The 7 Secrets to a Wealthier Retirement
Dear Retirement Watch reader,

Imagine yourself going into retirement.

You’ve prepared wisely for your golden years. You’ve scrimped, saved and invested your hard-earned money for decades, so you can retire on your own terms...

Only to discover one cold, shocking truth... the one that keeps you up at night:

*Your money is running out – faster than you’d planned.*

Well, this nightmare isn’t hard to imagine. In fact, it’s a reality that’s playing out with a vengeance for a fast-growing number of retirees – due to a rising cost of living, skyrocketing health care costs, and the fact that people are living longer.

That’s why I wrote this report:

To arm retirees and those nearing retirement with the most effective strategies out there (be assured -- they’re all 100% legal!)

So without further ado, let’s dig into the [7 Secrets to a Wealthier Retirement](#).

**Secret #1: Don’t make the “Inflation Mistake”**
(The # 1 factor people overlook when planning their retirement)

The biggest mistake people make in retirement planning is failing fully to factor *inflation* into their planning.

Make this common misstep, and you'll unknowingly drain your IRA and other accounts so fast it will make your head spin.

Retirement these days often lasts 20 years or more. To be safe, you should plan on living to age 90. Over that time inflation can make a safe, comfortable stream of income uncomfortably tight, even at low inflation rates.

For example, after 10 years of only 2% inflation, you need almost $12,200 to buy what $10,000 used to buy (a 22% increase).

After 15 years, you'll need almost $13,500.
And if inflation doubles to 4%, you'll need almost $15,000 after 10 years, and $18,000 after 15 years.

Here's another way to look at it.

A 1982 dollar today has the purchasing power of less than 59 cents. A 1967 dollar equals less than 19 cents today.

The inflation rate most cited is the CPI-U, the Consumer Price Index for Urban Consumers. There are other CPI indexes, but think about it... are any of these indexes a good planning tool for your retirement?

Your purchases almost certainly don't follow the basket of goods in the survey. You likely spend more of your income on medical care, and perhaps on eating out, recreation, and other leisure activities.

You also might spend a higher percentage on the necessities, such as food, fuel, housing, and travel. You likely spend less on education, clothing, and work-related expenses, among others.

Another potential problem is that the CPI is based on a survey of national prices. If you live in an area in which prices are rising faster, using the index could understate your needs.

The ideal option is first to figure out your itemized monthly or annual budget. Then apply an inflation factor to each spending item.

For example, you can inflate your food expenses by the actual food inflation of the last five or 10 years (or your estimate for the future).

Or you can go a step further and separate "food eaten away from home" and "food eaten at home," because restaurant costs have been rising faster than grocery store costs for several years.

Now let's turn to # 2 on my list...

**Secret #2: Why taking Social Security benefits as early as possible might no longer guarantee you the most money from "Uncle Sam"**

What is the best age to begin taking your Social Security benefits?

The answer might be changing.

As with everything else about retirement, the right decision changes over time and isn't the same for everyone.

Most people know that the earlier you begin Social Security benefits, the lower the payment will be.
Begin benefits before normal retirement age, and you receive a reduced monthly benefit. The amount the benefit is reduced depends on how long before normal retirement age it begins.

You can begin taking benefits as early as 62. Starting the benefits at age 62 results in a monthly benefit equal to about 75% of the normal retirement benefit.

But delaying receipt of benefits increases the monthly benefit. Delay benefits past normal retirement age, and the benefit increases by 6% to 8% per year.

The key is that the increase and decrease rates are set so that anyone who lives to life expectancy receives the same lifetime payouts regardless of the age benefits begin. That makes the normal life expectancy the "breakeven point."

Live beyond that point and you will benefit by waiting to receive benefits. Your lifetime benefits will exceed what you would receive by starting at age 62.

But here’s the rub...

The increase and decrease rates were set back in 1983 (the last time Social Security was reformed), using life expectancy tables available at the time. Life expectancies have increased considerably since then. About half of men currently age 65 will live past age 85.

Another factor is that the annual cost of living increases also increase the initial benefit for those who delay benefits. If you actually wait until age 70 to begin benefits, you should receive a higher benefit than the one estimated when you were age 62, because of the cost of living factor.

About two thirds of beneficiaries begin their benefits early, and for many years that made a lot of sense. But the change in life expectancy is a reason many should at least consider delaying benefits.

