Five Ways to Protect Your Retirement Income

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Five rules of thumb to help protect your savings and income—now and in the future.

If you're nearing or in retirement, it's important to think about protecting what you've saved and ensuring that your income needs are met now and in the future. Here are five rules of thumb to help manage the risks to your retirement income.

1. Plan for health care costs.

With longer life spans and medical costs that historically have risen faster than general inflation—particularly for long-term care—managing health care costs can be a critical challenge for retirees.

According to Fidelity's annual retiree health care costs estimate, the average 65-year-old couple retiring in 2014 will need an estimated $220,000 to cover health care costs during their retirement, and that is just using average life expectancy data.[1] Many people will live longer and have higher costs. And that cost doesn't include long-term-care (LTC) expenses.

According to the U.S. Department of Health and Human Services, about 70% of those age 65 and older will require some type of LTC services—either at home, in adult day care, in an assisted living facility, or in a traditional nursing home. The average private-pay cost of a nursing home is about $90,000 per year according to MetLife, and exceeds $100,000 in some states. Assisted-living facilities average $3,477 per month. Hourly home care agency rates average $46 for a Medicare-certified home health aide and $19 for a licensed non-Medicare-certified home health aide.

Consider: Purchasing long-term-care insurance. The cost is based on age, so the earlier you purchase a policy, the lower the annual premiums, though the longer you'll potentially be paying for them.

If you are still working and your employer offers a health savings account (HSA), you may want to take advantage of it. An HSA offers a triple-tax advantage: You can save pretax dollars, which can grow and be withdrawn state and federal tax free if used for qualified medical expenses—currently or in retirement.

2. Expect to live longer.

As medical advances continue, it's quite likely that today's healthy 65-year-olds will live well into their 80s or even 90s. This means there's a real possibility that you may need 30 or more years of retirement income.

An American man who's reached age 65 in good health has a 50% chance of living 20 more years, to age 85, and a 25% chance of living to 92. For a 65-year-old American woman, those odds rise to a 50%

chance of living to age 88 and a one-in-four chance of living to 94. The odds that at least one member of a 65-year-old couple will live to 92 are 50%, and there's a 25% chance at least one of them will reach age 97.[2] And recent data suggest that longevity expectations may continue to increase.

You may live longer than you expect.
People are living longer because they're healthy, active, and taking better care of themselves.

	65-year-old man	65-year-old woman	65-year-old couple*
50% chance of living to age:	85	88	92
25% chance of living to age:	92	94	97

*At least one surviving individual. Source: Annuity 2000 Mortality Table, Society of Actuaries. Figures assume that individuals are in good health. For illustrative purposes only.

Without some thoughtful planning, you could easily outlive your savings and have to rely solely on Social Security for your income. And with the average Social Security benefit being just over $1,294 a month, it likely won't cover all your needs.[3]

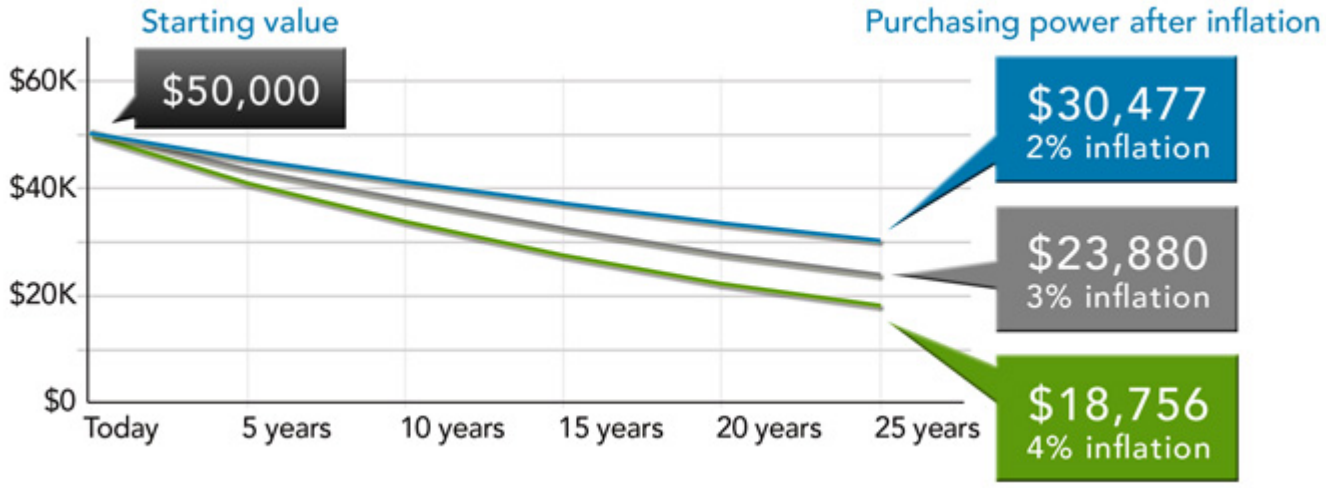
Consider: To cover your income needs, particularly your essential expenses, you may want to use some of your retirement savings to purchase an annuity. It will help you create a simple and efficient stream of income payments that are guaranteed for as long as you (or you and your spouse) live.[4]

