THE PROCESS OF MANAGING RETIREMENT INCOME
CONVERTING SAVINGS INTO MONTHLY SPENDING

Retiring baby-boomers, who can expect to spend 30 to 40 years in retirement, will likely need a framework for converting their savings into a sustainable monthly income stream. Investors who are on the road of retirement all share some common fears including spending too much, principal loss from market volatility, loss of purchasing power due to inflation, and the biggest fear of all, running out of money.

The road of retirement should be paved with more than good intentions. Soon-to-be retirees should develop and follow a retirement income plan that balances current lifestyle with the long-term sustainability of the retirement portfolio. The *Road of Retirement* series provides some best practices for accomplishing this balance.

As we have all experienced over the past few years, retirement plans designed to fund annual spending solely through the sale of the assets are exposed to the vagaries of the market. Therefore, we will outline how to convert the retirement savings to a monthly spending amount, using an approach that balances the need for current income and future growth.

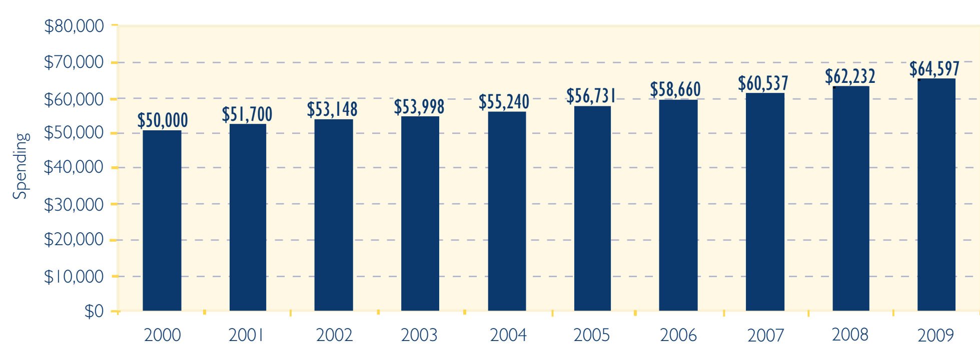
The objective of this conversion process is to utilize the strategies outlined in this series to build the framework that may help a retiree sustain a lengthy retirement time frame. This process will use a globally diversified portfolio with a cash flow reserve ladder structure that strives to generate an attractive level of current income with the possibility for growth. To illustrate how the conversion process is meeting this objective, we will use a hypothetical illustration of a retiree who began retirement on January 1, 2000 (2000 retiree) with $1 million in retirement savings and spending 5% of the assets in year one ($50,000), then indexing to inflation. For this 2000 retiree, the amount needed to keep pace with inflation from 2000 to 2009 (rate of inflation per the Consumer Price Index (CPI) (averaged 2.89% annually for this period) can be seen in the bar graph in ***figure one***.

Note that the annual spending amount increased from $50,000 to $64,597 (29.2%) during this ten-year time frame. Also keep in mind that during this period, the financial markets experienced two severe bear markets, one in 2000–2002 and another in 2007–2008. This environment will provide a good test case to see how a defined structure designed to convert the retirement savings to a monthly spending amount functions.

Cash Flow Reserve Ladder

To provide a structure to the conversion process, we will use the Cash Flow Reserve Ladder, as detailed in ***section 5*** of this kit. This ladder provides three rungs aligning the most liquid investments to fund near-term spending needs, while the more volatile, growth-ori-

