

All the Right Moves

Retire with Confidence

- How much will you need to retire comfortably?
- What asset allocation will make the most sense for you in today's low-interest-rate environment?
- What are the benefits of tax-deferred retirement accounts?

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Executive Summary

People resist retirement planning for many different reasons, including a general reluctance to think about aging. But recently one particular reason has come to the fore: the fear of hearing bad news. Today, even people of substantial means may no longer feel confident that their actual retirement will match their expectations.

Our research suggests that while the obstacles to retirement are real, the doubts about it are, in many cases, excessive. In this book, we lay out a rational and systematic approach to retirement planning that is built around the right moves: choices you can make, whether before retiring or after, that can put you

or keep you on the path to a secure retirement. We acknowledge the hurdles—longevity, uncertain market returns, taxes, inflation—but show how they can be cleared.

Some of the right moves are relatively painless: choosing an asset allocation, for example, or taking full advantage of tax-deferred vehicles. Others may require some level of personal sacrifice: among them, working longer, saving more, or living with additional market volatility. The right combination of these measures can lead you to retirement success—confidence that, even in adverse markets, you will have enough savings to fund all that you need.

The Hurdles Are Higher

Retirement begins a new phase of the life cycle—one that many people hope will be a time of less stress and greater personal fulfillment. Nonetheless, for many prospective retirees, the primary emotion surrounding retirement today is fear: Will I be able to live comfortably, potentially for many years, without earned income?

A significant proportion of Americans, pre-retirees and retirees alike, are no longer sure their retirement savings can withstand the headwinds of longevity, tax increases, market volatility, and inflation. These headwinds are beyond an individual's control, so it is not surprising that only half of workers and just three-fifths of retirees feel confident that their retirement savings are adequate. This represents a significant drop in confidence since 2007.¹ And there are good reasons to be less confident now: The hurdles to achieving a secure retirement are, indeed, higher.

If You Should Survive to 105

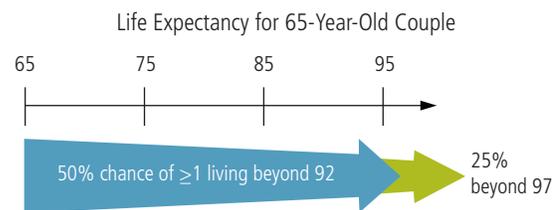
The first hurdle is a double-edged sword: our ever-increasing longevity. The traditional notion of a 20-year retirement comes nowhere near today's reality. Medical advances, along with more health-conscious lifestyles, have definitely made a difference. For a couple age 65, there's a 50% chance that at least one of them will live beyond 92, and a 25% chance that one will live past 97—and these probabilities are trending higher (*Display 1, top*). Thirty-year retirements are no longer rarities, and for early retirees, even four decades are possible.

Taxes Take a Bigger Bite

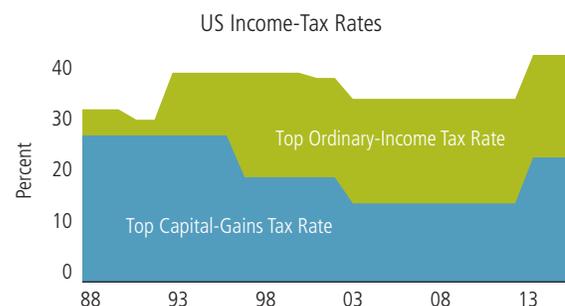
Tax rates are higher now than they've been in years (*Display 1, bottom*). In 2013, the top federal tax rate on earned income rose from 36.45% to 41.95%,² and the top rate on some forms

Display 1

Retirement May Last 30 Years or More



Tax Rates Have Risen



As of May 2013

Source: IRS, Society of Actuaries RP-2000 mortality tables, and AllianceBernstein

of investment income—taxable interest, non-qualified dividends, and short-term capital gains—rose from 35% to 43.4%. The highest rate for long-term capital gains and qualified dividends climbed from 15% to 23.8%. Americans who pay these rates are keeping less of what they earn from their work, and less from their investment portfolios, too.

¹Employee Benefit Research Institute (EBRI) and Mathew Greenwald & Associates, 2013 Retirement Confidence Survey

²41.95% = 39.6% top federal income-tax rate + 1.45% Medicare tax on earned income + 0.9% Medicare hospital insurance tax on earned income above \$250,000 for joint filers

Markets: Friend or Foe?

But can portfolios grow enough to sustain so many years of spending? The answer, of course, is subject to the vagaries of market forces and can vary widely from period to period.

Today's markets³—especially the bond market—are not very accommodating. In a normal environment, we'd expect diversified municipal bonds to generate a compound annual return of 4.8% (*Display 2*). Over the next 10 years, that expectation is down to 2.1%. Because of the dramatic monetary easing policies introduced to counteract the credit crisis of 2008, interest rates are currently very low. From this starting point, it is reasonable to expect that rates will rise, and as that happens, that bond values will fall. Over time, as bonds with low coupons mature or are sold, proceeds will be invested in new, higher-yielding bonds, and returns will eventually benefit. But the process will be choppy, especially for retirees who draw on their portfolios to support their spending.

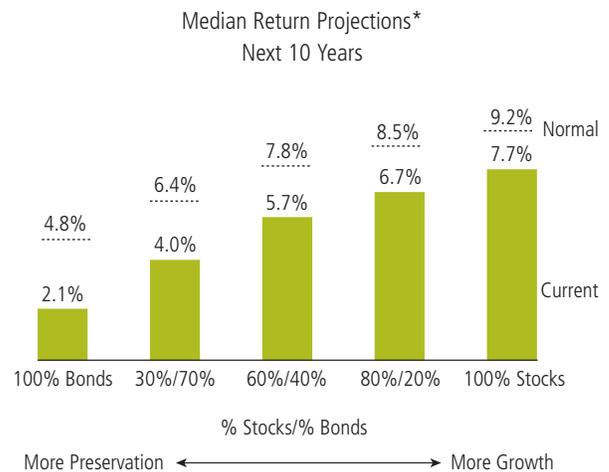
Display 2 shows that expected equity returns are far better, but even here returns are below long-term norms: Over the next 10 years, the expected compound annual return from an all-stock portfolio is 7.7%—somewhat less than the long-term average of 9.2%. Therefore, in portfolios that are blends of stocks and bonds, expected returns are below the normal levels too. This tells you that for any given asset allocation, you can't spend as much today as you could in the past. Or alternatively, if you can't reduce your spending, you may need to shift to a more growth-oriented allocation—assuming you can live with the accompanying risks. In the global financial crisis of 2007–2009, market volatility caused many investors to abandon stocks in whole or in part. The market subsequently rebounded, but a large number of these investors, too risk-averse to participate, remained on the sidelines for years. The result was permanent damage to their portfolios.

Less Purchasing Power, More Years to Spend

While inflation has been tame for some time, it could become less benevolent in the years ahead. Longer life spans, which bring more years of spending, will further subject retirees to corrosive inflationary effects. Inflation can be especially destruc-

Display 2

Future Investment Returns Are Likely to Be Below Normal



*Projected pretax 10-year compound annual growth rates. Unless otherwise indicated, stocks (or “global equities”) are modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small-/mid-cap, 22.5% developed international, and 7.5% emerging markets, and bonds are modeled as intermediate-term diversified municipal bonds. “Current” reflects Bernstein’s estimates and the capital-markets conditions as of March 31, 2013. “Normal” reflects Bernstein’s estimates of equilibrium capital-markets conditions, which are typically close to a very long-term historical average. Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See *Notes on Wealth Forecasting System*, page 24, for further details.
Source: AllianceBernstein

tive in retirement because its major offset, rising income from work, is no longer available.

Furthermore, there's a widespread—but inaccurate—notion that retirees spend much less than they did when they were working. Indeed, a recent survey found that while 58% of prospective retirees expected to reduce their spending in retirement, only 48% actually did, and 21% of retirees reported that spending *increased* after they retired.⁴ Raising the stakes are healthcare costs that have risen faster than the Consumer Price Index. Without a strategy that emphasizes portfolio growth and inflation protection, retirees may find that inflation can quickly eat into the funds they need to live on. ■

³The market conditions discussed here are subject to change. To see Bernstein's current outlook on market returns, please go to <http://www.alliancebernstein.com/abcom/Social/ReturnProjectionsandSustainableSpendingRates.pdf>

⁴EBRI and Mathew Greenwald & Associates, 2013 Retirement Confidence Survey

The Right Moves

These are daunting challenges indeed, and anxiety about retirement may be an appropriate response. But this anxiety is neither inevitable nor incurable. Investors who face today's financial realities squarely and make sound, research-based choices still have the power to achieve a secure retirement. That's because they have control over actions that really matter:

- Setting an asset allocation
- Seizing opportunities to defer taxes
- Optimizing the use of Social Security
- Setting a spending level
- Determining when to retire
- Choosing a savings rate

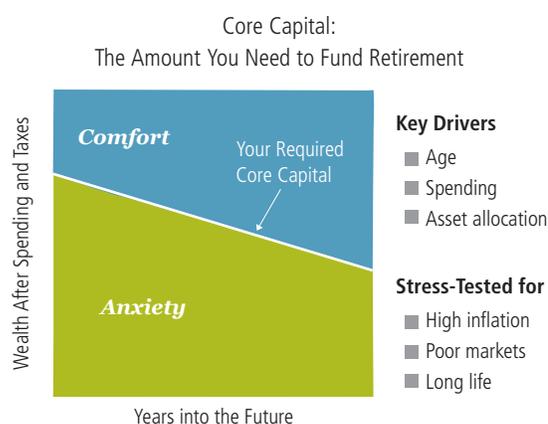
These decisions, taken individually or in combination with one another, can put you (or keep you) on a successful path. But before we discuss these possible solutions, we need to understand the goal.

Core Capital: A Critical Number

The first step in retirement planning is determining how much you intend to spend in retirement and when you plan to retire. These are very consequential choices that determine your "core" needs—the amount of capital required to fund retirement spending, even in hostile markets, for as long as you may live. At this stage of the process, it makes sense to start with the spending level and retirement date that you prefer. Planning is iterative, and if your early choices don't prove to be feasible, you'll have opportunities to revise them later on.