3. Be prepared for inflation.

Inflation can eat away at the purchasing power of your money over time. This affects your retirement income by increasing the future costs of goods and services, thereby reducing the purchasing power of your income. Even a relatively low inflation rate can have a significant impact on a retiree's purchasing power. Our hypothetical example below shows that $50,000 today would be worth only $30,477 in 25 years, even with a relatively low (2%) inflation rate.

The danger of inflation: The value of your savings is reduced.

Even a low inflation rate can reduce the purchasing power of your money.



Source: Fidelity Investments, 2014. All numbers were calculated based on hypothetical rates of inflation of 2%, 3%, and 4% (historical average from 1926 to 2013 was 3%) to show the effects of inflation over time; actual rates may be more or less and will vary.

Consider: While many fixed income investments and retirement income sources will not keep up with inflation, some sources, such as Social Security, and certain pensions and annuities can help you contend with inflation automatically through annual cost-of-living adjustments or market-related performance. Investing in inflation-fighting securities, such as growth-oriented investments (e.g., individual stocks or stock mutual funds), Treasury Inflation-Protected Securities (TIPS), and commodities, may also make sense.

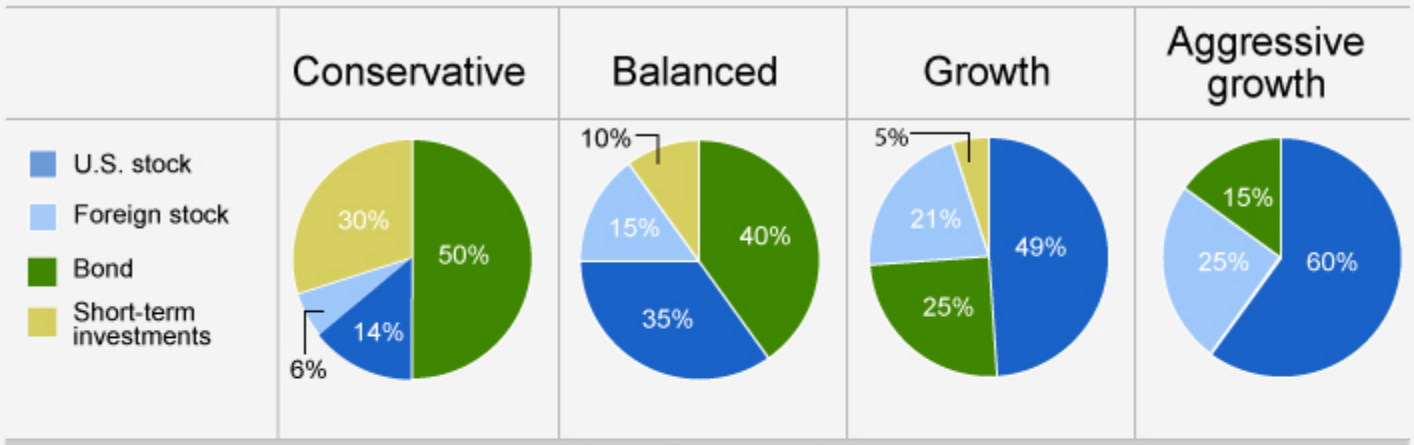
4. Position investments for growth.

A too-conservative investment strategy can be just as dangerous as a too-aggressive one. It exposes your portfolio to the erosive effects of inflation, limits the long-term upside potential that diversified stock investments can offer, and can diminish how long your money may last. On the other hand, being too aggressive can mean undue risk in down or volatile markets. A strategy that seeks to keep the growth potential for your investments without too much risk may be the answer.