FIGURE 1. HYPOTHETICAL ILLUSTRATION OF THE ANNUAL SPENDING FOR A 2000 RETIREE

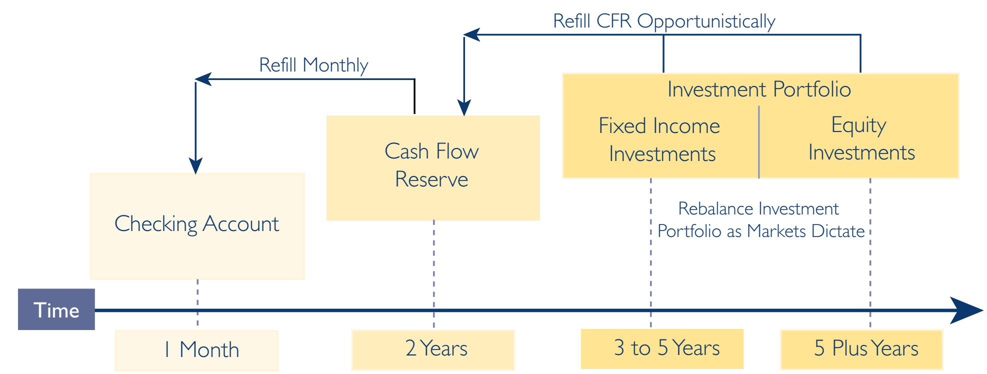


Assumes a 2.89% rate of inflation

Source: Thornburg Investment Management

ented investments are held inside a diversified portfolio with a five-year investment horizon.

FIGURE 2. HYPOTHETICAL CASH FLOW RESERVE LADDER



Using this cash flow ladder, the retiree writes a check each month from the money market fund within the cash flow reserve and deposits it into their checking account. In year one, the 2000 retiree would have written a monthly check for $4,167 ($50,000 / 12) from the money market account and deposited it into the checking account to cover the monthly spending. Providing a specified amount each month is a key attribute of the structure while also giving the retiree some separation from the larger pool of assets in the investment portfolio. This separation can help reduce the desire to overspend.

Within the various levels of investments from the cash flow reserve and investment portfolios, the interest and dividend income generated will not initially be re-invested. Instead this income will be deposited into the money market fund to continually replenish the cash flow reserve. However, if the income stream grows adequately enough to cover the spending amount and more, the excess is reinvested in the investment portfolio. The concept is to use a globally diversified portfolio that generates enough income to cover the current spending needs without having to sell assets. However, whatever portion of the spending is not covered by the current income will come from selling assets opportunistically into the market to refill the cash flow reserve back to the two-year spending level.

FIGURE 3. GLOBALLY DIVERSIFIED ASSET ALLOCATION EXAMPLE

Investment Accounts	Allocation
Cash Flow Reserve	
Municipal Money Market Fund	5%
5-year Municipal Bond Portfolio	5%
Investment Portfolio	
10-year Municipal Bond Portfolio	25%
Dividend Growers Portfolio	15%
Global Dividend Growers Portfolio	50%
Total	100%

Diversification does not guarantee against loss of principal.

Using a Globally Diversified Asset Allocation

Given the opportunities globally to invest in companies that have the ability and willingness to pay a high and growing dividend, the equity portion of the retirement portfolio will be allocated to these types of income investments. The balance of the portfolio will be allocated into municipal bond investments to help preserve capital, offer some diversification and provide a tax-efficient interest income stream.

Utilizing the Cash Flow Reserve Ladder (***figure three***), the retirement portfolio has been allocated as follows:

- The cash flow reserve portion of the portfolio represents approximately two years' worth of spending and is equally divided between a short-term municipal bond fund and a municipal money market account (5% each). A short-term (5-year) municipal bond fund is used since it may provide a higher income stream with a historically limited level of volatility. The cash flow reserve receives income generated from the various investments and is also the source from which the monthly spending check is written by the retiree for deposit into their checking account.
- Within the investment portfolio there is an additional 25% or approximately four to five years of spending allocated to intermediate-term (10-year) municipal bonds, which can be liquidated if there is a protracted decline in the equity markets. These municipal bond investments can help provide a more tax-efficient income stream and some good diversification benefits to the growing dividend stock strategy. Although the income from municipal bond investments is exempt from regular federal and state income tax they may be subject to the alternative minimum tax (AMT).

In terms of income expectations from the municipal bond investments, while the current level of income may be relatively attractive, they are not geared to grow. A common flaw of retirement portfolios is an over-allocation to fixed income investments, leaving the portfolio highly susceptible to the loss of purchasing power. This is clearly illustrated when analyzing the level of income these municipal bond investments would have generated on a hypothetical $1 million investment made in 2000. As shown in ***figure four***, the income level actually declined.

