

## KANAWHA CURRENTS

### Don't Risk Running Out

#### This Quarter's Highlights

Retirement Spending Policy and Run-Out Risk

Expiring Tax Provisions

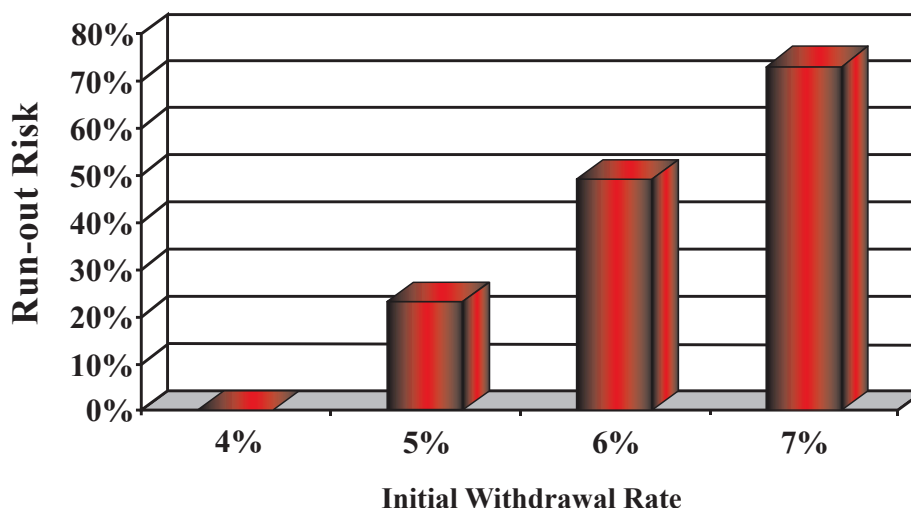
2012 Important Financial Data

It's no secret that recent stock market returns have impacted retirement spending policy. Historically low returns coupled with rising living expenses have put a strain on retirement *Spending Rates* – annual withdrawals relative to portfolio values.

There has been no shortage of research devoted to better understanding how much retirees can reasonably take from their savings and expect their portfolios to survive them. The general rule of thumb is that a 4% Initial Withdrawal Rate (IWR) is sustainable. That is, an investor should be able to withdraw 4% of his or her portfolio in year one of retirement and then increase that amount annually by inflation without entirely depleting savings.

Numerous studies have supported the so called 4% rule. However, we recently completed our own analysis to assess how IWRs between 4% and 7% affect *Run-out Risk* – the chance of one running out of money during retirement. Using stock and bond returns going back to 1926, we looked at how often retirees would have wound their assets down to zero assuming 30-year time frames.

**Run-out Risk for Initial Withdrawal Rates  
(50% Stocks & 50% Bonds)**



## Research Results

The results support the notion that a 4% IWR has very low Run-out Risk. Increasing the IWR to 5% and beyond, however, paints a different picture. Using withdrawal rates of 5%, 6%, and 7%, Run-out Risk increased to 23%, 49%, and 73% respectively. Clearly, as investors exert more withdrawal stress on their portfolios, the odds of them prematurely depleting their savings increases.

Like most of the research in this area, our analysis sets the withdrawal percentage only during the first year and then increases the withdrawal dollar amount by an inflation factor in subsequent years. It is important, however, for savers to monitor their withdrawal amounts relative to the underlying portfolio value on a regular basis.

### For Example

Take John and Jane Doe, for example. Let's assume they both retired at the age of 62 in the beginning of 2000 and needed a pre-tax amount of \$60,000 from their \$1.4 million portfolio. This represented an IWR of approximately 4.3%. Fast forward to the end of 2011 and, assuming the Doe's portfolio was indexed to a 60%-stock, 40%-bond portfolio, it would be worth approximately \$985,000. Let's also assume their spending need from investment assets has increased with actual inflation to approximately \$80,500. Now their current withdrawal rate stands at 8.2%. This represents a 91% increase in their withdrawal rate since they retired a dozen years ago. Under this scenario, questions emerge as to the likelihood the portfolio will be able to withstand the test of time and meet future spending needs.