Display 3

Core Capital: A Disciplined, Research-Based Framework



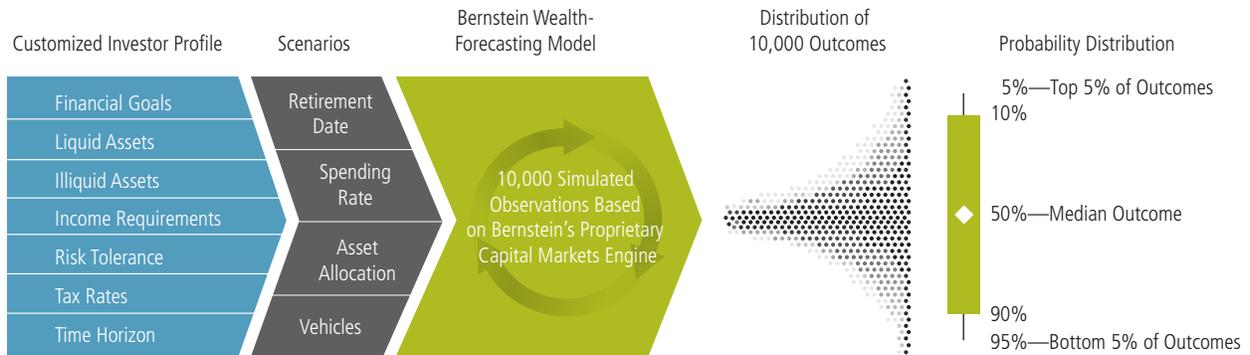
Source: AllianceBernstein

Display 3 identifies the area above the core-capital line as the comfort zone, and the area below as the territory of anxiety. But in reality, the line is not as sharp a division as it appears: Over the course of decades, many investors will cross between the green and blue zones more than once. As the chart shows, the core-capital line slopes downward. That's because, as time advances, there are fewer years to be funded and, hence, diminishing needs for capital.

Beyond your core-capital needs, you may also want to identify additional areas such as discretionary spending, wealth transfer, and other goals that call for surplus capacity. We discuss surplus capacity in other publications, but in this book we focus exclusively on core capital.

Display 4

Bernstein's Wealth Forecasting System Is Uniquely Able to Help



The Wealth Forecasting System is based upon our proprietary analysis of historical capital-markets data over many decades. We looked at variables such as past returns, volatility, valuations, and correlations to forecast a vast range of possible outcomes relating to market asset classes, not Bernstein portfolios. While there is no assurance that any specific outcome suggested by the model will actually come to pass, by quantifying the possibilities of achieving financial goals under changing, and sometimes extreme, capital-markets conditions, the tool should help our clients make better choices. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

Providing for what you need requires a customized plan. While we can't supply a crystal ball, we can use a quantitative model that combines the uncontrollable factors of longevity, market performance, and inflation with the levers you can control—among them when you retire, how much you spend, and how you allocate your assets in both taxable and tax-deferred accounts.

Setting a Rigorous Standard

To measure core capital and answer a multitude of investor questions, we use a financial modeling tool, Bernstein's Wealth Forecasting SystemSM, driven by our proprietary Capital Markets Engine (*Display 4*). We start from today's conditions and simulate 10,000 plausible paths for the economy, inflation, and a wide range of investments. From there, we can determine the probability of various investment outcomes, from poor to stellar. This allows clients to preview how they are likely to feel, over short and long periods of time, if they make certain decisions today. We believe core capital should meet your needs even if markets are dismal. So when our Capital Markets Engine simulates 10,000 paths, we often focus on core capital providing adequate resources in at least 9,000 of them. We call this the 90% level of confidence.

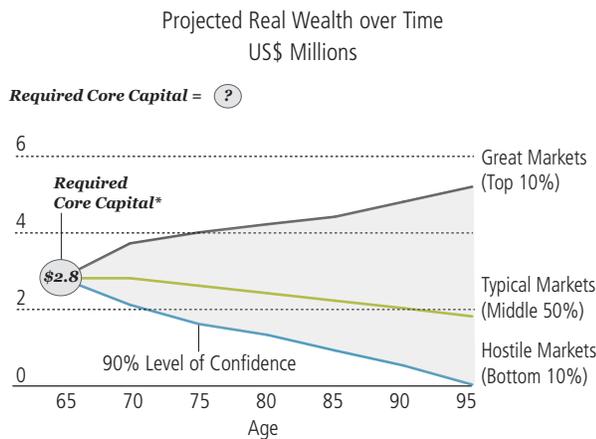
This is a very conservative standard, and deliberately so. We emphasize the 90% level of confidence because we know that, once in retirement, many people won't have the flexibility to cut spending drastically or to go back to work. As a fiduciary, we feel responsible for setting out a path that can lead our clients to success, even if times are tough.

As an example, let's suppose you are a 65-year-old couple funding your retirement from a portfolio with a moderate asset allocation that, for the sake of simplicity, is defined here as 60% global stocks and 40% municipal bonds (*Display 5, next page*). How much core capital do you need? Our Wealth Forecasting System tells us the answer is \$2.8 million for every \$100,000 of inflation-adjusted after-tax annual spending from your portfolio. This is a very conservative estimate; even if markets are hostile, a \$2.8 million portfolio will sustain \$100,000 of spending. If markets are typical, you certainly would not need that much; in fact, in median markets, for every \$2.8 million of starting value, your portfolio could be worth nearly \$2 million in today's dollars after supporting your spending for 30 years. And in great markets, every \$2.8 million of starting value could be worth more than \$5 million 30 years later.

Display 5

Core Capital Is Sized to Sustain Lifetime Spending Even in Hostile Markets

65-year-old retired couple per \$100,000 of annual spending from 60% stock/40% bond portfolio



*Core capital is the amount calculated at a 90% level of confidence for a 65-year-old couple spending \$100,000 annually (inflation-adjusted) from their portfolio; assumes 6.5% state income tax.

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

But no one can know which of these trajectories the markets will follow. That's why we recommend planning prudently by focusing on outcomes in hostile markets. A positive outcome at the 90% level of confidence is solid assurance that your money will last as long as you will need it.

Asset Allocation: Not Your Parents' Portfolio

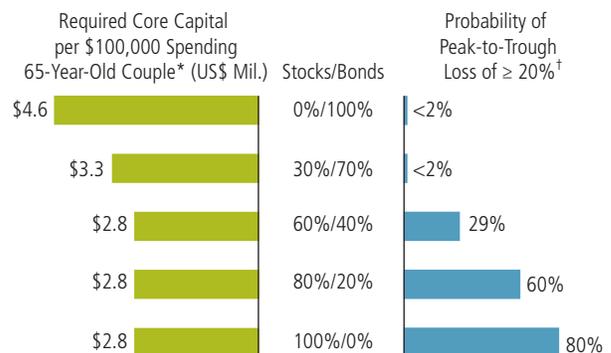
Your core-capital requirement depends on your spending level and retirement age, but it depends just as much on another key factor: your asset allocation. The \$2.8 million figure is contingent on your investing in a moderate portfolio. With different asset allocations, your capital requirement could be larger or smaller. For example, because expected bond returns are so poor, an all-bond allocation would require much more core capital—\$4.6 million—for every \$100,000 in inflation-adjusted annual spending (Display 6).

Know Thyself! Change Thyself?

But there's another side to this story: As the right-hand bars in Display 6 illustrate, the more growth-oriented a portfolio, the greater its volatility. We quantify volatility as the probability that a portfolio will undergo a peak-to-trough loss of 20% or more at some point during a particular period of time—20 years in this case. Such a short-term loss is large enough to give most investors pause. The first principle of risk-taking is "Know thyself!" Some people can tolerate a one-in-two chance of a loss this big, but others are uncomfortable with anything greater than a one-in-10 chance. This is a highly individual matter and, clearly, not an exact science, but an accurate estimate of your risk tolerance can prove very beneficial. If you underestimate your tolerance for risk, you may limit your investment returns unnecessarily. If you overestimate your tolerance for risk, you may panic when the market drops and do yourself serious financial harm.

Display 6

Higher Allocations to Equities Reduce Required Core Capital...but Also Increase Expected Volatility



*Core-capital amount is calculated at a 90% level of confidence for a 65-year-old couple spending \$100,000 annually (inflation-adjusted) from their portfolio; assumes 6.5% state income tax.

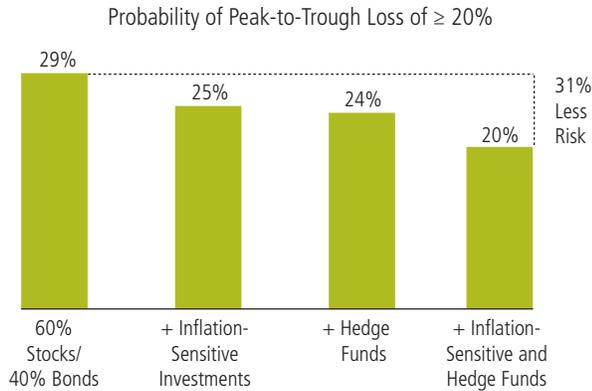
[†]Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of at least 20% over the next 20 years. Because the Wealth Forecasting System uses annual capital-markets returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years.

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

Display 7

Adding Diversifying Assets Can Mitigate Volatility



Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of at least 20% over the next 20 years. Because the Wealth Forecasting System uses annual capital-markets returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. “+ Inflation-Sensitive Investments” are modeled as 52%/40%/8% (stocks/bonds/REITs); “+ Hedge Funds” are modeled as 51.7%/34.5%/13.8% (stocks/bonds/hedge funds); “+ Inflation-Sensitive and Hedge Funds” are modeled as 44.5%/34.5%/7%/14% (stocks/bonds/REITs/hedge funds). Bonds for inflation-sensitive allocations are modeled as 75% intermediate-term diversified municipal bonds and 25% inflation-sensitive municipal bonds.

Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

This isn’t to say that your tolerance for risk is a fixed and permanent feature of your personality. Understanding long-term patterns in the investment markets can change your perspective. For some individuals in some situations, there’s a second principle, as well: “When necessary and possible, change thyself!”

As Display 6 shows, the risk of a 20% peak-to-trough loss is negligible with a preservation-oriented asset allocation, which we’re defining here as an allocation to stocks of 30% or less, but it’s 29% with a moderate allocation and 80% with an all-stock portfolio. There’s something else that’s noteworthy on this chart: Beyond a certain point, adding equities does not reduce your core-capital requirement. At the bottom left of the display, you can see that required core capital is just as high for

a portfolio with 80% or 100% equities as for one with a 60% allocation to stocks.

This may seem anomalous, but it’s actually due to a well-understood cause: the substantially higher volatility of an all-equity portfolio. A large allocation to equities may be fine if you are not currently withdrawing anything from your portfolio, but if you are drawing on your investments to support your spending, volatility can be very damaging. Withdrawing money when a portfolio is down can permanently erode wealth. So while an appropriate exposure to equities is certainly good for most retirees, more equities aren’t necessarily better.