Although these objectives may not be met, principal protection is the primary goal for including municipal bond investments in the cash flow reserve and investment portfolio rungs, with income as a secondary objective. While the level of income declined from 2000–2009, the principal of a hypothetical $1 million investment made in 2000, assuming no reinvestment of dividends, was actually very stable (*figure five*). This stability of principal can complement the more volatile equity investments made in growing dividend strategies.

FIGURE 4. INCOME ON TWO HYPOTHETICAL $1 MILLION INVESTMENTS IN MUNICIPAL BONDS

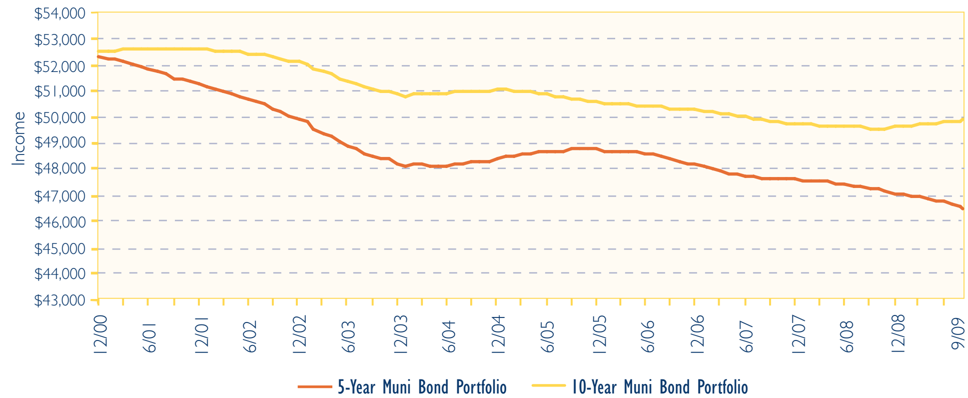
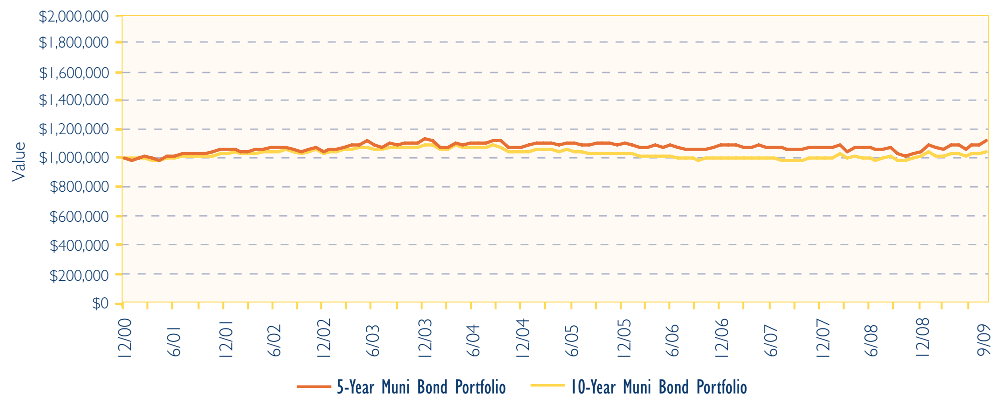


FIGURE 5. VALUE OF TWO HYPOTHETICAL $1 MILLION INVESTMENTS IN MUNICIPAL BONDS



We've assumed that the 5-Year Muni Bond Portfolio performed similarly to the Barclays Capital 5-Year Municipal Bond Index and that the 10-Year Muni Bond Portfolio performed similarly to the Barclays Capital 10-Year Municipal Bond Index. You may not invest directly in an index. Dividends and income were not reinvested.

