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Turn Your Nest Egg Into Steady Cash

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There's a new kid on the block vying to provide you with retirement income -- the mutual-fund industry.

Traditionally, retirees searching for a steady paycheck once they leave the office have turned to insurance companies selling immediate annuities. You pay the insurance company a lump sum, and in exchange you get periodic payments for the rest of your life.

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Two Routes to Regular Income

On a \$50,000 investment, here are monthly payments from fixed immediate annuities and Vanguard Group's managed-payout funds.

Three annuity options for a 60-year-old man*

\$305 (guaranteed by insurer for as long as he lives)

\$299 (for life, or for minimum 10 years if he dies early)

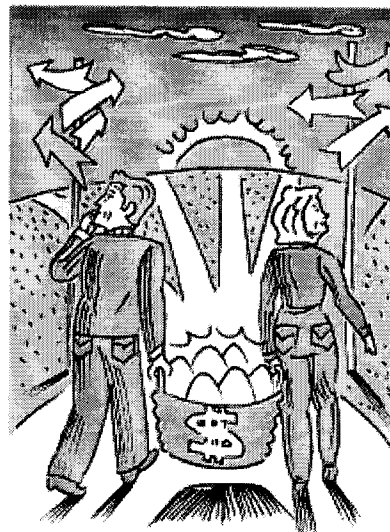
\$273 (for as long as he or his 60-year-old wife survives)

*Rates from ImmediateAnnuities.com for North Carolina residents

Vanguard payout funds†

| | Initial (variable) payment |
|---------------------------|----------------------------|
| "Distribution Focus" fund | \$292 |
| "Growth and Distribution" | \$208 |
| "Growth Focus" fund | \$125 |

†Payment is adjusted annually; "distribution" fund aims to maintain initial capital while "growth" fund aims for capital appreciation



Milan Trenc

But many people have a hard time letting go control of their cash at the same time they are forgoing their career and accompanying salary. After all, if you die unexpectedly early, the insurer keeps money that would otherwise have gone to you or your heirs.

Enter the mutual-fund industry with a new product, "managed payout" or "target distribution" funds. These are designed to help provide steady income while allowing you to pass along any remaining assets at death.

With such funds, the fees are generally cheaper than those charged for annuities, and your assets still belong to you -- but there's also no iron-clad guarantee that they will last as long as predicted.

So, how do you pick? Here's a look at the pros and cons of annuities and managed-payout mutual funds:

Fixed annuities: The simplest type of annuities, known as fixed, immediate annuities, can provide a steady stream of payments throughout retirement.

"If you need income, the most efficient product is the immediate annuity," says Michael Gallo, senior vice president of retirement income for New York Life Insurance. The insurer contends that you can secure the same lifetime income with an immediate annuity for a nest egg that is 25% to 40% smaller than what you'd need if investing in mutual funds, certificates of deposit or other investments.

It's getting easier to comparison shop for the products as well: Web sites such as immediateannuities.com let you get quotes instantly. And Longevity Alliance (longevityalliance.com¹) in Washington was launched in 2005 by a former AARP executive in part to offer annuity counseling and comparison shopping.

You can also hire a financial adviser (for an additional fee, of course) to help you shift investments into immediate annuities during retirement. MassMutual Financial Group of Springfield, Mass., has created a retirement management account to help people gradually shift dollars into annuities.

The big problem, of course, is that you're giving up your money permanently. And the payments you get will become worth relatively less over time as inflation eats into their value. Add-on "riders" providing inflation protection, continued payments for your spouse after you die or other death benefits are available -- but could substantially reduce your initial monthly payout.

Claude Waller, a 69-year-old real-estate broker in Yuma, Ariz., recently used about 40% of his and his wife's savings to buy an immediate annuity paying \$29,000 a year. "It's not what I want to live on, but it's an amount I could live on with our Social Security," he says. "I think everybody in my age group starts to think and worry about whether I'm going to outlive my money." The Wallers chose to pay for a rider called "cash return value," he says -- if they die before their initial investment is paid out, the remainder goes to their heirs.

Payout funds: In contrast, you keep control over your assets with payout funds, offered by large mutual-fund companies such as Fidelity Investments, Vanguard Group and Charles Schwab. And they charge relatively low fees, ranging from 0.5% to 1.9% of the portfolio's value each year. The products automatically generate a monthly payout and are managed with the goal of reducing volatility.

With some products, you choose a set time period, such as 20 or 30 years, over which you would receive your payments. Some funds try to return at least some of your initial investment, while others use those dollars to boost the payments.

But with control, and more potential for upside, comes more risk: There's no guarantee that the investments will last, or that your monthly checks will remain the same size.

As a result, some mutual-fund companies recommend using annuities along with the payout funds. Russell Investments, Tacoma, Wash., in April launched a series of mutual funds designed to provide retirees with ongoing, reliable income and flexibility to change their investment strategy throughout retirement. But it advises financial advisers to recommend that clients buy annuities if their assets drop to a worrisome level, so that they can then lock in a needed income stream.

And Fidelity wants you to buy both. It introduced its "Growth and Guaranteed Income" annuity last year at the same time as its "Income Replacement Funds" and recommends using them together.

Variable annuities: Another possible -- but potentially expensive -- approach is to use a variable annuity that offers mutual-fund-like investing but also provides regular income payments through so-called living benefits. Such products typically guarantee a base level of annual income, such as 5% to 6% of the original amount invested.

Typically, you still get the minimum guaranteed payments if the underlying investments perform badly. And if they do well, the annuity may let you reset your guaranteed income to a higher level.

But the fees are expensive -- often approaching 3%. And these annuities are complicated, involving hundreds of pages of fine print. One option: hire an adviser to help in selecting.

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