A Broader Investment Universe

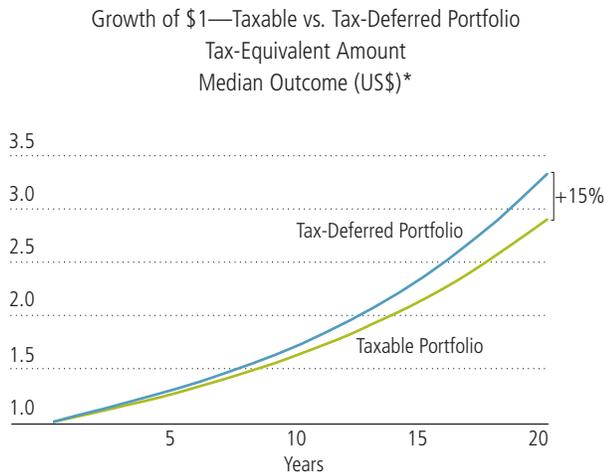
Happily, the investment universe contains more than just stocks and bonds. Today, investors can own a much broader array of assets, which we categorize as return-seeking, risk-mitigating, or diversifying. Equities and high-yield bonds are examples of return-seeking assets. High-quality intermediate-duration bonds, global bonds, and short-duration bonds are in the risk-mitigating category. Inflation-linked bonds are primarily risk-mitigating, but they are also diversifying because they tend to perform better than traditional bonds when inflation rises. Real assets and hedge funds are diversifying, owing to their low correlations to both stocks and bonds.

Real assets such as real estate investment trusts (REITs) and commodities are forms of tangible property that tend to rise in value as inflation mounts. This can make them an effective hedge against inflation. Hedge funds can also play an important role. While hedge funds as an asset class have a multitude of risk and return characteristics, a fund of diversified hedge funds, if properly structured, can provide diversification benefits as well as solid returns. As a result, it can improve the risk/return profile of most balanced accounts.

The 29% expected peak-to-trough volatility of a moderate portfolio could be brought down to 25% with the addition of real assets and inflation-linked bonds, or it could be brought down to 24% with the addition of diversified hedge funds (Display 7). Adding both of these new components would cut the odds of a large peak-to-trough loss from 29% to only 20%—a reduction in risk of more than 30%. This is why we

Display 8

Tax Deferral Augments Portfolio Growth



*After-tax portfolio amounts are net of implied capital-gains tax for assets in taxable portfolio (where applicable) and ordinary-income tax for assets in tax-deferred portfolio. Initial investment amounts are \$1.00 for taxable portfolio and \$1.50 (pretax equivalent) for tax-deferred portfolio. Assumes allocation of 60% stocks and 40% intermediate-term fixed income. Bonds are modeled as diversified municipal bonds in the taxable portfolio and taxable bonds in the tax-deferred portfolio. Income-tax rate assumptions: federal 33% ordinary and 15% long-term capital gains/qualified dividends; 1.45% Medicare payroll tax on earned income and contribution to tax-deferred portfolio. Assumes investor is 50½ years old (or younger) and no required minimum distributions are due for the 20-year analysis.

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals, as appropriate, before making any decisions. Source: AllianceBernstein

encourage all our clients, especially those who are spending from their portfolios, to diversify with appropriate asset classes like these, which reduce volatility without sacrificing expected return.

We also have tools to reduce portfolio risk further by using dynamic allocation strategies, which can help assure that the volatility of your portfolio won't exceed your tolerance.

Staying the Course

The return and volatility projections we present are all based on the assumption that investors will maintain a particular exposure to return-seeking, risk-mitigating, and diversifying assets throughout the given period. This may seem obvious, but it's a

critical point. When the stock market dives and your friends are telling you to sell, the temptation to bail out can be very strong. Likewise, when the market is soaring and the whole world seems to be buying, the pressure to join the crowd can be hard to resist. But those are precisely the times to remember the rationale behind your particular asset allocation, which has been tailored to your core-capital requirement and your tolerance for risk. Buying when everyone else is buying and selling when everyone else is selling means buying high and selling low, which is not one of the right moves.

Defer Taxes Whenever Possible

Tax-deferred retirement vehicles such as 401(k) plans and IRAs would seem to be an obvious preference, but there's a catch. When money is withdrawn from these plans, it's taxed as ordinary income, while in a taxable investment account, long-term capital gains and qualified dividends are taxed at a more favorable rate. Nonetheless, our research indicates that the benefit of tax-deferred compounding outweighs the difference in tax rates on withdrawal, and it's wise to make as much use of tax-deferred accounts as you can. Display 8 shows that after two decades, a tax-deferred portfolio will be worth 15% more after all federal taxes have been paid—assuming today's tax regime remains in effect throughout the period.

Display 9

Deferred Taxes May Be Paid at Lower Rates in Retirement

Example: Current Income = \$250,000; Marginal Tax Rate = 33%

Taxable Retirement Income	Marginal Tax Rate	Potential Tax Savings* (pct. pts.)
\$223,051 to \$250,000	33%	0
\$146,401 to \$223,050	28%	5
\$72,501 to \$146,400	25%	8
\$17,851 to \$72,500	15%	18

State taxes may also be lower in retirement

*Based on Health Care and Education Reconciliation Act of 2010 and the American Taxpayer Relief Act of 2012. Tax rates are federal-only for joint filers. Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals, as appropriate, before making any decisions.

Source: IRS and AllianceBernstein

In fact, your tax savings will likely be more than 15%. Once in retirement, your tax rate is likely to be lower than it was during your working years. If you earned \$250,000 a year before retiring but have income of \$145,000 in retirement, the marginal federal tax bracket on your investment returns could be eight percentage points lower in retirement (*Display 9*). You might realize further income tax savings at the state level—particularly if you live in a state that gives preferential tax treatment to withdrawals from retirement accounts or if you retire in a state with lower tax rates.

The Asset-Location Quandary

If you have both taxable and tax-deferred accounts, which assets should you shelter in the latter? If the point is to delay paying higher tax rates, it would seem logical to shelter bonds because the top federal tax rate on income from bonds is 43.4% while the top rate on qualified dividends and capital gains from a stock portfolio is 23.8%. But since in a balanced portfolio the bulk of returns is unlikely to come from bonds, it may, in fact, make more sense to shelter stocks.

Our research suggests that there is no clear answer to this question. We looked at tilting the tax-deferred portfolio to stocks, tilting the tax-deferred portfolio to bonds, and weighting the two asset classes equally. We found that tilting to stocks resulted in a small increase in median wealth over long horizons, but not enough to extend the years of sustainable spending from a portfolio at a 90% level of confidence.

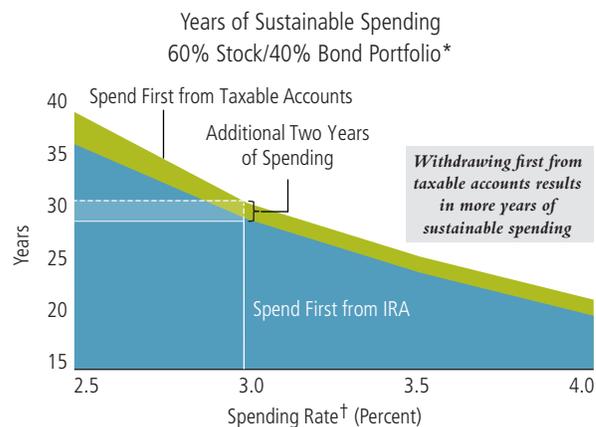
However, there may be some diversifying asset classes that are better housed in a tax-deferred portfolio. REITs, which pay out large dividends that are taxed as ordinary income, and hedge funds, which may take short-term capital gains, are two examples. To the extent possible, you might want to hold these assets in a tax-deferred account. Finally, working with your advisors, it is important to monitor changes in your tax bracket over time to ensure that the location and management of these assets remain as tax efficient as possible.

Taking Full Advantage of Tax Deferral

Clients approaching retirement or in retirement frequently want to know which account to spend from first—taxable or tax-exempt. For retirees who intend to leave tax-deferred assets to beneficiaries, this decision must be coordinated with their

Display 10

The Benefit of Spending Taxable Accounts Before Retirement Accounts



* Sustainable spending is calculated at a 90% level of confidence. Assumes a 65-year-old couple with \$2 million total assets: \$1 million IRA, \$1 million taxable portfolio. The analysis assumes blended effective federal/state tax rates of 35% for income and 20% for capital gains, and includes the impact of required minimum distributions in both scenarios.

† After-tax spending is modeled as percentage of initial assets, grown with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 40 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

estate plans. For others, the benefits of tax deferral continue into retirement, so it makes sense to extend the life of your 401(k) and IRA accounts for as many years as possible. In other words, spend down your taxable portfolio first. *Display 10* shows the case of a 65-year-old couple with half their assets in an IRA and half in a taxable account. They have a moderate asset allocation and spend 3% of their portfolio each year. If they withdraw first from their taxable account and take only the required minimum distributions from their IRA starting at age 70½, their assets will last 31 years instead of 29. Extending spending two additional years might seem like a small benefit today, but it will be very welcome if they reach age 94.

The Social Security Conundrum

Social Security payouts can be drawn as early as age 62, which is when the majority of recipients do begin taking them. But the benefit at that point is some 25% below the payout available at

(continued on page 12)

Should You Purchase a Fixed Annuity?

If you're concerned about outliving your assets, a fixed annuity might be an effective way to protect yourself against longevity risk and market volatility. Although Bernstein is not in the annuity business, we've studied the role of annuities and other insurance products in our clients' portfolios. (See *Appendix for our views on term life insurance.*)

The basic fixed annuity is a product purchased from a life-insurance company with a lump-sum payment. The insurer promises to make fixed payments at regular intervals for as long as you live.

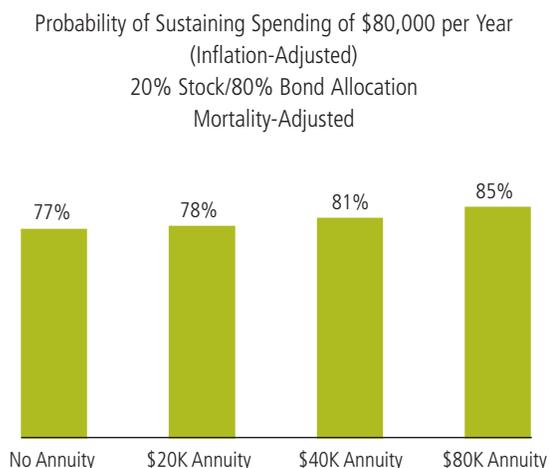
Let's consider the case of John Prudence, age 65 and retired. He has accumulated a portfolio of \$2 million, which is invested with a preservation-oriented allocation. His after-tax spending goal is \$80,000 per year, and he expects his expenses to increase with inflation during his lifetime. He's concerned about volatile markets and therefore wants to keep his current asset allocation, but he's also worried about outliving his assets. John wants to know whether he should buy a single-premium immediate annuity to cover a substantial portion—or perhaps all—of his anticipated expenses.