The sample target asset mixes below show some asset allocation strategies that blend stocks, bonds, and short-term investments to achieve different levels of risk and return potential. With retirement likely to span 30 years or so, you'll want to find a balance between risk and return potential.

Consider: Create a diversified portfolio that includes a mix of stocks, bonds, and short-term investments, according to your risk tolerance, overall financial situation, and investment time horizon. Doing so may help you seek the growth you need without taking on more risk than you are comfortable with. Diversification and asset allocation do not ensure a profit or guarantee against loss.

Find an investment mix with the right amount of growth potential and risk for you.
With retirement likely to span 30 years or so, you'll want to find a balance between growth and preservation.

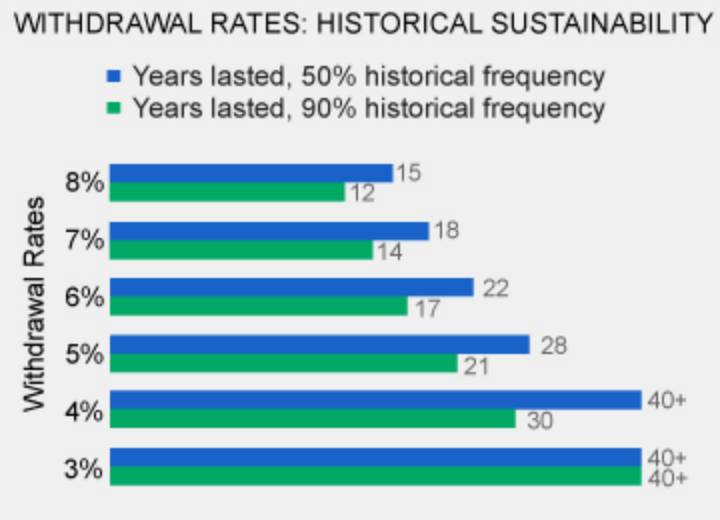


	Conservative	Balanced	Growth	Aggressive growth
Annual return %				
Average	6.01	7.98	8.97	9.64
Best 12 months	31.06	76.57	109.55	136.07
Worst 12 months	–17.67	–40.64	–52.92	–60.78
Best 5 years	17.24	23.14	27.27	31.91
Worst 5 years	–0.37	–6.18	–10.43	–13.78

The purpose of the target asset mixes is to show how target asset mixes may be created with different risk and return characteristics to help meet your goals. You should choose your own investments based on your particular objectives and situation. Remember that you can change how your account is invested. Be sure to review your decisions periodically to make sure they are still consistent with your goals. These target asset mixes were developed by Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company, based on the needs of a typical retirement plan participant. Data source: Ibbotson Associates, 2014 (1926–2014). Past performance is no guarantee of future results. Returns included the reinvestment of dividends and other earnings.

5. Don't withdraw too much from savings.

The lower the withdrawal rate, the longer a portfolio may last.



Past performance is no guarantee of future results. The information provided regarding the historical sustainability of various withdrawal rates is hypothetical in nature and is for illustrative purposes only. It is not intended to predict or project investment results and does not reflect actual results of any investment or investment strategy. Individual results will vary. The 28-year retirement period is based on a retirement age of 67 and a unisex longevity assumption. Balanced portfolio: 50% stock, 40% bonds, 10% cash. Analysis uses overlapping historical periods, which limits statistical relevance. Frequency of success uses historical real return data for withdrawal periods beginning each month, with the earliest period beginning January 1, 1926, and the latest period ending July 31, 2013, using a hypothetical balanced investment portfolio. See footnote five below for information on the indexes used for the balanced portfolios.

Spending your savings too rapidly can also put your retirement plan at risk. For this reason, we believe that retirees should consider using conservative withdrawal rates, particularly for any money needed for essential expenses.

A common rule of thumb is to use a withdrawal rate of 4% to 5%. Why? We examined historical inflation-adjusted asset returns for a hypothetical balanced investment portfolio of 50% stocks, 40% bonds, and 10% cash, to determine how long various withdrawal rates would have lasted. The chart to the right shows what we found: In 90% of historical markets, a 4% rate would have lasted for at least 30 years, while in 50% of the historical markets, a 4% rate would have been sustained for more than 40 years.

Consider: Keep your withdrawals as conservative as you can. Later on, if your expenses drop or your investment portfolio grows, you may be able to raise that rate.

In conclusion

After spending years building your retirement savings, switching to spending that money can be stressful. But it doesn't have to be that way if you take steps leading up to and during retirement to manage these five key risks to your retirement income, as outlined above.