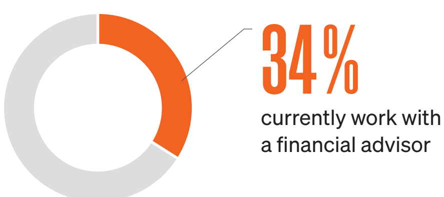
The number of DIY retirement asset allocation tools available to investors mushroomed with advancing technology. These tools facilitated a shift away from traditional advisors, conceivably leaving advisors with more time and attention for higher-net-worth clients. While DIY investors became more comfortable with their abilities to use these tools during market upswings, the recent downturn sent them considering a return to investment advisors for advice and guidance. With 22 million new Baby Boomer retirees—10,000/day for the next six years—there is a distinct opportunity for advisors to open their services to more clients with the help of more scalable offerings.

A recent study from the Employee Benefit Research Institute (ERBI) found that only one-third of workers, and 4 in 10 retirees, say they use a personal financial advisor for retirement planning information and advice. Coupling that with a recent Goldman Sachs finding that 95% of working individuals believed receiving financial help is important to successfully manage their retirement savings[2] leaves a huge opportunity for advisors today.

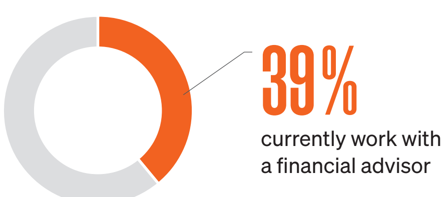
EXHIBIT 2

DO YOU CURRENTLY WORK WITH A PROFESSIONAL FINANCIAL ADVISOR?

Workers n = 1,320



Retirees n = 1,217

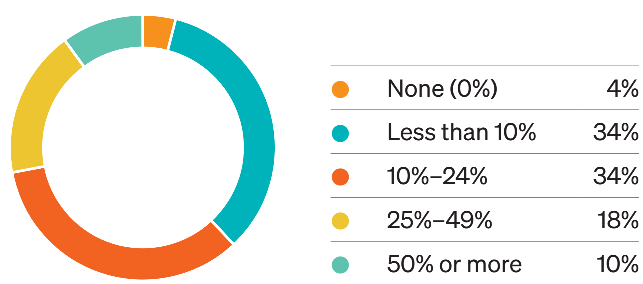


SOURCE: EMPLOYEE BENEFIT RESEARCH INSTITUTE (ERBI) 2023 RETIREMENT CONFIDENCE SURVEY

Investors looking to use considerably more of their principal to meet their retirement income needs are rightly seeking the wisdom of advisors. Advisors reported how many of their investors turned to leveraging more of their principal as a source of retirement income. Fully one-third (34%) of advisors said that between 10% and 24% of their clients draw down principal to generate retirement income, while more than one-quarter (28%) of advisors shared that 25% to more than 50% used principal to generate retirement income.

EXHIBIT 3

PERCENTAGE OF CLIENTS WHO DRAW DOWN PRINCIPAL TO GENERATE RETIREMENT INCOME



SOURCE: FUSE RESEARCH NETWORK, WEALTHMANAGEMENT.COM, 2021

[2] Goldman Sachs Retirement Survey and Insights Report 2022, Navigating the Financial Vortex: From Retirement Readiness to Retirement Income, p. 17.

Traditional asset allocation retirement models made conservative assumptions about an investor's longevity, income needs, and market returns. Today, investors are living longer. In 2000, the U.S. life expectancy was 76.75 years. By 2030, it is estimated that the average person will live to 80.28—a 4.6% increase. How have retirement models accounted for this increase?

