

**MAKING SENSE OF THE**  
**LUMP SUM PENSION DECISION**  
**Part Three**

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In Part One, we learned that our Verizon/Idearc Pension may be converted to a cash balance Lump Sum, and the amount of that Lump Sum depends on the interest rates at the time. In Part Two, we examined what affects the long term interest rates used in this calculation and found that they are driven predominately by forces beyond our control. So, depending on the state of the world at the time, we may want to convert to a lump sum and invest the money ourselves, or we may not.

There's another side to this question, however: "What will we do with the Lump Sum we receive to create more value than leaving it as guaranteed lifetime income?"

One could answer that question thus: If the interest rate (GATT rate) for the conversion to Lump Sum was *more* than our Investment Earnings turned out to be, we would have lost value by converting to a Lump. On the other hand, if the GATT rate was *less* than our Investment Earnings, then we would have ended up ahead.

Here's the rub: When we convert, we will know what our GATT rate is. It's a one time transaction. We do it, or not, and it's over. Investing the Lump is another story. That's an ongoing effort for the rest of our lives. And, each and every year, (indeed each and every week) we will get a different return, all of which will average out to some long term result. We won't know what that result is until many years from now. It depends on how well we do for all those years.

**Overriding Issue One; withdrawals affect earnings**

Most of us are familiar with investing through our 401k plan. We've seen it go up and down, and are comfortable that it seems to go up in the end. **That experience is based on an environment of deposits!** In an account subject to withdrawals, it's another world entirely. Our invested Lump Sum will be drawn upon continuously.

**What goes down and is withdrawn, isn't there to come back!** Looking at an example, if we have \$1000, and take out \$200 a year, and our investments go down 10%, our account is down \$300 at the end of the year. The next year, we have to take another \$200 to pay the bills from a base of only \$700. If the account earns zero in that second year, we'll end up with half our money left, only \$500. From there, we'd have to make \$700 to end up in year three back at the \$1000 we started with. (After another \$200 withdrawal, of course) Earning \$700 on \$500 is 140%, neigh on impossible and a very risky proposition.

In fact, the whole notion of risk is highly magnified in an account supporting withdrawals. And, the bigger the withdrawals (as a fraction of the account) the more downside we'll see.

**Overriding Issue Two; be conservative**

In the example above, an account was destroyed by a negative 10% return one year, followed by a zero return in the next year. Have those returns ever happened in the investment markets? Well, it was worse than that as recently as 2001-2002. It was much worse still in 1973-74, and there were a number of other time periods that could have

seriously threatened our account. The lesson of this study is that accounts in retirement need to be far more conservative than the 401k plan we used to collect the money.

So, how do we invest without downside? That would be the Holy Grail of investing, and unfortunately, impossible. (Some brokers are touting Insurance products that claim to do it, but at such a cost it's not worth it. That's another story for another time, however.) Even conservative investment accounts have negative years. What we can do is limit that downside to an amount small enough so that the account can still support the withdrawals and recover with the market. It's done with Balance.

### **Balance isn't the same as Diversification**

It's close, but not exactly the same. W.C.Fields was famous for putting a small deposit in a hundred different banks during his lifetime, but still becoming penniless in the great depression. What he missed was that all the banks would go broke at the same time. He was diversified but not balanced.

Balance means having investments that counteract each other. When one goes down, the other comes up. The classic example is stocks and bonds. In boom times, stocks roar, but no one wants boring old bonds. In recessions, stocks collapse, and everybody wants boring old bonds. An account that's 50/50 between the two has much less downside risk than an all stock account.

There are lots of investments that counteract each other. (The investment lingo for this is non-correlation) There are also thousands of studies examining just how good a job each does against the other, all at various economic times. The point to remember is that an account is structured to work as a whole, and not just as a group of individual pieces. There is no single investment that can't go down at times, but by properly mixing various investments, more stability can be achieved.

This stability is created when an account is set up with proper balance. It is further maintained over the life of the account by RE-balancing. In a rebalance, we actually buy more of the investments that declined, and sell off some of the investments that rose. This is, of course, predicated on our confidence that each declining investment is a "good" investment, but just out of phase with the economy, and temporarily unpopular. Rebalancing forces a "Buy Low and Sell High" process.

If this cursory look at investing a Lump Sum cash-out of your Pension Plan is of interest, and you would like more information, we'd be pleased to hear from you. Just give us a call and we can arrange some time for a more detailed discussion about how such an account can be created for you. Your portfolio will depend greatly on your budget, and the withdrawals you will need in Retirement. This is why we stress the use of a "Retirement Income Plan," an example of which can be downloaded from our Verizon Page. In the sample plan, our withdrawals are projected, and then applied to building our portfolio.

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