John learns that an annuity paying him \$80,000 a year will cost \$1.13 million of his \$2 million portfolio.⁵ He'll have guaranteed income for life, and his annuity will not be subject to market volatility. But there are some potential drawbacks: John will have limited access to the principal of the annuity, and its growth will be taxed at his ordinary income rate—not the more favorable rates applied to long-term capital gains and qualified dividends. Furthermore, after a period (corresponding to John's life expectancy) when his withdrawals will be deemed largely a tax-free return of premium, taxes on the payouts will spike—possibly when he needs the money most.

⁵Quote from *The Guardian Life Insurance Company of America* (July 2013)

Display 11

Can a Fixed Annuity Ensure Spending Needs Are Met?



Stocks are modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small-/mid-cap, 22.5% developed international, and 7.5% emerging markets, and bonds are modeled as intermediate-term diversified municipals. Based on Bernstein's estimates of the range of returns for the applicable capital markets over a 65-year-old male's life. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

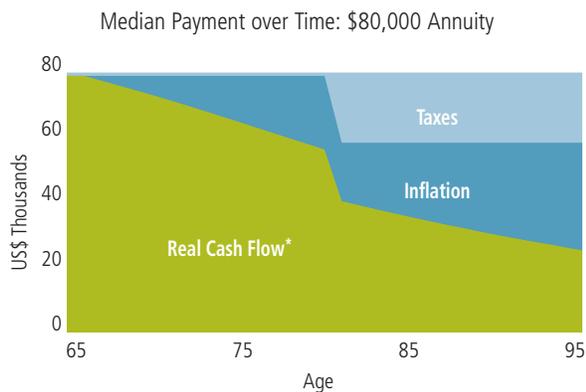
Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

Nevertheless, according to our mortality-adjusted wealth-forecasting analysis, the fixed annuity would increase John's chances of meeting his spending goal for life. Going from left to right across *Display 11*, you can see that the more funds he allocates to the annuity, the greater the likelihood of maintaining \$80,000 of after-tax, inflation-adjusted spending each year for life. However, no combination of fixed annuity and preservation-oriented portfolio gets him to the 90% level of certainty we'd typically like to see.

In addition, inflation and taxes limit the benefit of the fixed annuity (*Display 12*). Although John's living expenses will likely rise with inflation, the fixed annuity will not. As time

Display 12

Inflation and Taxes Reduce Annuity Purchasing Power



In accordance with Section 72 of the Internal Revenue Code, we assume that (i) for the first 15 years, each annuity payment will be treated partly as return of “investment in the contract” and partly as taxable ordinary income; and (ii) thereafter, each annuity payment will be entirely taxable ordinary income. For the taxable component of each annuity payment, we assume a blended federal and state ordinary income tax rate of 21% for the first 15 years (because of the very low amount of ordinary income recognized under Section 72 in those years) and 27% thereafter.

* “Real Cash Flow” means inflation-adjusted, after-tax distribution.

Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals, as appropriate, before making any decisions.

Source: AllianceBernstein

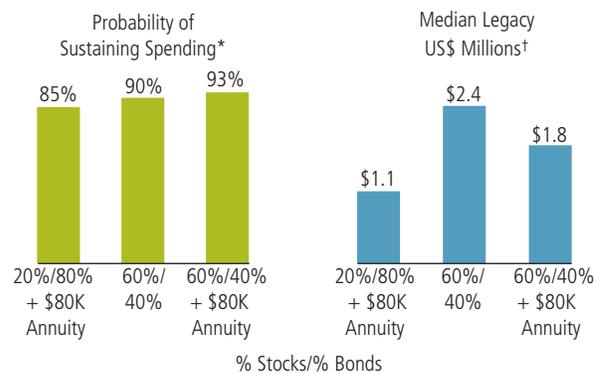
passes, the annuity will meet less and less of his spending needs, and his capital-markets portfolio, which is preservation-oriented, will have to bear an ever-increasing spending burden. But the annuity might help John in another way. Knowing he’ll receive \$80,000 a year for life could give him the confidence to shift his remaining capital-markets portfolio to a less preservation-oriented allocation. Let’s suppose that he combines a moderate portfolio with the annuity (Display 13). Now the picture really changes. With a fixed annuity for the lion’s share of his spending needs in the early years of his retirement, John might be able to tolerate

a moderate asset allocation in his remaining portfolio. This would raise the probability of meeting his spending goal to 93%. That is the true merit of the fixed annuity: It’s a relatively simple, inexpensive product that can decrease your reliance on your portfolio for near-term spending and potentially give you the confidence to take on a more appropriate level of portfolio risk.

However, this strategy does involve some trade-offs. John’s retirement security will now depend on the continuing financial strength of the insurance company providing the annuity. Furthermore, as shown in the blue columns on the right side of Display 13, John’s estate at death is likely to have less wealth with the annuity than without it. Put another way, he’ll have less flexibility in his later years to deal with any unanticipated needs that might arise. ■

Display 13

A Proper Asset Allocation Is Critical



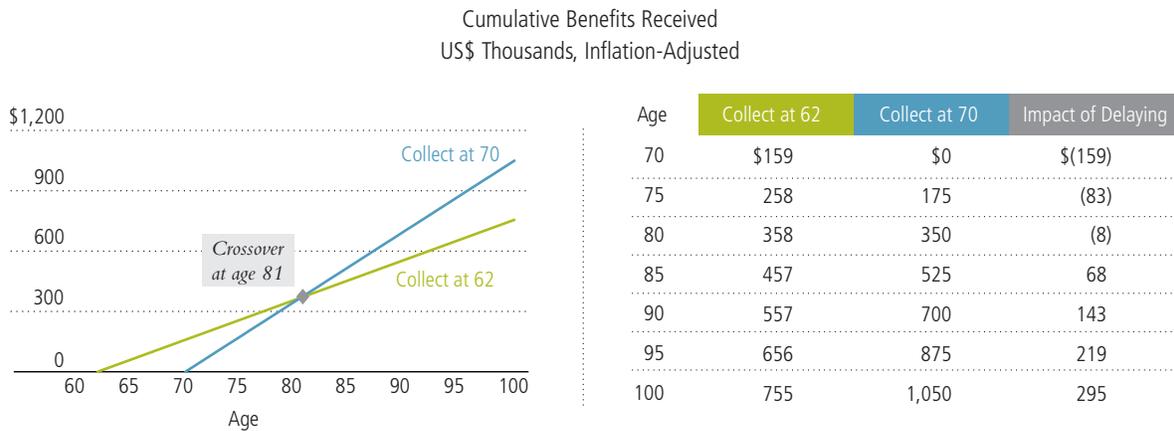
*Indicates probability that the annuity and/or portfolio will be sufficient to sustain investor’s annual living expenses for life

†Median assets remaining in portfolio at Year 20 (age 85)

Based on Bernstein’s estimates of the range of returns for the applicable capital markets over a 65-year-old male’s life. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

Delaying Start of Social Security Augments Income Later in Life, When You May Need It Most



Assumes that the individual has paid the maximum amount into Social Security since age 22 before beginning to receive benefits. Also assumes no earned-income offset if benefits begin at age 62.
 Source: Social Security Administration and AllianceBernstein

“full retirement age” (66 for those born between 1943 and 1954). Furthermore, as an incentive for workers to wait still longer, the Social Security Administration offers “delayed retirement credits” of 8% per year between ages 66 and 70. These can translate into as much as \$17,000 more in annual benefits. So is it better to receive small Social Security payouts for a longer period of time, or to wait and receive larger benefits later?

The answer depends on where you stand with respect to core capital. If you’ve met your core-capital requirement and live to your full life expectancy, you’ll have roughly the same amount of wealth no matter when you start receiving benefits. Beginning at age 66 is likely a smart choice.

But if you have not reached core capital, waiting until age 70 can be quite valuable. And the longer you live, the greater the value of waiting will prove to be. If you reach age 85, collecting at age 70 versus age 62 could add \$68,000 in cumulative benefits received, and if you live to 95, it could add \$219,000 (Display 14).

This approach may seem counterintuitive. Since your retirement is underfunded, you might instinctively think that it is better to support spending with Social Security funds as soon as possible. However, an important part of our core-capital calculation is determining whether your portfolio is sufficient to support you if you live longer than expected. Waiting until age 70 and taking advantage of the higher Social Security benefits provides you with a kind of low-cost longevity insurance, courtesy of the government.

Married couples may have additional ways to maximize their Social Security benefits. The rules regarding spousal benefits are particularly complex, and two strategies, known as “claim-and-switch” and “file-and-suspend,” have enabled many couples to take full advantage of the available benefits. For more information about our research into these issues, see “Tapping into Social Security: A Framework for Timing Benefits,” published in the February 2013 issue of *The CPA Journal*.⁶

Can You Compromise?

The measures we’ve discussed—setting your asset allocation, utilizing tax-deferred retirement accounts, and optimizing the use of Social Security—are all relatively painless steps that you

⁶To access The CPA Journal article, go to <http://viewer.zmags.com/publication/81bfaf6e#/81bfab6e/54>, page 52.

Sustainable Spending Rate: Driven by Age, Allocation, and Market Conditions

Sustainable Spending Rate—Current Conditions

Age	Allocation (% Stocks/% Bonds)		
	30%/70%	60%/40%	80%/20%
62	2.7%	3.2%	3.3%
65	2.9	3.4	3.6
68	3.2	3.7	3.8

Sustainable Spending Rate—Normal Conditions

Age	Allocation (% Stocks/% Bonds)		
	30%/70%	60%/40%	80%/20%
62	3.3%	3.7%	3.8%
65	3.6	4.0	4.2
68	3.8	4.3	4.3

These spending rates are for couples and assume an allocation of globally diversified stocks and intermediate-duration diversified municipal bonds in the proportions noted. Spending is a percentage of initial value of the portfolio and is grown with inflation; spending rates assume maintaining spending with a 90% level of confidence. Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the period analyzed as of March 31, 2013. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. All information on longevity and mortality-adjusted investment analyses in this study are based on mortality tables compiled in 2000. To reflect that high-net-worth individuals tend to live longer than average, we subtracted three years from each individual’s age (e.g., a 55-year-old would be modeled as a 52-year-old). In our mortality-adjusted analyses, the life span of an individual varies in each of our 10,000 trials in accordance with mortality tables. Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

can take. But if they don’t put you on a path to core capital at a 90% level of confidence, you may want to review your starting assumptions: your retirement date, your spending level, and (if you are still working) your savings rate. These may lead to less comfortable planning choices, but compromises here can assure that you’ll have everything you need, if not exactly everything you want.

