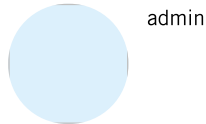




EDUCATION

Retirement Income Planning Takes a Flexible Approach

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admin

If you are like many people, you probably have put plenty of thought into what your ideal retirement would look like. Maybe it involves exotic travel, pursuing a favorite hobby or spending more time with friends and family. The challenge lies in determining how much you need to save to see your vision materialize, particularly when attempting to plan for unexpected expenses. Dennis Heinke, vice president of North America Product Strategy at Franklin Templeton Investments, recently spoke with Asset TV's Gillian Kemmerer on the challenge of generating retirement income. He discusses the "precarious" situation for those facing retirement—and some strategies that can help alleviate some of the anxiety surrounding it.

Dennis Heinke
Vice President, North America Product Strategy
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Listen to our full ["Talking Markets" podcast](#) and hear more from Dennis Heinke on the important subject of retirement.



Talking Markets w. Franklin Templeton Investments
Retirement Income Planning

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Here are some highlights from Heinke:

- Many Baby Boomers entering retirement face a complex situation. Many have had several jobs, and maybe several 401(k) plans and/or defined benefit plans as well as Social Security benefits. And, perhaps there's a spouse with myriad of other factors that all need to come together in a single retirement plan. That complexity needs to be managed with the goal of achieving better outcomes with better solutions and advice.
- There are a lot of investors who are essentially "armchair CFOs" who go all in on equities when it comes to their retirement portfolios because equities have generally been performing quite strongly. That's a naïve view.
- The market has been moving to innovate toward outcome-oriented retirement solutions. What we've had is an industry designed upon style boxes, asset classes, equities, fixed income. The newer outcome-oriented products take a different approach. One such example is income-targeting, a balanced portfolio that tries to generate a paycheck over time in one's retirement.
- Our annual Retirement Income Strategies and Expectations survey¹ has revealed an interesting trend when

it comes to retirement planning. It shows distinct differences in attitude based on age. Between the ages of 45 and 55, there's a crescendo of stress about retirement, according to the survey. The good news is by the time you're 65 or go into retirement, there's a renewed euphoria about it.

The full transcript of the podcast follows.

Host/Richard Banks: Hello and welcome to Talking Markets with Franklin Templeton Investments: exclusive and unique insights from Franklin Templeton.

I'm your host, Richard Banks.

The focus of this episode: retirement income.

Host/Richard Banks: Speaking with Mr. Heinke is Asset TV's Gillian Kemmerer – we hope you enjoy their conversation.

Gillian Kemmerer: Let's get started with an overview of the macro picture right now. What do you make of our capital-market environment?

Dennis Heinke: I think there is a fairly constructive near-term outlook, but frankly it's a precarious situation for most retirement investors. I'm going to drop a couple of statistics out. So the 10-year Treasury has been capping out about 2½%, inflation targets. That's not a great situation for investors who can't quite meet CPI [consumer price index] demands with the T-bill. Meanwhile, you've got \$6 trillion in government paper that's got negative yields right now. And you've got an equity market that's 98 months into the cycle and up 250%. A typical cycle is 16 months and 170%. And the tailwind of fixed income has kind of tapped out. So I think we really need to be thinking as asset managers, how can we solve some problems for our clients?

Gillian Kemmerer: I feel like the question everyone's asking is: Does the market still have room to run in equities?

Dennis Heinke: I think we've still got a fairly constructive environment. You've got earnings momentum. You've got actually maybe even a tick up in earnings this year. So there's no immediate action for a decline in the cycle, but the easy money has gone.

Gillian Kemmerer: We also have interesting changes happening demographically. So Baby Boomers are approaching retirement, and many are working through it. What are some of the challenges and questions that they're encountering?

Dennis Heinke: It kind of brings up some thoughts about what are Boomers' retirement situations relative to the olden days. And so I'm thinking about [the television program] "Little House on the Prairie" and hiding money under the mattress. In the olden days you could buy a CD [certificate of deposit], you could buy the Treasury. Boomers have a much more complex situation. We've had several jobs. We've probably got 401(k)s, maybe some defined benefit plans, a Social Security plan and a spouse with a myriad of other situations as well that all need to come together to be put together into a single retirement plan. So what do I see? I see Boomers facing a situation of complex financial markets and a very complex set of assets, and combining those two is complicated. This is where the retirement advisor, this is where the expert comes in and we need to do a good job helping out those investors.