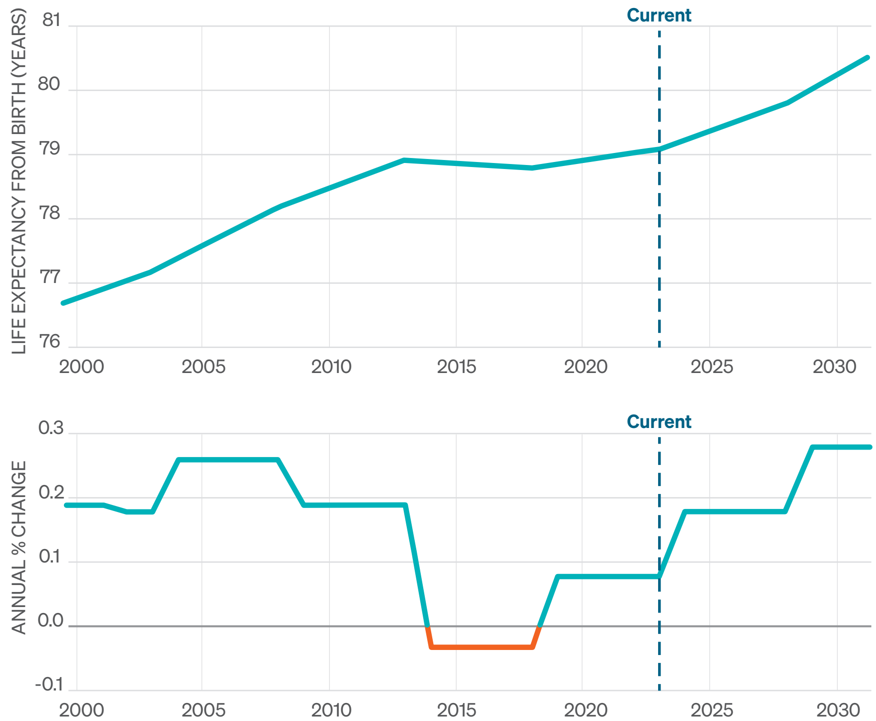
Retirement income assessments must cover a longer period of time—amplified by inflationary pressures and higher interest rates—and should be adjusted to meet retirees' realistic income needs. Market volatility further complicates income planning.

In 2021, 82% of advisors rightly predicted that retirement income planning would make up a larger proportion of their practice over the next two years.[3] That year, investment advisors were already significantly focused on retirement income planning, taking up an average of 42% of their time—with more than one-fifth (22%) of advisors stating that it consumes more than 60% of their time.

Given the expected increase in the number of retirees over the next few years and the challenging experience DIY pre-retirees have had over the past few years, advisors' time allocations for retirement income planning will likely increase. To better gauge advisor time and energy expenditure requirements, it is helpful to quantify and qualify retiree concerns and trends.

EXHIBIT 4

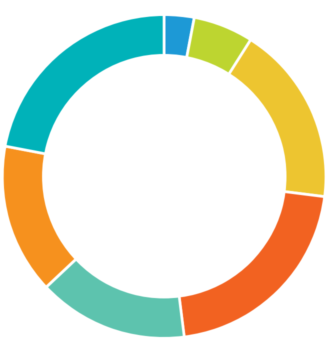
U.S. LIFE EXPECTANCY, 2000–2030



SOURCE: HTTPS://WWW.MACROTRENDS.NET/COUNTRIES/USA/UNITED-STATES/LIFE-EXPECTANCY, 2000, 2030 (ESTIMATED); DATA SOURCE: UNITED NATIONS – WORLD POPULATION PROSPECTS

EXHIBIT 5

AMOUNT OF TIME SPENT ON RETIREMENT INCOME PLANNING



Less than 10%	3%
10%–19%	6%
20%–29%	18%
30%–39%	21%
40%–49%	15%
50%–59%	15%
60% or more	22%

SOURCE: FUSE RESEARCH NETWORK, WEALTHMANAGEMENT.COM, 2021

[3] FUSE Retirement Income Update Part II, June 28, 2021, p. 2.

Investor Concerns and Current Trends Point Toward Need for More Income

According to Fidelity's analysts, retirement account balances in 401(k) plans lost nearly one-quarter of their value in 2022. Retirees' confidence in their ability to generate sustainable income in retirement generally fluctuates with the markets, but the past two decades have been particularly volatile.