So what can investors and retirees do if they notice a potentially unsustainable rate of withdrawal from

their portfolios? As with most difficult questions, there are no easy answers. The most effective way to avoid or resolve an imbalance is through a set of *Decision Rules*. For example, let's continue to assume a retiree increases withdrawals each year by the amount of the preceding year's Consumer Price Inflation rate.

One rule might state the annual withdrawal increase be capped at a certain percentage, say 5%. A second rule may freeze the withdrawal amount in years following negative investment returns for the portfolio. Lastly, a third rule may state that if the current year's withdrawal rate is more than 20 or 30% greater than the IWR, then the withdrawal amount is actually reduced by some percentage, say 10%. This lower amount will then serve as the basis for future withdrawals. These rules are designed to address higher-than-expected rates of inflation and drawdown risk.

### Conclusion

In conclusion, while there is much debate on a feasible and sustainable withdrawal rate in retirement, there is no such thing as a "one size fits all" spending policy. Certain rules of thumb may offer good beginning points for discussion, but each retiree's situation is unique. Some investors will experience a retirement in which spending is fairly consistent in inflation-adjusted terms throughout their retirement years. Others may experience higher spending in the early years to fund their active retirement phase, while others may find their overall expenses rising faster than ordinary inflation due to rapidly increasing healthcare costs. Nonetheless, having a plan in place that defines one's spending policy and monitors changes over time can help alleviate stress and reduce surprises during retirement.

Analysis of Run-out Risk is based on historical total return data using a looping time-path approach. Stock returns are based on Ibbotson Associates Large Company Stock Index 1926-2002, S&P 500 2003-2011. Bond returns are based on Ibbotson Intermediate Government Bond Index 1926-2002, Barclays Capital Government/Credit Intermediate Index 2003-2011. Index returns do not reflect the cost of fees, taxes, or transaction costs. Historical returns should not be used as an indication of expected future results. The results of this analysis should not be interpreted as advice.

## Expiring Tax Provisions

As individuals prepare their 2011 tax returns, here are several important tax provisions which expired at the end of last year or are due to terminate at the end of 2012.

### Expired on December 31, 2011:

- The Alternative Minimum Tax “Patch.” If legislation is not adopted by the end of 2012 to address this, millions more taxpayers may be subject to the AMT as the exemption amounts revert to lower limits.
- The provision allowing IRA owners age 70½ and older to make tax-free distributions directly to qualified charities. As with other provisions, this could potentially be extended retroactively prior to year-end by Congress.
- The ability to deduct state and local general sales taxes in lieu of state and local income taxes expired in 2011.

### Due to Expire on December 31, 2012:

- The individual income tax rates of 10%, 15%, 25%, 28%, 33%, and 35% as well as the 15% rate on long-term capital gains and qualified dividends (0% for those in the 10% and 15% tax brackets). These lower rates were extended for two more years in December of 2010, but are scheduled to revert to pre-2001 levels beginning in 2013 without any new legislation.
- The repeal of the itemized deduction and personal exemption phaseouts for high-income taxpayers.
- The estate and gift tax exemption amount of \$5 million (\$5.12 million in 2012) and the maximum estate and gift tax rate of 35%. Also due to expire at year-end absent further legislation are portability rules for surviving spouses.
- The extension of the payroll tax cut from the 6.2% to 4.2% rate for the employee’s Social Security portion has recently been extended through December 31, 2012.

These are just a few of the many expiring federal tax provisions for 2011 and 2012.

For other important 2012 tax rates and annual limitations, please refer to the **2012 Important Financial Data** sheet on the following page.

Source: Joint Committee on Taxation, *“List of Expiring Tax Provisions 2011-2022.”*

This is for informational purposes only and should not be interpreted as tax advice.  
Consult your tax professional for specific advice about your personal situation.