Past performance does not guarantee future results. Source: Thornburg Investment Management

The equity allocation within the investment portfolio represents 65% of the total allocation. This investment is made with a minimum horizon of five years and is therefore positioned in the third rung, or far right-hand side of the Cash Flow Reserve Ladder. This 65% allocation will be invested in growing dividend equity investments and separated into two distinct pieces. The first is a 15% allocation to a hypothetical portfolio of domestic dividend growers and the second is a 50% allocation to a hypothetical portfolio of global dividend growers. The domestic Dividend Growers portfolio performed similarly to the S&P 500 Dividend Aristocrats Index. This Index is provided by Standard and Poor's and includes the 52 companies (for 2009) in the United States that have increased their dividend payouts for 25 consecutive years. The Global Dividend Growers portfolio performed similarly to the S&P Global Dividend Opportunities Index. This Index represents 100 exchange-traded common stocks from around the world (including the U.S.) that offer high dividend yields. Given that the Global Dividend Growers portfolio includes an approximately 23% (subject to change) allocation to the United States, we have used a 15% allocation to the domestic Dividend Growers portfolio to achieve approximately 65% international, and 35% domestic allocations to dividend paying companies. As we briefly discussed at the end of the ***Value of Dividends in Retirement*** section of this kit, using a global approach to investing in companies that provide growing dividends allows an opportunity to improve portfolio diversification by industry, sector, and country.

These allocations to dividend-focused strategies were chosen for their historic ability to provide an attractive level of current income plus the possibility to grow the income over time. Illustrated in ***figure six*** is the annual income from a $1 million investment made on January 1, 2000 into the hypothetical domestic Dividend Growers portfolio and the Global Dividend Growers portfolio.

What is readily apparent from the chart is the growth of income provided by the Global Dividend Growers portfolio. While the growth has been dramatic on the upside, it has also experienced a decrease since mid-2008. The volatility can be attributed to the sole focus of the portfolio on the top dividend yielding stocks versus a more diversified investment approach. What is less apparent on this chart is the slower but steady increase of income provided by the hypothetical domestic Dividend Growers portfolio. This portfolio includes only those companies that have increased their dividend for each of the past 25 years, so they have a tendency to be more established and stable.

While these dividend grower strategies historically provided a growing dividend stream, they also historically provided the ability for the portfolio to grow based upon price appreciation alone. Shown in ***figure seven*** is a comparison of the value of $1 million investments made on January 1, 2000 in the hypothetical dividend growers portfolios versus the investments in the two municipal bond portfolios, assuming no reinvestment of income.

Note that while the equity investments declined in value during the bear markets of 2000–2002 and more recently in late 2007–2008, they also provided strong appreciation from 2003 to late 2007, and turned positive once again mid-2009. Also note how the municipal bond portfolios remained relatively stable during the periods of decline in the dividend growers portfolios. Using the Cash Flow Reserve Ladder, with its focus on maintaining two years of liquidity in the reserve, together with an allocation to municipal bonds, allows the portfolio to benefit from the growing dividend income stream while also alleviating the need to sell these more volatile equity investments at inopportune times.

FIGURE 6. INCOME ON TWO HYPOTHETICAL $1 MILLION INVESTMENTS

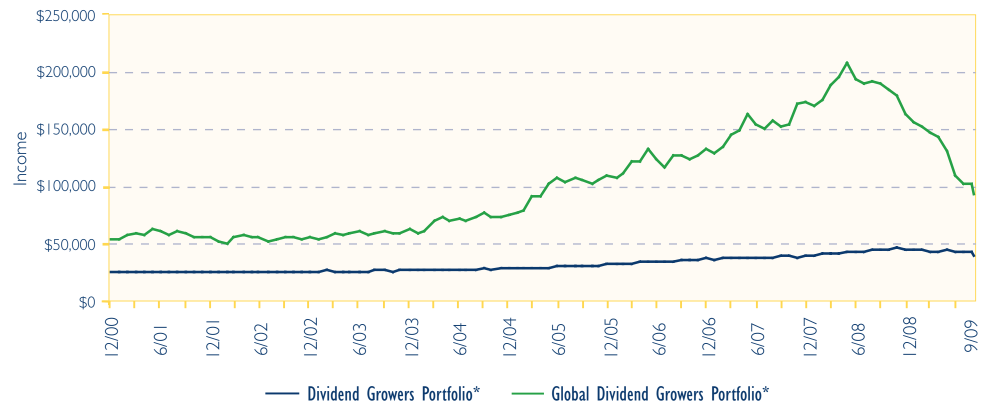
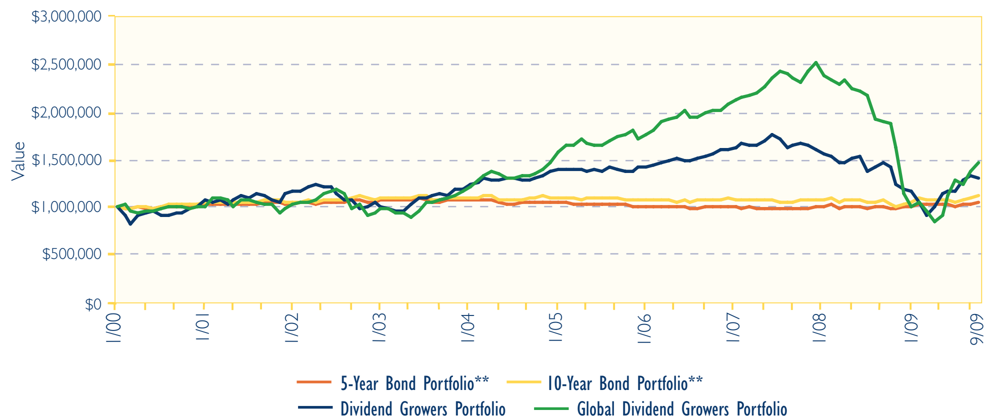