EXHIBIT 6

AVERAGE RETIREMENT ACCOUNT BALANCES IN THE U.S. FELL AT THE END OF 2022

Year-over-year percent change in the fourth quarter

	Q4 2022	Q4 2021	% CHANGE
Average IRA	$104,000	$130,700	-20%
Average 401(k)	$103,900	$135,600	-23%
Average 403(B)	$92,683	$115,100	-19%

SOURCE: HTTPS://WWW.CNBC.COM/2023/02/23/401K-RETIREMENT-SAVINGS-ACCOUNT-BALANCES-SANK-IN-2022-FIDELITY-SAYS.HTML

Small ups and downs in the market over time are tolerable, but the bigger swings on the roller coaster of market activity often leave investors needing a seatbelt, strong stomach muscles, and—in the end—feeling a bit sick. In 2023, both workers' (64%) and retirees' (73%) confidence dropped significantly, returning to 2018 levels. The last time confidence declined this much was in 2008 during the global financial crisis, based on findings from EBRI's 2023 Retirement Confidence Survey.

Their lack of confidence is not unfounded. With each noteworthy market downturn, Baby Boomers and retirees feel the pinch, worrying more about the "absolute value" of their financial futures. They ask their advisors:

» "How much should I spend (with prices rising?)"

» "How much income can I withdraw (with markets down and/or volatile?)"

» "How long will my savings last (with increased spending needs in the future?)"

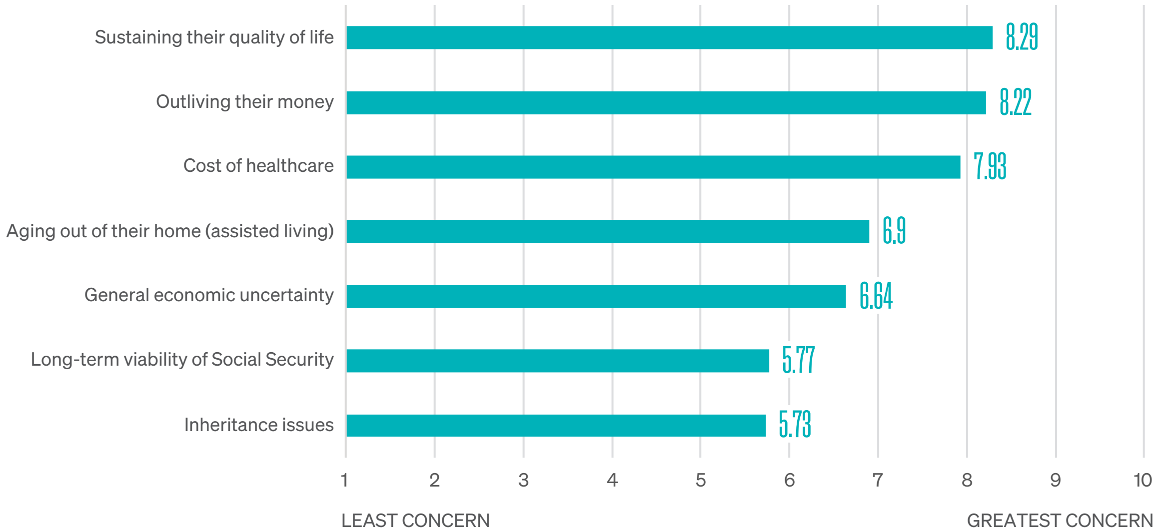
Consumer prices are rising substantially faster than income, and their purchasing power is eroding. Gasoline is up over $7.00 in some locations, while consumer food staples such as eggs, milk, bread, and meat have doubled and even tripled from prices three years ago. According to EBRI, four in 10 retirees who do not feel confident state that it is due to inflation, and 73% of workers and 58% of retirees are concerned they will have to make substantial cuts to their spending due to inflation.

