William Meyer
Founder and CEO
Retiree Inc.
www.Income Solver.com

5 Critically Important Points for Successful Portfolio Coordination

The recent development of the concept of Gamma brings Social Security and tax-efficient withdrawal strategies into sharp relief

By **William Meyer**, co-author of *Social Security Strategies: How to Optimize Retirement Benefits.*

Advisors have a Greek letter all their own—at least if they claim to be comprehensive. Alpha? Sure. Beta? Definitely. But Gamma is less known and far more important to what they do every day.

It's been a little over two years since we spoke with Morningstar about the concept surrounding Gamma, and David Blanchett and Paul Kaplan's resulting paper on the subject titled, "Alpha, Beta, and Now…Gamma."

For those still unfamiliar with the concept, it's "designed to quantify the additional expected retirement income achieved by an individual investor from making more intelligent financial planning decisions."

Calculations of Alpha and Beta are numeric and precise, but how does one quantify the often-esoteric advice provided on a comprehensive financial plan? This is what Gamma is designed to do.

Gamma will vary for different types of investors, but Blanchett and Kaplan took our idea and developed it further by focusing on five fundamental financial planning decisions and techniques: a total wealth framework to determine the optimal asset allocation, a dynamic withdrawal strategy, incorporating guaranteed income products (i.e., annuities), tax-efficient decisions and liability-relative asset allocation optimization.

Getting in good with Gamma has tangible results.

"We estimate a retiree can expect to generate 29% more income on a utility-adjusted basis using a Gamma-efficient retirement income strategy when compared to our base scenario, which assumes a 4% constant real withdrawal and a 20% equity allocation portfolio," they wrote.

Surprisingly, given its difficult nature that (at least initially) seems tough to quantify, they claimed (and we support) Gamma—and Gamma equivalent alpha—can be achieved by anyone following an efficient financial planning strategy.

It's therefore central in coordinating Social Security with the retirement portfolio in order to develop a tax-efficient withdrawal plan. Let's take each of the five fundamental planning decisions Blanchett and Kaplan described in order:

1). Total wealth framework—A guaranteed income stream for life will certainly impact the overall asset allocation, but for whatever reason, too many advisors and their clients still consider Social Security to be this "other" source of income and fail to coordinate it with the rest of the portfolio. It throws off the optimal asset allocation, resulting in less efficient draw-down strategies.

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2). A dynamic withdrawal strategy—Touched on above, it makes it far more difficult to develop an effective withdrawal strategy without including a major fixed income asset like Social Security.

3). Incorporating guaranteed income products (i.e., annuities)—Social Security is an annuity, period. The recipient is the owner/annuitant, the government is the insurance provider and the benefit is the contact value. Annuities issues by private carriers would certainly be included in the retirement portfolio, and therefore so should Social Security.

4). Tax-efficient decisions—We all know it's not what you earn, it's what you keep. Coordinating Social Security with the overall retirement portfolio affects tax-efficient planning beyond the withdrawal strategy.

5). Liability-relative asset allocation optimization—"Asset allocation methodologies commonly ignore the funding risks, like inflation and currency, associated with an investor's goals," Blanchett and Kaplan wrote. "By incorporating the liability into the portfolio optimization process it is possible to build portfolios that can better hedge the risks faced by a retiree." Social Security is tied to inflation as measured by the Consumer Price Index (CPI).

Each one of the five fundamental planning decisions are the Gamma that advisors provide, and each therefore must consider Social Security in the overall portfolio coordination when developing the tax-efficient withdrawal plan. Failing to do so will result in a portfolio that isn't properly coordinated and a withdrawal plan that isn't fully optimized.

About William Meyer

Bill Meyer is founder and managing principal of Retiree Inc. and Social Security Solutions, Inc., a leading Social Security software firm with patented technology that is dedicated to educating and assisting financial advisors and their clients in optimizing their Social Security claiming strategies. More information is available at www.IncomeSolver.com.

About Retiree Inc.

Retiree Inc. is an advice and technology company that delivers an innovative retirement income planning process to Baby Boomers. We leverage both tax efficient methodology and leading edge technology solutions to extend the spend-down of assets in retirement.