FIGURE 7. ACCOUNT VALUES FOR FOUR HYPOTHETICAL $1 MILLION INVESTMENTS



* We've assumed that the hypothetical Dividend Growers Portfolio performed similarly to the S&P 500 Dividend Aristocrats Index and the hypothetical Global Dividend Growers Portfolio performed similarly to the S&P Global Dividend Opportunities Index.

** We've assumed that the 5-Year Bond Portfolio performed similarly to the Barclays Capital 5-Year Municipal Bond Index and the 10-Year Bond Portfolio performed similarly to the Barclays Capital 10-Year Municipal Bond Index.

You cannot invest directly into an index.

Dividends and income not reinvested.

Past performance does not guarantee future results. Source: Thornburg Investment Management

Pulling It All Together

Now let's look at combining the different investment portfolios we have discussed into a globally diversified hypothetical portfolio. This portfolio will consist of a 5% allocation to a municipal money market fund; 5% to 5-year muni bonds; 25% to 10-year muni bonds; 15% to domestic dividend growers; and 50% to global dividend growers. So, let's measure the effectiveness of our plan by using this hypothetical Globally Diversified Portfolio with the Cash Flow Reserve Ladder. Return to the chart used in ***figure one***, which shows the annual spending for the 2000 retiree. In ***figure eight***, on the following page, we now show the spending level as well as the source of the funds used to support the spending. The dark blue portion of each bar represents the income generated by the portfolio, the gold portion represents the principal redeemed via asset sales, and the green represents excess income provided by the portfolio beyond what is needed for spending.

In 2000, the retiree spent a total of $50,000; spending was increased in subsequent years to account for inflation. Note how the growing income stream represented by the green portion of the bar reduces the amount of principal redemption needed through 2004. Subsequent to 2004, there was no need to redeem principal since the hypothetical portfolio generated more than enough income to cover the spending. This excess income was retained in the investment portfolio. As recapped in the table below the chart, total dividend and interest earned during the period was $617,813; the retiree spent $550,695, leaving $67,118 of excess income in the portfolio. And while this portfolio has provided the increasing level of income to cover spending, the value of the initial $1 million investment has grown to $1.468 million as of September 30, 2009.

It should also be noted that while the portfolio is valued at $1.468 million as of September 30, 2009, this value has changed since the 2000 retirement. In ***figure nine*** we compare the hypothetical account value for our Globally Diversified portfolio versus the various municipal bond and growing dividend portfolios. What is remarkable is that the Globally Diversified portfolio is less volatile than the dividend growers portfolios, but with much better growth than the municipal bond portfolios.