Advisors shared their clients' retirement-related anxieties in a FUSE/wealthmanagement.com survey. Pre-retirees and those already in their retirement years especially worry about so-called "longevity issues," namely the ability to sustain their current quality of life, outlive their assets, and reside in their own homes as they age. What was a reasonable outlook just 20 years ago has become a source of significant investor distress today.

EXHIBIT 7

ADVISOR RATING OF CLIENTS' RETIREMENT CONCERNS

Note: Scale of 1-10, with 10 being of greatest concern.



SOURCE: FUSE RESEARCH NETWORK, WEALTHMANAGEMENT.COM, 2019

They also have concerns about the rising costs of healthcare, and the impact of premiums and healthcare bills on retirement income. Recent estimates show that in order to have a 90% percent chance of meeting their healthcare spending needs in retirement, a man will need to have saved $166,000, and a woman will need to have saved $197,000. Couples enrolled in a Medigap plan with average premiums, meanwhile, will need to have saved $212,000 for a 50% chance of covering their medical expenditures in retirement, and $318,000 to have a 90% chance.[4] The nightmare scenario of being unable to afford healthcare solutions in their later years is very real and cause for investor alarm, pointing to the need for more immediate solutions.

Adding insult to injury, the Social Security Administration recently indicated that current retirement benefits replace only 40% of pre-retirement income. Therefore, investors must have additional income sources to bolster this leg of the retirement stool. Potential Social Security funding shortfalls have led to proposals to make cuts to the Social Security Program,[5] which has investors even more troubled.

Compounding all these worries is mounting debt: total household debt rose by $16 billion, reaching $17.06 trillion in 2Q23, according to the latest Quarterly Report on Household Debt and Credit. The same report found that credit card balances saw brisk growth, rising by $45 billion to a series high of $1.03 trillion. All this, and middle-class income taxes are on the rise, taking more out of consumers' wallets. More than ever before, U.S. investors are finding themselves struggling to pay off debt, let alone save for retirement. The old financial planning mantra, "Pay Yourself First" has morphed into "Pay Off Your Debt First," which makes retirement income planning exponentially more difficult for investors and their advisors.

Bleak as the data may appear, and given all the economic obstacles, advisors and their clients do have alternatives to traditional investment models to optimize the potential for retirement income.

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[4] https://www.ebri.org/retirement/publications/issue-briefs/content/projected-savings-medicare-beneficiaries-need-for-health-expenses-remained-high-in-2022

[5] https://www.gobankingrates.com/retirement/social-security/major-cuts-to-social-security-are-back-on-the-table-whats-being-proposed-now/

Optimizing Retirement Income

Traditional models for retirement income planning are insufficient for today's investor needs. Retirement income planning requires a new approach to the traditional processes and products. For the last three decades, investors relied heavily on debt securities to position their portfolios for sustainable retirement income. Today's yields are considerably lower, making them less sustainable for predictable income.

Traditional assumptions have been disproven, and correlations have become less foreseeable. Fixed-income markets were generally considered inversely correlated to the equity markets, but 2022's market anomaly demonstrated differently. Investors learned that fixed-income, while diversifying a traditional asset portfolio, was not nearly the "guaranteed" solution necessary to combat equity market downturns and longevity risk.

Equity markets, on the other hand, have historically garnered higher average returns when compared with fixed-income returns over time. Higher returns can potentially reduce longevity risk, provided no significant principal drawdowns exist.

