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Opportunistic Retirement Investing

By Ann Marsh

EFFICIENT ETFs

The size of the mutual fund market, with nearly 12,000 funds, vastly outnumbers that of ETFs, with about 1,400 in the U.S. But that gap looks likely to shrink in this still-new era of market volatility and low yields.

Many planners say they prefer ETFs to mutual funds because of their low fees and their tax efficiencies, as well as the ability to sell in and out of them more easily during periods of volatility — a key factor in keeping a retirement portfolio intact during a fast-moving market slide.

As planner Sandra Field, founder and CEO of Asset Planning in Cypress, Calif., puts it: "If the market was dropping 600 points, I can sell right now. I'm out and I'm into cash. With a mutual fund, I have to wait until 1 p.m. [Pacific time]." Some funds require sales many hours earlier, and selling mutual fund shares can take as long as three days from the time an order is placed.

GROWTH THROUGH ANNUITIES

"Immediate annuities are a perfect flip on life insurance policies," says Steve Williams, director of U.S. financial planning strategy for Chicago-based BMO Harris Bank, a subsidiary of Bank of Montreal. Instead of giving an insurer a monthly payment in exchange for a single large payout when policyholders die, investors pay a onetime lump sum in exchange for reliable monthly payment for the rest of their lives. "We find it particularly appealing for someone in the 65- to 70-year range," Williams says.

''I'm not anti-annuities,'' says Cypress, Calif., planner Sandra Field, who swims competitively. ''I'm just anti-annuity without education.''

Traditional retirement planning, Williams says, comprises three legs on a stool: Social Security income, pension income and proceeds from savings.

"A couple of those have really been shortened or done away with altogether," Williams notes. "Much pension income disappeared and Social Security has been reduced and, so, the predictable stream in retirement has greatly been reduced."

For that reason, Williams likes immediate annuities despite their relatively high costs. He's not alone. Sales of immediate annuities grew 3% in the first three quarters of 2011 over the same period in 2010, according to Judith Alexander, director of sales and marketing at Beacon Research, which collects data on the insurance industry.

That doesn't sound like much, but Alexander says the jump is remarkable given that rates have been dropping, which means the monthly annuity payments have shrunk. The increased sales of immediate annuities is likely due to their rising use as pension-replacement tools and the growing number of baby boomers entering retirement, she adds.

Field says it's critical that investors understand when and how to use annuities and the differences between annuity classes. One of her clients decided to put more than $2.5 million into a tax-deferred annuity with a five-year contract before he began working with her.

Field describes him as a savvy executive with an annual income of more than $600,000. The client believed, based on the insurance company's sales pitch, that he could invest in it as if it were a CD. He anticipated making a 2.8% return, more than a bank account would have earned.

"Oh, nay, nay, nay," Field says she had to explain to him. Taking the proceeds at the end of those three years exposed him to such high tax rates given his already high tax bracket that his after-tax gain was about 1.4%, about what he could have earned in a CD.

"When I pointed this all out, he said, 'Why didn't they explain all this to us?'" Field recalls. "I said, 'They just don't.' "

"I'm not anti-annuities," the planner hastens to add. "I'm just anti-annuity without education.

BEWARE OF FUTURES

Some planners are using managed futures, an investment that has been getting much attention lately. Many advisors, though, caution that they are complex and carry heavy tax burdens. An investment with the world "futures" in it comes with a K1, Field notes. "And your investor will not be happy with you. That's a huge imposition at tax time for the CPA to fill out."

She learned that the hard way. Recently, Field believed she had made a great investment in the PowerShares DB US Dollar Bullish Fund (UUP), betting that the dollar would strengthen against foreign currencies. It didn't end up mattering that she was right.

"It looks like a normal ETF," says Field, who thought the managers were doing actual currency trading. The fund turned out to be made entirely of contracts. "It doesn't say 'beware.' We did these trades. We hopped in, made some money and hopped out and — oh, darn!"

> THE INCREASED SALES OF IMMEDIATE ANNUITIES IS LIKELY DUE TO THEIR RISING USE AS PENSION-REPLACEMENT TOOLS.

The tax burden generated by the contracts outweighed the gains that were reaped, Field says. "That was my mistake," she says, adding that when she shared her experience in her study group composed of other top planners in the area, no one knew about this particular trap either. "So I didn't feel quite so dumb."

Brouwer says he and the members of his team have looked at futures for years, but they haven't used them because of their complexity. "They have some particular benefits in that they are not correlated with the other markets very closely," he says, "but there haven't been many liquid ways of investing in that world. It can be hard to understand them and they are often fairly expensive in terms of overall cost structure. We've looked at them and looked at them and haven't pulled the trigger."

Field says she's also discovered that in the post-Madoff era her errors and omissions insurance policy doesn't cover investments containing futures or futures contracts. Insurers, she says, "want everything plain vanilla. Thank you, Bernie Madoff."

CASH FLOW IS KING

These days, plain-vanilla investments must perform with vigor to win over planners. It's pay to play," says Field, that rare planner who reserves part of many days to trade in her clients' portfolios, a task she relishes.

Most investments don't make the cut unless they throw off serious income, she says. Since the downturn, Field has completely changed her investment orientation toward income, with an eye to tax efficiencies and growth with very few growth stocks. She has set up many clients with monthly cash deposits to their bank accounts from their investment accounts to mimic payments they might otherwise be getting from pension plans.

"It's pretty horrible to go through a year of volatility and end up flat," says Field, who says she's determined not to let that happen to her clients. "Stocks pay dividends four times a year, bonds pay interest two times a year. I need a 4.5% to 6% return so that when we have exposure to the market, it gives us that extra boost when the market is running like it is now."

The era is over for set-it-and-forget-it retirement plans. Nowadays, it takes enterprise, innovation and constant review to create strategies that offer growth in volatile times. **FP**

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