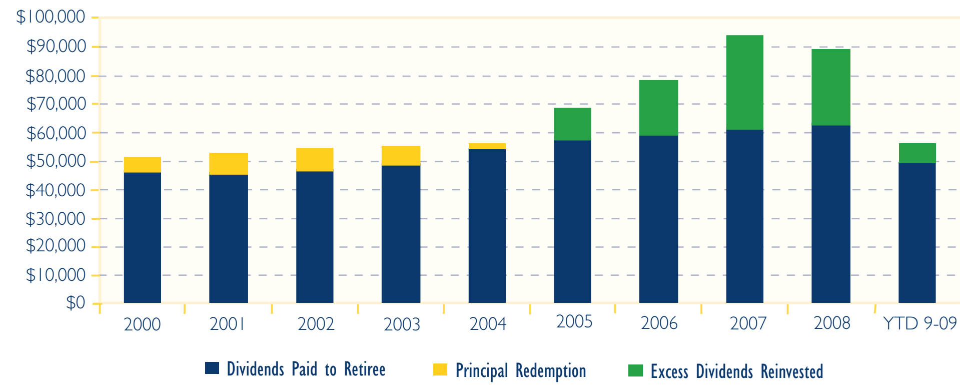
The hypothetical portfolio value actually fell below $1 million on several occasions during 2000–2003, as a result of a challenging time in the equity market. However, the use of the Cash Flow Reserve Ladder and a globally diversified portfolio focused on a growing income stream allowed the retirement portfolio to generate the majority of the income it needed during that time without having to sell significant assets and suffer the effects of reverse dollar cost averaging.

Notice how the portfolio value declined again beginning in mid-2007 through early 2009, since it was impossible to escape the turmoil affecting the financial markets. However, with the portfolio generating a sufficient level of income to cover spending needs during 2007 and 2008, once again the portfolio was kept intact to benefit from the recent recovery in the investment markets.

Best Practices

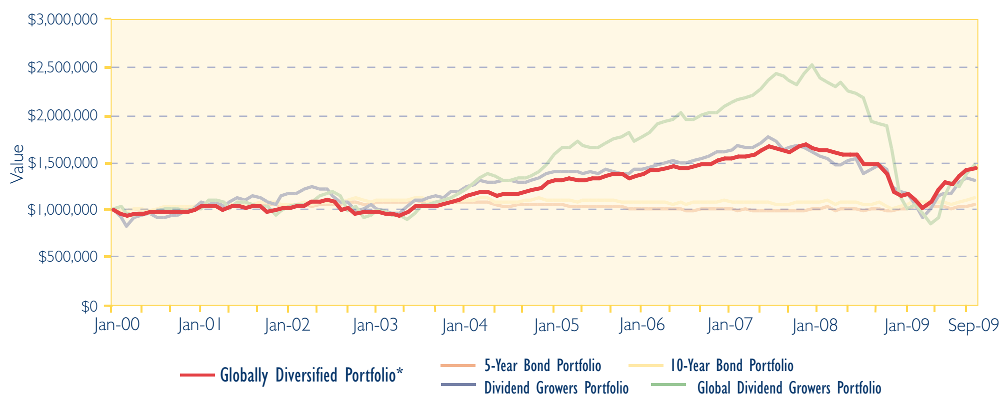
This structured process for converting hard-earned retirement savings into a monthly spending amount should be attractive to the majority of baby-boomers looking to retain control of their assets in retirement. One of the best ways to increase the potential for a higher dividend income stream at the time of retirement is to get a head start. Three to five years before your planned retirement date, begin investing in a well managed globally diversified portfolio of high and growing dividend stocks. Reinvest the growing dividend income that's generated before the retirement begins, thereby buying more shares and increasing the level of dividend income available when retirement distributions finally do begin. And remember to revisit the retirement plan annually with your financial advisor.

FIGURE 8. INCOME FROM A HYPOTHETICAL $1 MILLION INVESTMENT IN A GLOBALLY DIVERSIFIED PORTFOLIO*



Dividends and Interest Earned	Net Reinvested	Amount Spent	Ending Portfolio Value
$617,813	$67,118	$550,695	$1,468,186

FIGURE 9. HYPOTHETICAL 2000 RETIREE PORTFOLIO VALUE COMPARISON



* We assume that the hypothetical Globally Diversified Portfolio performed similarly to the following: 5% Morningstar Municipal Money Market Index; 5% Barclays 5-Year Municipal Bond Index; 25% Barclays 10-Year Municipal Bond Index; 15% S&P 500 Dividend Aristocrats Index; and 50% S&P Global Dividend Opportunities Index.