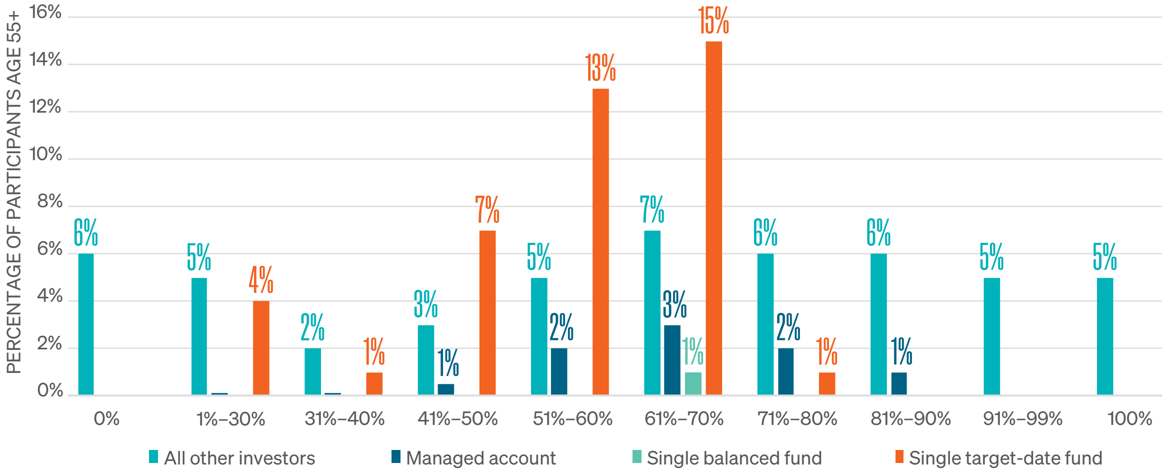
Even if the correlation between equities and fixed-income were to remain positive over the next 20 years, investors may experience a period where an equity/fixed-income combination provides little performance risk diversification.

When considering a retirement timeline, conventional wisdom includes considering at least two phases: Accumulation and Distribution. Some advisors also consider a separate and distinct middle-ground Preservation phase, where investors throttle back on various risks to the portfolio to meet the objectives of the Distribution phase. Others integrate specific risk-lowering investment strategies toward the end of the Accumulation phase and the beginning of the Distribution phase. Regardless, during this "Preservation" period, investors have historically shifted their exposures to underweight equity and overweight fixed-income.

EXHIBIT 8

DISTRIBUTION OF EQUITY EXPOSURE BY OLDER PARTICIPANTS, 2022

Vanguard defined contribution plan participants age 55+



	ALL OTHER INVESTORS	MANAGED ACCOUNT	SINGLE BALANCED FUND	SINGLE TARGET-DATE FUND
Percentage of population	50%	9%	<1%	41%
Average balance	$324,636	$240,076	$167,424	$76,965
Median balance	$152,414	$126,071	$62,576	$20,683

SOURCE: VANGUARD, HOW AMERICA SAVES 2023

The factors influencing age-related equity exposure in defined contribution plans are changed in 2023. In its How America Saves 2023, Vanguard found that on the one hand, existing participants make few changes in their allocations as they grow older because of inertia in financial decision-making. On the other hand, the growing use of professionally managed allocations is contributing to a sharper delineation of equity risk-taking by age. Older participants who were preparing for or already in retirement were most likely to construct their own portfolio in 2022.

Vanguard's 2023 report noted that 50% of participants 55 or older created their own allocations, with 4 in 10 using a single target-date fund and 9% using a managed account program. While older participants with professionally managed allocations had equity exposure between 40% and 80%, those who constructed their own portfolio had a wide dispersion of equity allocations, which were evenly distributed from 0% to 100%. These participants also had the highest balances.

That approach in today's economy may still not yield the degree of retirement income necessary to meet investors' needs. Equity returns are what is needed, but as the desired withdrawal rates increase, the total amount of future spending needs also rises. **Exhibit 9** illustrates three different distribution rates from a $1,000,000 portfolio. Withdrawals in years 2–30 are increased by 2.5% annually to account for increases in the cost of living, otherwise known as inflation. At the bottom of the table are the sums of future spending needs.