If you have no reason to believe your life expectancy will be below average, the delay might make sense. Since half of your age group will live beyond life expectancy, and that life expectancy is higher than what was assumed in 1983, most people will receive a higher lifetime benefit by waiting.

For some people, though, taking Social Security benefits early is the best move.

Some people simply need the income as soon as they are eligible. Perhaps they left their employment and are unable or unwilling to seek other work. Additionally, they may not have enough savings to wait for benefits.

Another reason not to delay benefits is if there are health or other reasons to doubt a person will reach the breakeven point of normal life expectancy. If that is the case, there is no reason to delay benefits except perhaps to increase benefits for a surviving spouse.

Some people who do not need the benefits still want to begin them early. Their reasoning is
that they can invest the benefits. They believe the return they earn will be high enough to offset the higher benefits they would receive from waiting.

They might be right. But be sure to consider all the factors. The benefit at age 70 can be twice the age 62 benefit, after considering the age adjustment and inflation increases.

In addition, that higher benefit will continue for life and will increase with inflation. There also will be a benefit for a surviving spouse. It will take some good returns to equal that package.

**Secret #3: Pay your IRA taxes now instead of later**

Some of you could substantially lower your tax bill in retirement by doing so. In fact, you could avoid paying tens of thousands of dollars in needless taxes!

Here's what you must consider in order to carry out this strategy.

One of the most powerful tax-saving retirement weapons that should be in every retiree's arsenal is the Roth IRA. Their unique benefits are tremendous!

*No age limit on contributions. *No required minimum distribution at age 70½. *And the best reason ever to open a Roth IRA: Not one dime you withdraw from it in retirement is ever taxed (no matter how much your money has grown over the years!)

Many of my readers cannot open contributory Roth IRAs, because their incomes are too high. Currently Roth IRAs are unavailable to higher income tax payers. This means anyone with adjusted gross income of $160,000 or more ($110,000 for singles) is not allowed to make a contribution. (The limits are adjusted for inflation annually.)

But since 2010 taxpayers of any income legal have been allowed to convert a traditional IRA to a Roth IRA. They are able to take advantage of the significant tax savings Roth IRAs offer.

Taking advantage of this is easy.

Simply build up your traditional IRA and other tax-deferred accounts as much as possible. Then, convert your regular IRA to a Roth IRA (and consider doing the same with your 401(k) as well if you can roll it over to an IRA). You will pay taxes on the conversion, but it could be considerably less in taxes then you'd be forced to shell out in the future.

Many people aren’t excited about paying taxes before they have to. But, unless your income tax rate is going to be lower in the future than it is now, it can make a lot of sense to pay taxes now and shelter all the future gains and income from taxes.

I’ve explained the rationale for this in some detail in my books and in articles in Retirement Watch that are available in the Archive in the members’ section of the web site.

**Secret #4: How to take required minimum distributions (RMDs) from an IRA without liquidating a single share of stock or mutual funds you currently own**
RMDs do not have to be taken in cash.

Most IRA custodians allow you to set up a taxable account. Then, you can have specific shares or assets transferred from the IRA to the taxable account to satisfy the RMD.

You still will owe taxes on the distribution as though it had been made in cash. The distribution amount will be the market value of the assets on the day they were transferred.

But you won’t have to liquidate an investment you like or incur expenses to buy and sell an investment just to make the RMD.

**Secret #5: The order in which you draw down the different retirement savings accounts affect the amount of after-tax wealth in retirement**

Most people have more than one type of retirement account. There usually is at least one tax-deferred account, such as an IRA, plus a taxable account. The standard advice is to draw down the taxable accounts and leave money in a tax-deferred account as long as possible to let the tax-deferred compounding work.

My research shows that in many cases that traditional advice is correct. The retiree's wealth will last longer if the tax-deferred compounding is allowed to work for as long as possible. My conclusions are supported by other research.

The results, however, depend on the assumptions made. For some people, retirement savings will last longer if the tax-deferred accounts are tapped first.

I have identified two scenarios in which spending your IRA first makes sense.

My research shows that if the annual return in your taxable account is at least four percentage points higher than the return in your tax-deferred account (i.e. IRA), you should drain your tax-deferred accounts first. Why? Because the higher return in your taxable account makes up for the lack of tax deferral. This money is likely earning more for you than the money in your tax-deferred account. It might be taxed at the lower tax rate for long-term capital gains when it is time to spend the money.