Spending Less

Your planned spending level in retirement has a direct and powerful impact on your core-capital requirement. If you cut your spending 10%, your core-capital requirement will fall proportionately.

It’s very helpful to turn the equation around. To this point, we’ve asked how much core capital you need to sustain a given spending level; now, let’s ask how much you can sustainably

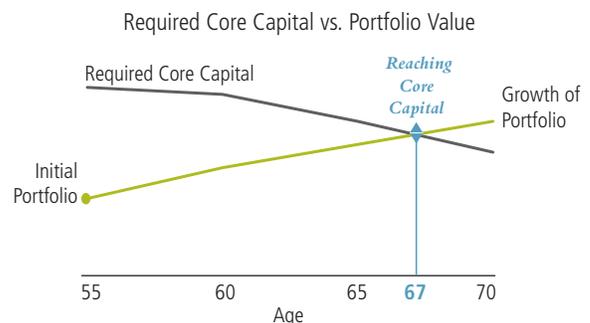
spend from a given amount of core capital. As illustrated in Display 15, your age and asset allocation have a large impact on the answer, as do market conditions. Today, a 65-year-old couple with a moderate asset allocation can sustainably spend 3.4% of their portfolio each year with a 90% level of confidence. As the bottom of the chart indicates, in more normal markets they could sustain a 4% spending rate—a further reminder that in today’s more constrained conditions, planning and discipline are absolutely critical to retirement success.

(To see our current market-return projections, together with a sustainable-spending index for a range of asset allocations and ages, go to <http://www.alliancebernstein.com/abcom/Social/ReturnProjectionsandSustainableSpendingRates.pdf>)

Working Longer

As we discussed on page 4, the core-capital line slopes downward because the older you are, the less core capital you need. That is why setting your retirement date is such a momentous decision. If you are not on track to reach your core-capital requirement, putting off your retirement date may put you in range—first, because your portfolio will have additional years to grow, and second, because it will not have to last as long. Display 16 shows the case of a 55-year-old couple who have

Working Longer Allows Greater Portfolio Growth



Required core capital calculated at a 90% level of confidence for a 55-year-old couple invested in a 60% global stock/40% intermediate-term municipal-bond portfolio. “Initial Portfolio” depicts the median growth of a 60% stock/40% bond portfolio and assumes no spending. Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

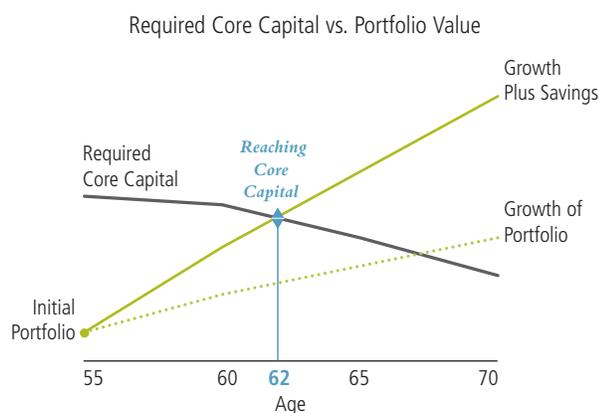
started to formulate their retirement plan. They had always expected to retire at 65, but they're not on track to reach core capital until age 67. Working those two extra years could make a large difference.

Saving More

But what if they decide that they hate the idea of working until age 67? What if they really want to retire at 62? *Display 17* shows how they could do it. By saving 5% of their portfolio's current value annually, grown with inflation, they'd be able to reach their required core capital at age 62 rather than 67. But advancing their retirement date by five years is a very significant change in their plan, and it will require a major increase in their savings rate. Remember, this is 5% of their portfolio, not 5% of their income—in other words, \$50,000 of annual savings, grown with inflation, for every \$1 million in their portfolio. Should they do it? The choice is theirs to make. Only they can decide if this would be a sensible path for them.

Display 17

Additional Savings Can Fund an Earlier Retirement



Required core capital calculated at a 90% level of confidence for a 55-year-old couple invested in a 60% global stock/40% intermediate-term municipal bond portfolio. "Growth-of-Portfolio" line depicts the median growth of a 60% stock/40% bond portfolio and assumes no spending. "Growth-Plus-Savings" line depicts the growth of the portfolio if the couple saves 5% of their initial portfolio value annually, grown with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See *Notes on Wealth Forecasting System*, page 24, for further details. Source: AllianceBernstein

An Ongoing Process

When we spoke earlier (see page 8) about staying the course, we did not mean to imply that your retirement plan should be inscribed in marble and permanently installed on your mantelpiece. Flexibility is vitally important to success. At regular intervals, you'll want to monitor your progress against the plan and, when necessary, revise it. Are you advancing toward your core-capital requirement at a reasonable pace? Are you moving away from it—either by overshooting it or undershooting it? Small variations around core capital are to be expected, but if the goal truly seems to be eluding you, it could be time to review the right moves we've discussed throughout this book. You could rethink your asset allocation, your use of tax-deferred vehicles, your retirement date, your savings rate, or your spending level.

If, on the other hand, the investment markets have been favorable enough to put you significantly above your core-capital line, you will have several options to consider. You might want to reduce portfolio volatility by shifting to a more preservation-oriented asset allocation. Another possibility is to bring your spending up to the level that's now become sustainable. Yet another path would be to make plans to transfer some of what you can now recognize as surplus capacity to family members or charitable causes that you favor.

Choices that Matter

We've reviewed a series of significant choices you can make to put yourself on the path to a secure retirement. To recap, you can move toward meeting your core-capital requirement by:

- Increasing your allocation to return-seeking assets
- Keeping more of your savings in tax-deferred accounts
- Working longer
- Spending less

The case studies that begin on page 15 make these alternatives more tangible. As you'll see, pre-retirees and retirees may combine several of these steps to reach their goals. ■

Putting It All to Work: Case Studies

Meet the Maykits and the Stretches

While the case studies that follow are hypothetical, they are based on thousands of actual clients we've helped in recent years. The dollar values are specific to these cases, but the planning concepts are broadly applicable. The Maykits are years away from retirement, so they're in a position to control their asset allocation, their retirement date, and their spending level in retirement. The Stretches have already retired and can still make decisions about their asset allocation, spending level, and starting date for Social Security.

Case #1: The Maykits

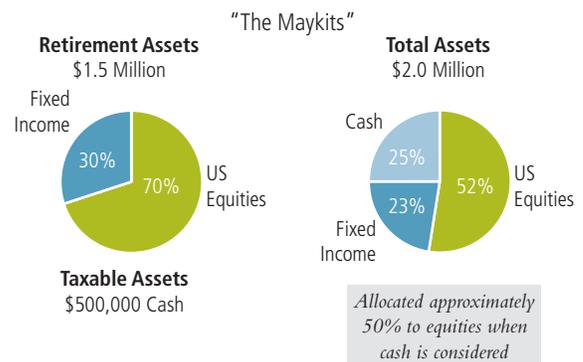
Will and Wanda Maykit, both age 55, have always expected to retire at 67. Will earns \$200,000 and Wanda \$250,000 a year. They've become diligent savers in recent years, and they both max out their 401(k) contributions and take full advantage of their employers' matching programs.⁷ Each year, after taxes, they're able to save an additional \$70,000. They have a total of \$2 million in liquid net worth, including \$1.5 million in retirement accounts and \$500,000 of cash in the bank from their bonuses of the last few years. The Maykits' annual expenses, roughly \$250,000, currently include \$50,000 in tuition for a daughter entering her junior year of college. They make monthly mortgage payments of \$2,275.⁸ Their projected spending rate in retirement is \$200,000 a year in today's dollars.

When we met Will and Wanda, their primary concern was whether they were on a path to retiring at age 67. They had a second question, too: Because of an article they had read, they wanted to know if they should pay off their mortgage.

We started by creating a net-worth statement that illustrated their asset allocation (*Display 18*). With their retirement accounts

Display 18

Starting Point: Net-Worth Statement



*Initial allocation assumes intermediate-term fixed income, diversified US equities, and a tax-free money-market fund.
Source: AllianceBernstein*

invested 70% in stocks and 30% in bonds, they thought of themselves as growth-oriented investors. But when we included their \$500,000 of cash, they could see that the picture was quite different: At 52% of their portfolio, their allocation to return-seeking assets was only moderate. And all that cash was earning nothing.

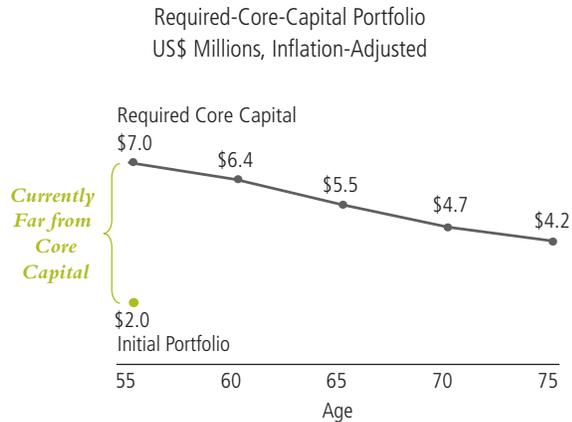
Next, we evaluated where they stood versus their core-capital requirement (*Display 19, next page*). If they retired today, they would need \$7 million of core capital, so with savings of just \$2 million, they'd be \$5 million short. Over time, however, investment gains plus additional savings would eventually close the gap. As illustrated in *Display 20 (next page)*, in typical markets we'd expect them to reach core capital at age 70. They'd get there earlier if markets were great, and later if markets were poor.

⁷Employers match 5% of salary, considered an "average" match according to the US Bureau of Labor Statistics.