EXHIBIT 9

INCOME DISTRIBUTION FROM A $1M PORTFOLIO

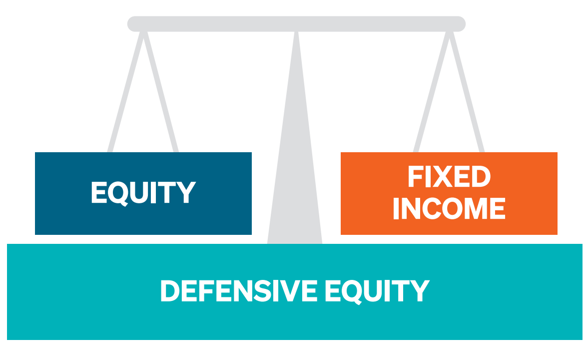
YEAR	2% WITHDRAWAL	4% WITHDRAWAL	6% WITHDRAWAL
1	$20,000.00	$40,000.00	$60,000.00
10	$24,977.26	$49,954.52	$74,931.78
20	$31,973.00	$63,946.01	$95,919.01
30	$40,928.15	$81,856.30	$122,784.44
Total	**$117,878.41**	**$235,756.83**	**$353,635.23**

SOURCE: DATA BASED ON MEEDER INVESTMENT MANAGEMENT INVESTMENT TEAM CALCULATIONS.

Advisors are challenged to balance the client's desires to protect their assets in the Preservation and Distribution phases with their actual income needs. Ultimately, more equity growth is necessary to optimize retirement income in today's economic environment. Adding more equity to a retirement portfolio during the Preservation period allows a retiree greater potential upside, which may result in a larger legacy or additional spending flexibility over time. Drawdown risk and the fear of holding significant equity positions as a retiree approaches retirement remain, but the investor would have the benefit of longer-term equity market participation. This approach is known as a "Defensive Equity" strategy. The goal of Defensive Equity is to capture the upside of equity returns while reducing volatility and downside risk.

No retiree wants to hold a significant equity position and run headlong into another financial crisis such as we experienced in 2007 and 2008. A Defensive Equity total return strategy creates the flexibility to more quickly move assets from equities to cash or fixed-income as dictated by market risk. By using this nimbler strategy, the portfolio better meets longevity expectations, so that the portfolio is positioned to seek current income while maintaining its prospects for capital appreciation.

Defensive Equity strategies are typically unconstrained tactical investments that can shift from equity securities to cash or fixed-income securities when the risk/reward relationship of the stock market is deemed unfavorable. When used as part of a portfolio to generate income, the versatility of Defensive Equity strategies allows the opportunity for greater equity exposure, while maintaining the flexibility to reduce equity exposure to protect against market declines should conditions change.



Looking Beyond Traditional Retirement Income Models

Traditional retirement income models should be sidelined in the current economic environment. Investors looking for sustainable retirement income need longer-term, harder-hitting strategies for their portfolios. To achieve this, they will increasingly need more professional advice and guidance. Advisors have an opportunity to educate and meet client needs with a different retirement income model: Defensive Equity strategies that hold positions longer into the Preservation period and Distribution phase and/or build in flexibility to actively shift allocations and hedge positions.

Advisors understand how holding on to equities through market turbulence makes sense and should now have an easier time educating clients about this approach. Investors who held their equity allocations through 2022 into 2023 saw the evidence: the number of people with at least $1 million in their Fidelity 401(k) accounts grew about 25% as of June 30, 2023, which coincides with the S&P 500's 16.71% surge, including dividends, since January 1, 2023. The Bloomberg U.S. Aggregate bond index, meanwhile, was up 0.31%.[6]

Today's retirement income portfolios require the flexibility of Defensive Equity strategies to shift asset allocation weightings when changes in the risk environment occur. This could yield a longer runway for income production.

Talking Baby Boomer clients through market turbulence, reassessing income needs and goals, resetting asset allocation retirement strategies, and taking a longer-term view of equity positions should result in more positive outcomes and satisfy client expectations.

[6] https://www.wsj.com/personal-finance/retirement/stock-market-rally-makes-more-401-k-savers-millionaires-30040838

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