## 2012 Important Financial Data

## 2012 Tax Rate Schedule

Taxable Income	Marginal Rate
<b>Single</b>	
\$0 to \$8,700	10%
\$8,701 to \$35,350	15%
\$35,351 to \$85,650	25%
\$85,651 to \$178,650	28%
\$178,651 to \$388,350	33%
\$388,351 +	35%
<b>Married Filing Jointly &amp; Surviving Spouse</b>	
\$0 to \$17,400	10%
\$17,401 to \$70,700	15%
\$70,701 to \$142,700	25%
\$142,701 to \$217,450	28%
\$217,451 to \$388,350	33%
\$388,351 +	35%
<b>Head of Household</b>	
\$0 to \$12,400	10%
\$12,401 to \$47,350	15%
\$47,351 to \$122,300	25%
\$122,301 to \$198,050	28%
\$198,051 to \$388,350	33%
\$388,351 +	35%
<b>Married Filing Separately</b>	
\$0 to \$8,700	10%
\$8,701 to \$35,350	15%
\$35,351 to \$71,350	25%
\$71,351 to \$108,725	28%
\$108,726 to \$194,175	33%
\$194,176 +	35%
<b>Estates and Trusts</b>	
\$0 to \$2,400	15%
\$2,401 to \$5,600	25%
\$5,601 to \$8,500	28%
\$8,501 to \$11,650	33%
\$11,651 +	35%

## Estate and Gift Tax

Annual gift tax exclusion	\$13,000
Estate and gift tax exclusion	\$5,120,000
Maximum estate tax	35%

## Capital Gains Tax Rates

Short-term (held 1 year or less)	Same as ordinary income
Long-term (held > 1 year):	
For taxpayers in 10% and 15% brackets	0%
For taxpayers in 25%, 28%, 33%, and 35% brackets	15%
Unrecaptured gains on Section 1250 property	25%
Collectibles	28%

## Qualified Dividend Income Tax Rates

For taxpayers in 10% and 15% brackets	0%
For taxpayers in 25%, 28%, 33%, and 35% brackets	15%

## Income Tax Deductions and Exemptions

<b>Standard Deduction</b>	
Single	\$5,950
Married filing jointly	\$11,900
Head of household	\$8,700
<b>Over age 65 or blind additional standard deduction</b>	
Married or surviving spouse	\$1,150
Single or not a surviving spouse	\$1,450
<i>There is no itemized deduction phaseout for 2012.</i>	
Personal exemption	\$3,800
<i>There is no personal exemption phaseout for 2012.</i>	

## Retirement Plan Contribution Limits

401(k), 403(b), 457 plans elective deferrals	\$17,000
Catch-up contributions for 50 and older	\$5,500
Defined contribution plans	\$50,000
Defined benefit plans	\$200,000
SIMPLE plans elective deferrals	\$11,500
Catch-up contributions for 50 and older	\$2,500
Traditional and Roth IRA	\$5,000
Catch-up contributions for 50 and older	\$1,000
Traditional IRA deductibility for active participants	Phaseout Limits:
Single	\$58,000 to \$68,000
Joint	\$92,000 to \$112,000
Spousal IRA if one spouse is covered by a plan	\$173,000 to \$183,000
Married filing separately	\$0 to \$10,000
Roth IRA income phaseout	
Single	\$110,000 to \$125,000
Joint	\$173,000 to \$183,000
Married filing separately	\$0 to \$10,000

## Medicare

## Part A Hospitalization

First 60 days inpatient deductible	\$1,156
Days 61 - 90	\$289 per day
Days 91 +	\$578 per day

## Part B Premium

MAGI Single	MAGI Joint	Part B Monthly Premium	Part D Increase
\$85,000 or less	\$170,000 or less	\$99.90	\$0
\$85,001 to \$107,000	\$170,001 to \$214,000	\$139.90	\$11.60
\$107,001 to \$160,000	\$214,001 to \$320,000	\$199.80	\$29.90
\$161,001 to \$214,000	\$320,001 to \$428,000	\$259.70	\$48.10
\$214,001 +	\$428,001 +	\$319.70	\$66.40
Part B Deductible		\$140	
Coinsurance		20%	

## Long Term Care Insurance: Potential Deductibility of Premiums for Qualified Policies

Age	Amount of premium that may be treated as a medical expense
40 or less	\$350
41 to 50	\$660
51 to 60	\$1,310
61 to 70	\$3,500
71 +	\$4,370

Source: [www.irs.gov](http://www.irs.gov), IRS Rev. Proc. 2011-52, IR-2011-103, Centers for Medicare & Medicaid Services.

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