⁸Assumes a 30-year fixed-rate mortgage of \$500,000 at 3.6%

Display 19

The Maykits Are Still Building Their Core Capital



Core capital calculated at a 90% level of confidence. See Display 18 for the allocation of the initial portfolio. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

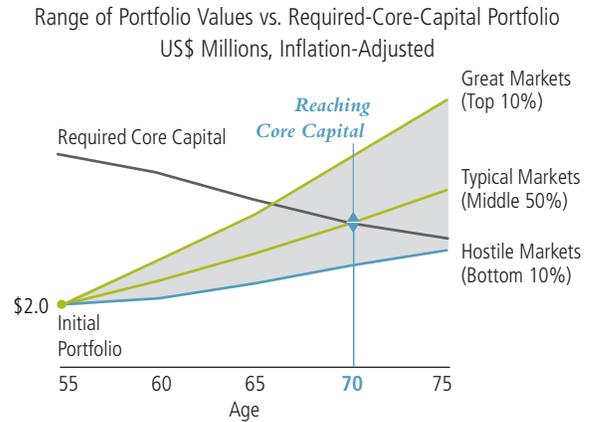
But remember, their goal was to retire at age 67. What can they do besides crossing their fingers and wishing for bull markets? The first step would be to put their cash to work. Simply by investing it at their current 70% stock/30% bond mix, they could boost their median return projections over the next 10 years from 4.4% to 5.6%. That would be helpful, but the risk of at least a 20% peak-to-trough loss over that period would surge from 14% to 33%.

We suggested, instead, an enhanced asset allocation⁹ for their entire portfolio—both the retirement accounts and the \$500,000 of cash. This asset mix, which would include non-US stocks, inflation-sensitive investments, and alternative assets, would improve their projected returns to 5.8% while limiting the risk of a 20% peak-to-trough loss to just 19%. The enhanced asset allocation gave the Maykits a high probability of reaching their required core capital three years earlier. In other words, they would be able to retire at 67, their target age (Display 21). They were thrilled with this result.

⁹Enhanced allocation is modeled as 49.5% global equities, 25% bonds, 8.5% REITs, and 17% hedge funds. Bonds are modeled as 75% intermediate-term fixed income and 25% inflation-sensitive bonds.

Display 20

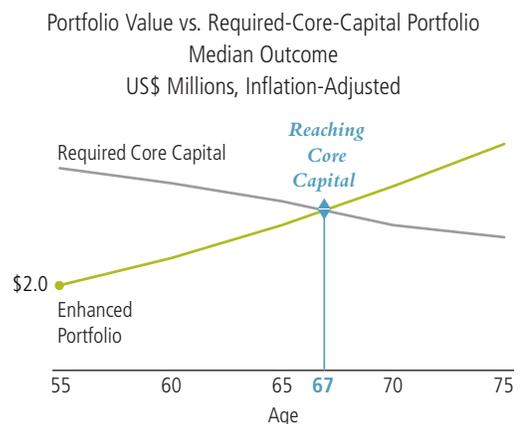
In Typical Markets, They'll Reach Core Capital at Age 70



Core capital calculated at a 90% level of confidence. See Display 18 for the allocation of the initial portfolio. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

Display 21

Enhanced Allocation Allows the Maykits to Retire Three Years Earlier



Required core capital is calculated at a 90% level of confidence for a couple spending \$200,000 annually, adjusted for inflation, from a 70% stock/30% bond portfolio. "Enhanced Portfolio" illustrates the median growth of the portfolio. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

We also showed the Maykits that paying off the mortgage would not affect their retirement date. While it might feel good to stop writing checks to the bank each month, the benefit of eliminating monthly payments would be offset by forgoing returns on investment of the capital they would use, especially since it's a fixed-rate mortgage and interest rates are rising. In addition, maintaining the mortgage could provide an incremental benefit due to the tax deductibility of mortgage interest.

They planned to take Social Security next year and wondered if the extra income would allow them to spend more.

The Stretches were open to the idea of owning more stock, but they wanted to know how this might impact their budget. Would they be able to sustain their current spending with 90% confidence? Could they, perhaps, get back to their old spending level?

Case #2: The Stretches

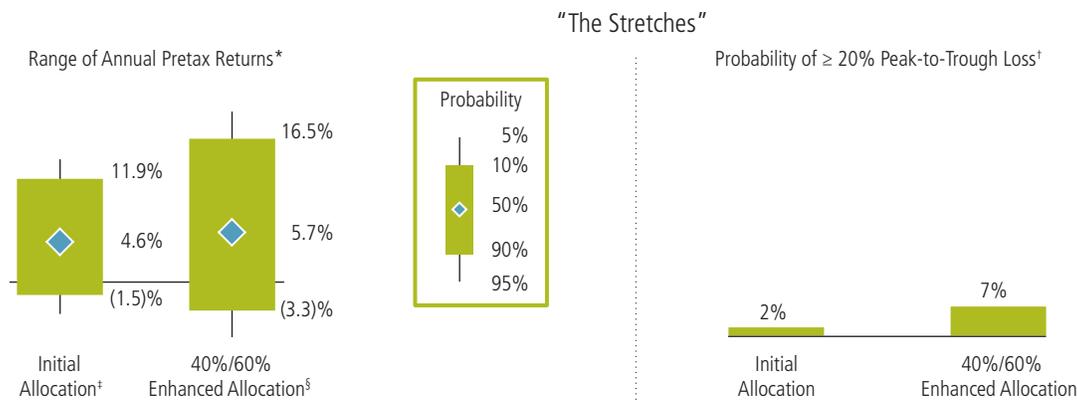
Ken and Nida Stretch are a retired couple in their mid-60s. When we met them, their current assets, which totaled \$3 million, were invested 20% in stocks, 60% in bonds, and 20% in cash. Before the credit crisis, they had been invested in a 40% stock/60% bond portfolio, but in 2009 they sold half their stock, and they kept the proceeds in cash ever since. In 2009, the Stretches also cut back their spending from \$12,000 to \$11,000 a month (or \$144,000 to \$132,000 a year). This meant giving up some travel and family visits that they really treasured.

Our Wealth Forecasting Analysis showed that their plan would not support their spending of \$132,000 a year. If, as they intended, they were to take Social Security next year at age 66, their portfolio would sustainably support spending of \$117,000 a year. Delaying Social Security to age 70 would let them spend \$122,000 a year. That would help, but not enough.

To enable the Stretches to stretch their budget further, we also looked at their long-term asset allocation. We wanted to get them back to 40%/60%, but we had more in mind than that:

Display 22

An Enhanced 40%/60% Allocation Improves Expected Returns with Little Increase in Risk



*First-year volatility of the portfolios: initial allocation = 4.0%; 40%/60% enhanced allocation = 6.7%. The annual-equivalent volatility of the portfolios over the 35-year analysis: initial allocation = 9.0%; 40%/60% enhanced allocation = 10.5%. Annual-equivalent volatility differs from the first-year volatility because the expectation and distribution of asset-class returns change over time. If the allocation targets change over time, this will also affect the annual-equivalent volatility of the portfolio, but will not be reflected in the one-year volatility.

†Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of at least 20% over the life of the forecast. Because the Wealth Forecasting System uses annual capital-markets returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years.

‡The Initial Allocation is modeled as 20% global equities, 60% intermediate-term bonds, and 20% cash equivalents.

§The 40%/60% Enhanced Allocation is modeled as 33% global equities, 57% bonds, 3% REITs, and 7% hedge funds. Bonds are modeled as 75% intermediate-term fixed income and 25% inflation-sensitive bonds.

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 35 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

We thought they needed greater diversification. Adding diversifiers—inflation-sensitive assets and hedge funds—would make an important difference (*Display 22, previous page*). Investing the cash and enhancing the allocation would raise their median expected return from 4.6% to 5.7% without much increasing the risk of a large loss. The Stretches felt the additional volatility was a reasonable price to pay for the extra return.

The combination of delaying Social Security and enhancing their asset allocation helped a lot. It brought their sustainable annual spending to \$136,000—enough to support their current budget. But it was still short of their \$144,000 goal.

We wondered how growth-oriented their asset allocation would have to be to reach their goal. We found that they'd need a 70%/30% allocation. Some clients could live with that kind of portfolio, but not the Stretches. With a 70/30 portfolio, they'd

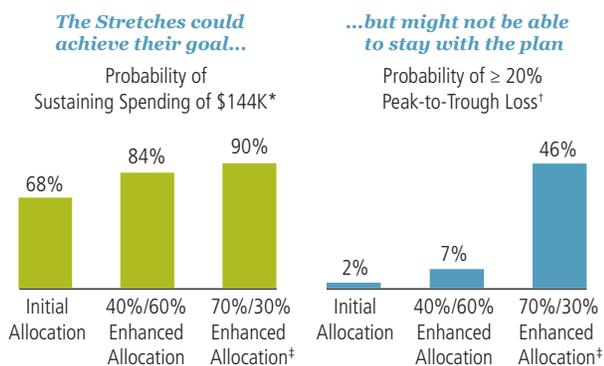
face nearly 50% odds of experiencing at least a 20% peak-to-trough drop (*Display 23*). The Stretches had already been through this kind of stress in 2008, and they knew that they were likely to bail out of stocks once again. So they told us, regretfully, that 70/30 would not work for them.

Then we made a different suggestion: They could spend at their desired \$144,000 annual level for the next 10 years—as long as they were ready to cut their spending to \$132,000 in Year 11 if their investment returns were disappointing. This two-stage plan would let them achieve their spending goal for 10 years with 90% confidence. And if the markets turned out to be good—or even just typical—the Stretches would be able to go on spending \$144,000 a year. In fact, there would be an 83% chance that they would not need to cut their spending at all (*Display 24*).

The Stretches were very happy with this solution, which underscored how much they still controlled, even in retirement. ■

Display 23

Would a More Growth-Oriented Allocation Be the Answer?



*Based on Bernstein's estimates of the range of returns for the applicable capital markets and the Society of Actuaries RP-2000 mortality tables. Spending is assumed to increase each year with inflation.

†Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of at least 20% over the next 35 years. Because the Wealth Forecasting System uses annual capital-markets returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years.

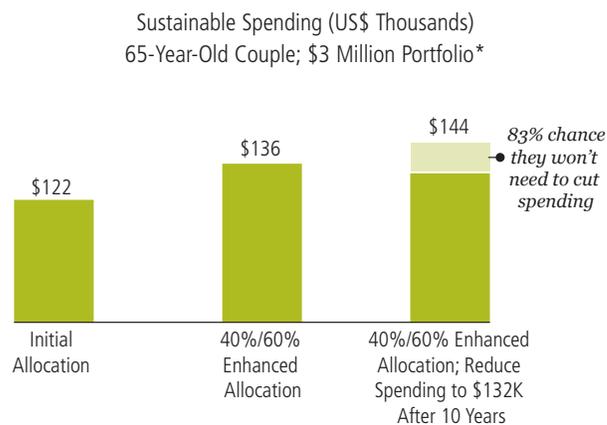
‡70%/30% Enhanced Allocation is modeled as 53% global equities, 25% bonds, 5% REITs, and 17% hedge funds. Bonds are modeled as 75% intermediate-term fixed income and 25% inflation-sensitive bonds.

Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

Display 24

An Alternative: Spend at Target Now; Plan to Reduce Spending in 10 Years



*Sustainable spending calculated at a 90% level of confidence. Spending is assumed to increase each year with inflation. Assumes each spouse receives \$34,991 in pretax Social Security benefits at age 70. Social Security benefits are in today's dollars and adjusted with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the period analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

How Bernstein Helps You Formulate and Implement Your Plan

The first step in developing a retirement plan is deciding on your goals: your preferred spending level and the age at which you want to retire. With those inputs, our Wealth Forecasting System can determine your core-capital requirement.

Next, we can help you better understand your overall financial picture: Are you on a path to securing core capital? We can also help you determine how much risk you're truly prepared to take. We can then work with you to build a portfolio for today's environment.

Finally, it's crucial to meet with your Bernstein Advisor to reevaluate your plan, both before and during retirement. Are you on track? Can you take action—possibly even reducing your level of risk—and still achieve your goals?

You *Can* Make All the Right Moves

- Focus on the goal of core capital—getting there and staying there;
- Set a strategic asset allocation that incorporates a full range of available assets and can help you reach your goal without exceeding your tolerance for risk;
- Stay the course: Don't let market swings divert you from your long-term asset allocation;
- Keep as many of your assets as possible—for as long as possible—in tax-deferred accounts;
- Start taking Social Security at the optimal time; and
- If necessary, spend less, work longer, and/or save more.

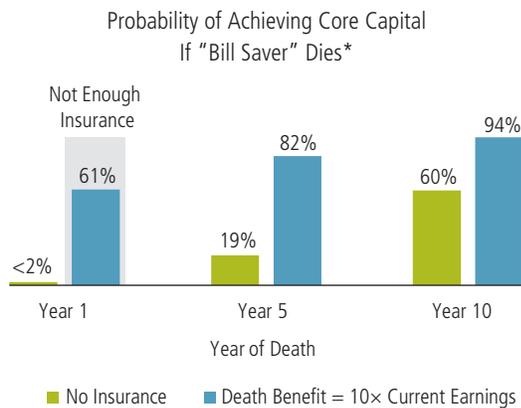
Appendix

Term Life Insurance

While we have focused on your investment portfolio as the center of your retirement plan, there remain some risks that might best be addressed through other means. If, for example, you're a primary wage-earner in a family that is still working toward its core-capital requirement, your early death could be a financial tragedy, as well as an emotional one. A term life-insurance policy, if properly sized, could help assure your spouse's retirement. Let's look at a case study.

Display 25

Fifteen-Year Policy Provides Insufficient Protection in the Near Term



*Probability of accumulating portfolio of \$3.3 million, adjusted for inflation and net of spending, after 15 years. "Year 1" assumes Bill dies immediately, "Year 5" after five years, and "Year 10" after 10 years.

The insurance case study is based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 15 years as of March 31, 2012. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.

Source: AllianceBernstein

Bill and Nancy Saver are a successful 50-year-old professional couple. Some years back, Nancy left the practice of law to become a full-time mom, and Bill, who earns \$350,000 a year, became the sole breadwinner. We call them the Savers for good reason: Each year, they spend \$100,000, pay \$110,000 in taxes, and save \$140,000. They've already managed to set aside about \$2 million invested 60% in global stocks and 40% in bonds. Bill plans to retire in 15 years, when he turns 65.

Their core-capital requirement at that time will be \$3.3 million in today's dollars, and if Bill lives 15 years, the Savers have better than a 90% probability of getting there. But actuarial data suggest that there's a 6% chance that Bill will die before reaching age 65; it's unlikely, but still possible. If this should happen, the probability that Nancy will have enough money in 15 years to meet her core needs is only about 50/50—a coin flip.

Display 26

A Tailored Approach: "Staggered" Term Policies

Alternative Planning Concept:
Purchase Three Term Policies

Term Years	Coverage US\$ Millions	Annual Premium*
5	\$0.75	\$1,778
10	1.25	2,963
15	2.00	6,100

*Based on quotes for "Select (Nonsmoker)" from New York Life Insurance Company (June 2012)

Source: New York Life Insurance Company

Life insurance might help, but how large a death benefit would they need? According to a standard rule of thumb, they need seven to 10 times Bill's after-tax earnings, or \$1.7 to \$2.4 million. Bill learns that he can buy a policy at the high end of this range for an annual premium of \$7,320. That sounds reasonable, but is it really a good solution?

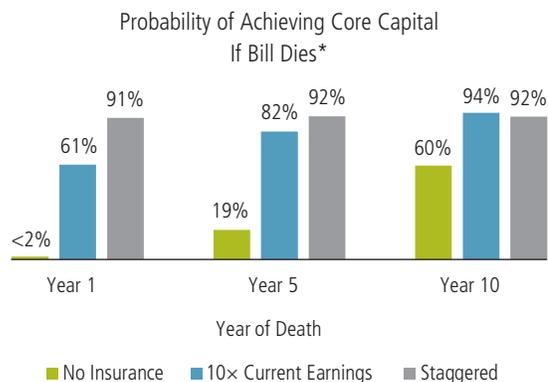
The answer is...it depends. As you can see in the group of columns on the right side of *Display 25*, if Bill were to die 10 years from now, the \$2.4 million term policy would significantly improve Nancy's probability of meeting her core needs for life. However, if Bill were to die sooner than that (within one to five years, say), there is a substantial risk that Nancy could fall short—even with the \$2.4 million of term insurance. They need a better solution.

Instead of getting one policy, Bill can buy three policies with different face amounts of insurance and different terms. He can start off with an aggregate death benefit of \$4 million, spread across three policies. After five years, \$750,000 of coverage will drop off, leaving him with \$3.25 million of death benefit. After 10 years, another \$1.25 million will fall away, leaving \$2 million of coverage for the remaining five years (*Display 26*).

The total premiums for the three staggered policies are a little bit higher—some \$20,000 more, spread over 15 years—than the cost of the single policy. But in *Display 27*, you can see that if Bill were to die at any time, the staggered policies would provide enough death benefit to allow Nancy to meet core spending needs for life with greater than a 90% level of confidence. And, just as importantly, if Bill lives, the cost of this insurance solution has a minimal effect on the Savers' portfolio (*Display 28*). This is exactly what a hedge is supposed to do: protect an investor from risk (in this case, mortality risk)—at minimal cost.

Display 27

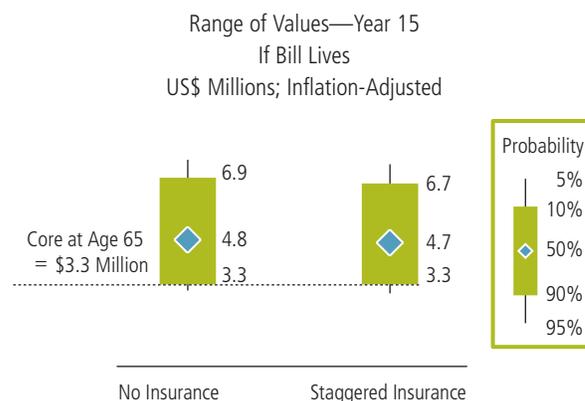
Staggered Policies Provide Better Protection Throughout the Period



*Probability of accumulating portfolio of \$3.3 million, adjusted for inflation and net of spending, after 15 years. "Year 1" assumes Bill dies immediately, "Year 5" after five years, and "Year 10" after 10 years. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 15 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

Display 28

The Solution Is Relatively Cheap



Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 15 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details. Source: AllianceBernstein

A Powerful Planning Tool

Two inconvenient facts complicate retirement planning. One, we can't know what the future holds, and two, as human beings we're hardwired to search for clues but all too often look for them in a rearview mirror.

A Range of Possibilities

To add to the confusion, when we look at what's happened in the past, we usually focus on averages. This isn't a bad way to start, but averages often don't tell us enough. After all, the average outcome almost never occurs; most of the time, we experience something better or worse—sometimes much better or worse.

In making decisions, investors need to plan for a vast range of possibilities, so they can feel comfortable that their actions will allow them to meet their goals, not only when the environment is benign but also when it's hostile.

Valuable Research Hinges on Quality Input

So-called Monte Carlo models respond to this research need by randomly simulating thousands of possibilities for each asset class and producing a probability distribution of returns. While these models are an improvement on averages, they're only as good as the underlying inputs. Indeed, often their estimates for asset-class returns, volatility, and correlations rely too heavily on history or on simplistic assumptions of how the capital markets work.

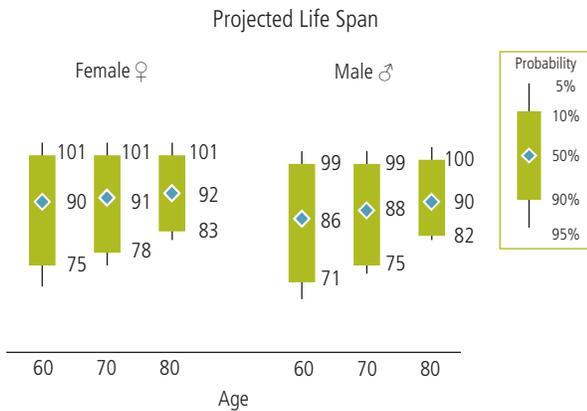
To carry the freight, a wealth-forecasting tool must be founded on a sophisticated understanding of how economies and markets work together. At Bernstein, our methodology is based on, but refines, the Monte Carlo model. In developing forecasts we:

- Consider historical patterns of returns without relying exclusively on them: Some approaches randomly draw from a set of historical returns in order to produce estimates for the future. The problem, of course, is that the forecast is based on specific time periods, which cannot capture the variety of possible scenarios, including multiyear recessions, booms, double-digit inflation, deflation, wars, and so forth.
- Model the fundamental drivers of returns: We base our forecasts on the building blocks of asset returns, such as inflation, yields, yield spreads, corporate earnings, and stock price multiples—since, over time, returns conform to basic financial and accounting realities.
- Incorporate the complex interrelationships that exist among asset classes: By modeling return drivers, we're able to more directly account for the various linkages that exist among the assets in the capital markets. If inflation rises, for example, it's likely to put upward pressure on interest rates, which in turn affects corporate earnings and influences stock valuations.
- Take into account current market conditions: Prudent forecasting also requires factoring in what the world looks like at the beginning of the planning period. Bonds offer one extreme example. At the end of 1981, the 30-year Treasury yield was 13.5%. On the other hand, long-term bond returns from 1950 through 1980 compounded at a meager 2.1% annual growth rate. Which of these numbers represented the better estimate of future returns? While history matters, in this instance the current pricing dominated, since an investor in 1981 could simply buy and hold the bond and generate double-digit returns by collecting the high coupon.
- Embrace uncertainty to determine a realistic range of outcomes: Finally, our model does all the above but also takes into account the fact that there is always some degree of randomness and unpredictability. Nobody can divine the future. But to help our clients make thoughtful decisions based on a realistic assessment of potential future outcomes, we've dedicated enormous research resources to developing a nuanced quantitative capital-markets model. Once again, the planning task is to account for both the controllable and the unpredictable factors that determine investment success.