We've assumed that the hypothetical Dividend Growers Portfolio performed similarly to the S&P 500 Dividend Aristocrats Index and the hypothetical Global Dividend Growers Portfolio performed similarly to the S&P Global Dividend Opportunities Index.

We've assumed that the 5-Year Bond Portfolio performed similarly to the Barclays Capital 5-Year Municipal Bond Index and the 10-Year Bond Portfolio performed similarly to the Barclays Capital 10-Year Municipal Bond Index.

You cannot invest directly into an index.

Dividends and income not reinvested.

Past performance does not guarantee future results. Source: Thornburg Investment Management

Disclosures:
Following these strategies does not assure or guarantee sustainability of a retirement portfolio or better performance, nor do they protect against investment losses.

The views expressed in this article are subject to change.

Bonds are debt investments in which an investor loans money to an entity (corporate or governmental) which borrows the funds for a defined period of time at a fixed interest rate. Bonds are subject to certain risks, including interest-rate risk, credit risk, and inflation risk. The principal value of bonds will fluctuate relative to changes in interest rates, decreasing when interest rates rise.

Municipal bonds are debt obligations issued by States, cities, counties, and other governmental entities. Municipal bonds offer a predictable stream of income which is free from Federal and, in some cases, State and local taxes, but may be subject to the Alternative Minimum Tax.

A stock is a share in the ownership of a company. As an owner, investors have a claim on the assets and earnings of a company as well as voting rights with the shares. Compared to bonds, stock investors are subject to a greater risk of loss of principal. Stock prices will fluctuate, and there is no guarantee against losses. Stock investors may or may not receive dividends. Dividends and gains on an investment may be subject to Federal, State or local income taxes as well as the alternative minimum tax.

Investments in stocks and bonds are not FDIC insured, nor are they deposits of or guaranteed by a bank or any other entity.

Investments in a money market are not FDIC insured, nor are they deposits of or guaranteed by a bank or any other entity. Although a money market fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in a money market fund.

Investing outside the United States, especially in emerging markets, entails special risks, such as currency fluctuations, illiquidity, and volatility.

Diversification does not assure or guarantee better performance and cannot eliminate the risk of investment losses.

Notes:

Monthly Cash Flow – monthly check withdrawn from Cash Flow Reserve and assumed placed into checking account at the beginning of each month.

The Consumer Price Index (CPI) measures prices of a fixed basket of goods bought by a typical consumer, including food, transportation, shelter, utilities, clothing, medical care, entertainment and other items. The CPI, published by the Bureau of Labor Statistics in the Department of Labor, is based at 100 in 1982 and is released monthly. It is widely used as a cost-of-living benchmark to adjust Social Security payments and other payment schedules, union contracts and tax brackets. Also known as the cost-of-living index.

The S&P 500 Dividend Aristocrats Index is equally weighted and measures the performance of large cap, blue chip companies within the S&P 500 Index that have followed a policy of increasing dividends every year for at least 25 consecutive years.

The S&P Global Dividend Opportunities Index is designed to serve as a benchmark for global income seeking investors. The index seeks to provide exposure to 100 high yielding common stocks from around the world while meeting diversification, stability and tradability requirements.

The S&P 500 Index is an unmanaged broad measure of the U.S. stock market.

Barclays Capital 5-Year Municipal Bond Index covers USD-denominated, investment-grade, tax-exempt bonds with maturities between four and six years. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

Barclays Capital 10-Year Municipal Bond Index covers USD-denominated, investment-grade, tax-exempt bonds with maturities between eight and twelve years. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

The performance of any index is not indicative of the performance of any particular investment. Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index.

Before investing, carefully consider the investment goals, risks, charges, and expenses. For a prospectus containing this and other information, contact your financial advisor. Read it carefully before investing.