The other scenario in which tax-deferred accounts should be drawn down first is when it makes sense to empty one's IRA early. Consider this strategy if your IRA is more than you'll spend during your lifetime. See details in item #32 below and also in my book, The New Rules of Retirement (Wiley). Details also are in the Archive on the members section of the web site at www.RetirementWatch.com.

**Secret # 6: The one investment you should ALMOST ALWAYS sell when you start tapping your retirement accounts**

Investments with paper losses usually should be sold first.
The realized losses offset any capital gains for the year, including distributions from mutual funds. Losses that exceed gains offset other income up to $3,000 per year. Any additional losses are carried forward to future years to be used in the same way until exhausted. You'll whittle your tax liability to the bone by using this simple strategy.

In addition, you give the winning investments more time to compound income and gains before they are tapped. The only exception to this rule is when you believe the losing investment is ready to turnaround and begin earning a higher return than the rest of the portfolio.

Now here’s how to determine the best investment to sell for the lowest possible tax bill...

When it is time to draw down taxable retirement accounts, care should be taken with the choice of investments to sell each year.

Good tax management can make the accounts last longer and provide greater after-tax wealth.

The rule to follow is to sell first the assets with the lowest tax cost. I favor selling the assets with the lowest taxes as a percentage of their value.

To compute this, divide the taxes that would be due on the sale by the value of the asset to be sold. Using this simple calculation incurs the lowest taxes each year. You will have to sell a lower value of assets, because less of the sale proceeds will be used to pay taxes, leaving more after-tax money for spending.

**Secret # 7: The one and only time it makes sense to hold stocks in an IRA**

Most investors own both taxable and tax-deferred accounts. Some also own tax-free accounts, such as Roth IRAs. Few investors consider which investments are best held in these different accounts.

Yet, properly allocating the investments between the accounts can change the amount of after-tax income available for retirement.

A typical investor will hold stocks and equity mutual funds for the long term. The mutual funds will have low annual distributions that are subject to taxes. For this investor, the best advice is the conventional advice. Hold in a taxable account investments that already are tax-advantaged, such as stocks, equity mutual funds, and real estate.

Gains from these investments will be taxed at the long-term capital gains rate. If the investor incurs losses in the taxable account, these can offset gains from other investments in the account or other income.

If these tax-advantaged investments instead were in a tax-deferred account, the investor would be converting tax-advantaged income into ordinary income. That is because distributions from an IRA are taxed as ordinary income. Long-term capital gains earned in the IRA would be taxed at the ordinary income tax rate instead of the long-term capital gains rate.
The conventional advice does not work for every investor. Suppose an investor owns stocks and equity mutual funds but rarely holds them for more than one year. Or the mutual funds do a lot of trading and distribute a lot of taxable gains each year.

The gains earned by this type of investor would be taxed at ordinary income rates in a taxable account because they would be short-term gains. The investor could be better off holding those investments in tax-deferred accounts.

**BONUS SECRET:** The simple rule of thumb that makes it a snap to avoid needless taxes

Few people can hold all of their stocks and mutual funds for the very long term. They need to sell at least a few investments each year, or the mutual funds make some distributions.

What is the break-even point? When does it make sense to hold stocks and equity mutual funds in an IRA (where taxes on the gains are deferred but are imposed at the top ordinary income tax rate when distributed) instead of in taxable accounts?

Here is the rule developed from my research: Stocks and equity mutual funds should be held in a taxable account unless at least 25% of the annual return from them is taxed at ordinary income tax rates.

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**About Retirement Watch…**

Trained as a CPA and attorney, Bob Carlson’s *Retirement Watch* was the first publication to cover all the financial aspects of retirement. Launched in 1991, it remains the only source of its type. The advice and recommendations in *Retirement Watch* are based on independent, objective research, designed to give you the best recommendations for how to increase your financial independence. Bob’s strategies have helped make tens of thousands of satisfied subscribers happier and far more financially secure than they ever dreamed possible.

In addition, Bob has authored numerous books including the *Retirement Tax Guide, The New Rules of Retirement, and Invest Like a Fox...Not Like a Hedgehog*. He has been appointed to the Board of Trustees of the Fairfax County (VA) Employees’ Retirement System, elected chairman by the board, and has also served on the Virginia Retirement System Board of Trustees.

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