Our treatment of mortality and of inflation illustrates the depth to which we go in our modeling. Because the number of years of spending is critical in planning, instead of guessing at that number, we've taken an important additional step by building the mortality tables into our models. In our analyses, the life span of an individual varies in each of our 10,000 trials in

Display 29

Mortality-Adjusted Modeling

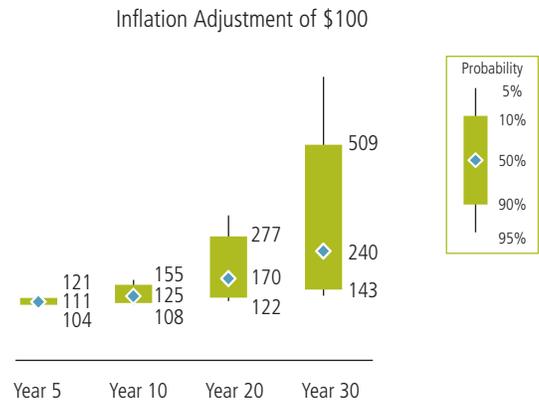


In our mortality-adjusted analyses, the life span of an individual varies in each of our 10,000 trials in accordance with mortality tables. To reflect that high-net-worth individuals tend to live longer than average, we subtracted three years from each individual's age (e.g., a 60-year-old would be modeled as a 57-year-old).
 Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

accordance with mortality tables (Display 29). We also reflect the fact that individuals with substantial investable assets live, on average, about three years longer than the general population (so a 60-year-old would have the life expectancy of a typical 57-year-old).

Display 30

Inflation-Adjusted Modeling



Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System, page 24, for further details.
 Source: AllianceBernstein

Inflation is a serious hazard for retirees, and we model it as carefully as we model the performance of an asset class (Display 30). Our analysis integrates the correlations between inflation levels and asset-class returns. Our findings help us understand the potential risk of inflation so we can make thoughtful asset-allocation recommendations to mitigate that risk. ■

Notes on Wealth Forecasting System

1. Purpose and Description of Wealth Forecasting System

Bernstein's Wealth Forecasting SystemSM (WFS) is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals, and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term, and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: our proprietary model that uses our research and historical data to create a vast range of market returns, taking into account the linkages within and among the capital markets, as well as their unpredictability; and (4) A Probability Distribution of Outcomes: Based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.

2. Retirement Vehicles

Each retirement plan is modeled as one of the following vehicles: traditional IRA, 401(k), 403(b), Keogh, or Roth IRA/401(k). One of the significant differences among these vehicle types is the date at which mandatory distributions commence. For traditional IRA vehicles, mandatory distributions are assumed to commence during the year in which the investor reaches the age of 70½. For 401(k), 403(b), and Keogh vehicles, mandatory distributions are assumed to commence at the later of (1) the year in which the investor reaches the age of 70½ or (2) the year in which the investor retires. In the case of a married couple, these dates are based on the date of birth of the older spouse. The minimum mandatory withdrawal is estimated using the Minimum Distribution Incidental Benefit tables as published on www.irs.gov. For Roth IRA/401(k) vehicles, there are no mandatory distributions. Distributions from a Roth IRA/401(k) that exceed principal will be taxed and/or penalized if the distributed assets are less than five years old and the contributor is less than 59½ years old. All Roth 401(k) plans will be rolled into a Roth IRA plan when the investor turns 59½ years old to avoid minimum distribution requirements.

3. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs, and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be kept reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix

between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

4. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses that will have capital gains tax implications.

5. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As	Annual Turnover Rate
Cash Equivalents	Three-Month Treasury Bills	100%
Intermediate-Term Diversified Municipals	AA-Rated Diversified Municipal Bonds of Seven-Year Maturity	30%
Intermediate-Term Taxables	Taxable Bonds with Maturity of Seven Years	30%
Intermediate-Term Inflation Municipals	Long-/Int.-Term Diversified Munis, Long-/Int.-Term TIPS, and Short-/Int.-Term Treasuries Adjusted for Cost	30%
Intermediate-Term TIPS	Seven-Year Treasury Inflation-Protected Securities	30%
US Diversified	S&P 500 Index	15%
US Value	S&P 500 Index/ Barra Value Index	15%
US Growth	S&P 500 Index/ Barra Growth Index	15%
Developed International	MSCI EAFE Unhedged Index	15%
Emerging Markets	MSCI Emerging Markets Index	20%
US Small-/Mid-Cap Stocks	Russell 2500 Index	15%
Real Estate Investment Trusts	NAREIT Index	30%
Diversified Hedge-Fund Portfolio	Diversified Hedge-Fund Asset Class	33%

6. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed in Capital-Markets Projections below. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.0%. But with intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that volatility of fixed-income assets is different for different time periods.

7. Technical Assumptions

Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of March 31, 2013. Therefore, the first 12-month period of simulated returns represents the period from March 31, 2013, through March 31, 2014, and not necessarily the calendar year of 2013. A description of these technical assumptions is available on request.

8. Tax Implications

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. **Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.**

9. Tax Rates

Bernstein's Wealth Forecasting System has used various assumptions for the income tax rates of investors in the case studies that constitute this analysis. See the assumptions in each case study (including footnotes) for details. Contact Bernstein for additional information.

The federal income tax rate is Bernstein's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is the lesser of the top marginal income tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The state income tax rate generally is Bernstein's estimate of the top marginal state income tax rate, if applicable.

The Wealth Forecasting System uses the following top marginal federal tax rates unless otherwise stated: For 2013 and beyond, the maximum federal tax rate on investment income is 43.4% and the maximum federal long-term capital gains tax rate is 23.8%.

10. Assumptions: Capital-Markets Projections

	Median 40-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	40-Year Annual Equivalent Volatility
Cash Equivalents	3.3%	3.6%	3.6%	0.0%	11.4%
Int.-Term Diversified Municipals	3.5	3.7	3.7	3.3	9.0
Int.-Term Taxables	4.3	4.6	5.9	3.9	10.3
Int.-Term Inflation Municipals	2.2	2.6	3.5	3.2	14.1
Int.-Term TIPS	3.0	3.5	4.5	2.5	16.3
US Diversified	8.0	9.7	3.1	16.3	21.6
US Value	8.3	9.9	3.7	15.8	21.3
US Growth	7.8	9.8	2.5	18.2	23.0
Developed International	8.7	10.7	3.5	18.0	22.0
Emerging Markets	6.8	10.8	4.1	25.8	29.3
US Small-/Mid-Cap Stocks	8.2	10.3	2.7	18.6	24.0
REITs	7.6	9.2	5.1	16.7	19.2
Diversified Hedge-Fund Portfolio	6.4	7.0	3.5	10.8	16.4
Inflation	3.0	3.4	N/A	1.0	11.1

Based on 10,000 simulated trials each consisting of 40-year periods. Reflects Bernstein's estimates and the capital-markets conditions as of March 31, 2013. Does not represent any past performance and is not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns. For hedge-fund asset classes, "Mean Annual Income" represents income and short-term capital gains.

11. Core-Capital Analysis

The term “core capital” means the amount of money necessary to cover anticipated lifetime net spending. All non-core-capital assets are termed “surplus capital.” Bernstein estimates core capital by inputting information supplied by the client, including expected future income and spending, into our Wealth Forecasting System, which simulates a vast range of potential market returns over the client’s anticipated life span. From these simulations we develop an estimate of the core capital the client will require to maintain his/her spending level over time. Variations in actual income, spending, applicable tax rates, life span, and market returns may substantially impact the likelihood that a core-capital estimate will be sufficient to provide for future expenses. Accordingly, the estimate should not be construed as a promise of actual future results, the actual range of results, or the actual probability that the results will be realized.

12. Hedge-Fund Model

Unlike other investment options modeled in the Wealth Forecasting System, hedge funds are not a single or cohesive asset class whose returns tend to respond in a similar fashion to economic events like corporate earnings growth or changes in interest rates. Rather, hedge funds are a set of unique, actively managed investment strategies. They rely most heavily on the manager’s ability to generate returns that are independent of broad market conditions—returns commonly referred to as “alpha.” Since the ability of a particular hedge-fund manager to generate alpha varies widely, we model the possibility that the average level is both materially higher and materially lower than the levels we have measured historically. We also model volatility in alpha levels from year to year. Further, since hedge-fund fees can be a very material component of investor returns—they average approximately 1.5% of assets under management and 20% of annual profits—we incorporate their levels into our analysis. For tax purposes, the system assumes that the hedge funds modeled do not produce any unrelated business taxable income.

13. Mortality

In our mortality-adjusted analyses, the life span of an individual varies in each of our 10,000 trials in accordance with mortality tables. To reflect that high-net-worth individuals tend to live longer than average, we subtract three years from each individual’s age (e.g., a 65-year-old would be modeled as a 62-year-old). Mortality simulations are based on the Society of Actuaries Retirement Plans Experience Committee RP-2000 mortality tables.

Securing Your Financial Future

Building and preserving wealth across generations requires expert planning, unbiased advice, and highly disciplined investing. Our clients are individuals and families, business owners, family trusts and foundations, and other financial guardians. We work in concert with their accountants, tax planners, trust and estate attorneys, and other expert advisors to resolve complex financial issues.

The core principles of our approach to building and preserving our clients' wealth are:

Lifetime Wealth Planning

The Advice You Deserve

Putting sophisticated planning tools and expert advice to work for you, we help you make well-informed investment decisions.

Our Best Thinking

Centrally Managed Investments

To give you direct access to our best thinking, we've structured our business around centralized research and investment management, with integrated wealth planning.

Customized Portfolios

Attention to Your Details

Your particular circumstances guide the way we manage your money, as we tailor portfolios to your goals, income needs, tax situation, and tolerance for risk.

Tax-Aware Investing

Keeping More of What You Earn

To help you keep more of what your investments earn, we employ tax management strategies in multiple ways.

Keeping You Informed

Communication Works Both Ways

When you're well-informed about the strategies we pursue, you're more secure. And the more we understand you, the better we can tailor solutions just for you.

A Legacy of Trust

Commitment to Individuals, Families, and Their Causes

When you entrust Bernstein to serve as your investment manager, you become part of a proud tradition of integrity, trust, and financial success.

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