Do you know where your income will come from in retirement? Many people don’t. They’ve prepared for retirement by savings and investing as much as possible, which is an essential step. But two more steps are necessary. First, it’s important to map out what you will need in income in each year of retirement. Second, your investment strategy needs to track to your income needs. Income-based planning can help clarify how well prepared you are for retirement over the long-term while providing clear benchmarks to judge your progress from year to year.

Morgan Stanley takes an approach to investing retirement assets that considers your particular financial situation and the goals that are important to you. Then, we estimate how much cash flow you will need—and when you will need it. As we look together at the amount and timing of future expenses, our goal is to give you liquidity for near-term needs as well as growth that preserves purchasing power over the long-term.
Cash Flow in Retirement

The task of estimating what your expenses will be and how you will meet them is complex. For couples age 65 today, at least one spouse is expected to live to age 92. As longevity increases, estimates need to be made for longer periods of time. To prepare for adequate cash flow, many factors need to be considered.

**SOURCES OF INCOME.** The income you will have to meet expenses once you retire may come from several sources, including the following:
- Social Security
- Pension
- Working in Retirement
- Annuities
- Rental Property
- Inheritance
- Retirement Plans
- Investments
  - Interest
  - Dividends
  - Appreciation
  - Principal

In the past, Social Security and pension payments constituted a meaningful share of retirement income for many people. This is no longer the case. Most companies do not have pension plans for their employees anymore, and the long-term prospects for Social Security are uncertain. As a result, you are likely to be highly dependent on receiving adequate income from the retirement savings you invest.

**THE LONG VIEW.** Calculating future costs often involves more than applying a forecast of overall inflation. Certain costs — notably medical and long-term care — are rising faster than inflation. In addition, expenses vary considerably in different parts of the world, so reliable local estimates are important if you plan to move when you retire. From the standpoint of both forecasting and investing, it helps to look at spending across some broad categories: needs, wants and wishes.

**Key Factors as You Prepare for Retirement**
- Near- and long-term inflation outlook
- Years left before desired retirement
- Liquidity for market downturns
- Funds reserved for emergencies
- Portfolio payouts and life expectancy
- Health and long-term care funding
- Legacy goals
programs and charities that you want to support.

The last category is a wish list of projects you would like to undertake if and when you have the resources to do so. Here, you might include plans for a new business, a gift to a philanthropic organization and contributions to help cover the cost of your grandchild’s education. Making a wish list can help motivate you to set aside money for far-reaching goals.

**MONEY AND MARKETS.** Beyond your particular circumstances, inflation will have a critical impact on your ability to provide for yourself and your family once you retire. There have been periods—such as the early 1970s—when persistently high inflation had a devastating impact on people’s savings, and even low inflation can affect purchasing power over time.

Market performance is another key variable. Of course, no one knows what the market is going to do from one year to the next. However, once you retire and begin to draw down your savings, the sequence of returns will have a significant effect on your retirement security. As many investors discovered in 2008, a sharp drop in the financial markets in the early years of retirement can be devastating if you do not have adequate liquidity on hand to meet expenses.

**ASSET CONSOLIDATION.** Generally speaking, people accumulate wealth during the years in which they work and then put that wealth to work as they spend down their assets in retirement. In the accumulation phase, many people acquire multiple retirement savings accounts; they may hold 401(k)s with different employers and IRAs for themselves and family members, as well as profit sharing accounts.

Coordinating and consolidating these assets is essential in retirement. Decisions about distributions need to be based on your full investment picture. Estimating the tax implications of different strategies also requires a comprehensive view. Finally, as people get older they often find that streamlining investment accounts in conjunction with a long-term strategy gives them greater freedom to pursue other goals.

There are two key objectives to aim for when investing for retirement. You need adequate liquidity to keep significant declines in the market from disrupting your entire investment strategy. Also, you want to protect the purchasing power of your savings. Dividing your portfolio into segments based on when you will need the money is one way to help you visualize levels of risk and weather market storms.

**DIFFERENT SEGMENT, DIFFERENT STRATEGY.** At Morgan Stanley, retirement assets are generally divided into five investment portfolios: four of these provide income over your years...
in retirement, one optional segment can either be used for income or to segment assets to be left to your heirs.

Money that you will need to live on in the first few years of retirement is invested conservatively with the purpose of providing you income. The remaining segments are invested according to your risk tolerance, time horizon and investment objective. Generally speaking, the shorter the time horizon and smaller amount of emphasis we put on growth the more conservative the income segment will be invested. Periodic rebalancing takes place so that there is an appropriate amount of cash or liquid investments to meet your needs at each stage of retirement.

**HOW IT WORKS.** The figure below shows a sample of how our Retirement Income Strategy works over time. The specific amounts to be invested in each segment will depend on your cash flow needs over the course of your retirement.

Generally, the money is invested as follows:

- **Majority of** your total assets are divided between four retirement income portfolios with the purpose of funding your lifestyle in retirement.
- **5% – 10% of your portfolio** is set aside for emergencies.
- **Amount to be invested in the legacy fund** is based on your legacy objectives and assumed life expectancy.

Consistent with this investment strategy, the projected return is lowest on money you will need in the early years of retirement and grows higher for the money that can be invested for the longer term.

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