Gillian Kemmerer: So much of the retirement conversation is about that move from defined benefit to defined contribution. Would you say the Boomers are going to be the first generation to really exemplify that, or are many of them still on legacy pension plans?

Dennis Heinke: We've done a lot of research in this exact topic and talked to a lot of investors out in the market. We're at that movement point. What do I mean? A lot of people have both, they have a pension and they have a DC [defined contribution] plan or multiple DC plans. So that just adds to the complexity.

Dennis Heinke: You've got a mom-and-pop retirement investor that's really becoming the decision-maker on very complicated assets. They're trying to get more invested in stocks to meet those obligations, the longevity risk of an aging demographic. It's a very difficult role that we're requiring our retirement investors to take.

Gillian Kemmerer: When you think about this generation that's coming up, they have more information on financial markets than ever. Does that make them maybe more flighty than ever before as well in terms of their investments?

Dennis Heinke: I think that is a close to fair assessment. We've done a lot of focus-group testing. We do a lot of that two-way mirror [exercise], where you ask a focus group to come in and describe their current investments and how they plan for retirement. What I've found are some shocking takeaways. There are a lot of armchair CFOs really deciding to just go all in on equities, because why would you be in anything but the outperforming asset class? It's a little bit of that naïve view towards diversification or risk control. I do think there's a lot of vision toward a more active lifestyle or planning for legacy. A lot more complexity versus the "Little House on the Prairie" demographic, a little bit more complexity in the requirements. We have people in those focus groups who are going back to school. They're starting a new career. They're changing careers. They're continuing to work into retirement. So that complexity needs to be managed with better outcomes, better solutions and better advice.

Gillian Kemmerer: When you think about the overabundance of information, is there also an overabundance of offerings that makes it confusing too?

Dennis Heinke: I don't know if I would say it that way. But I do think there are a lot of products. There are also a lot of "me-too" products; a lot of asset managers come out with a solution that's just the same as every other solution on the market. I'm thinking of the target-date market. But what I find is if you keep it simple and you keep it outcome-oriented, and you have an advisor or a professional plan or some type of professional advice that can help an investor realize going all in on the stock market is not the appropriate risk/reward for their portfolio, you can actually get some mine share with that outcome, with that specific targeting. So I just don't know if we on the asset-management side have provided the market with the right products.

Gillian Kemmerer: So you referenced outcome-oriented before. Are most products not designed with that in mind, or is that a unique offering from your end?

Dennis Heinke: I think the market is moving to innovate towards outcome. So what we've had is really an industry designed behind style boxes, asset classes, equities, fixed income. You need to be the armchair CFO in order to navigate these markets. The newer products are more outcome-oriented. Here's your income targeting. Here's your balanced portfolio that tries to generate a paycheck over time in your retirement. So I think we are moving in the right direction.

Gillian Kemmerer: Now, this might sound naïve, but when I think about a retiree coming into retirement, do they necessarily already know what they'll need month by month from that moment that they decide that they're done working? Does it take a lot more education to get them to a place where they can accurately analyze what their bills will be, how much they'll need? I would imagine that's a hard number just to come up with.

Dennis Heinke: We do a research document every year. It's a survey with thousands of Americans, called the RISE survey: Retirement Income Strategies and Expectations. Year to year, we have seen a really interesting trend. It shows a difference based on age. And this actually is somewhat logical. So in your 20s and 30s you know you're happy if you're employed, you're saving money and you've got a long time to retirement. There's this euphoric sense of, "I'm doing the right thing."

In your 40s it starts to get real. Between the ages of 45 and 55, you hit a crescendo of stress about retirement, planning for retirement specifically. This is actually somewhat logical where you are starting to move from human capital to financial capital. Your wealth is very important and you don't have it figured out yet. You don't know what your replacement income is going to look like, where your income's coming from. Again, maybe there have been multiple jobs, maybe there are multiple employer 401(k) plans, maybe there's a pension. You haven't looked at it and planned it out.

The good news is by the time you're 65 or by the time you go into retirement, there's a renewed euphoria [according to the RISE survey]. Even if your replacement income is down to 85% or less [of your former income], you end up happy because you've figured it out. You've taken the work to define, decide, work with a professional and put a plan together. So you hit this crescendo of stress, and then you come into a euphoric state as you retire. So there's a bit of good news and light at the end of the tunnel. Again, what we need to do is provide the tools to allow people to manage that process.

Gillian Kemmerer: On the DOL [Department of Labor] front, obviously the fate of the DOL ruling is hanging in the balance with the new administration. If it comes off the table, do you think that this kind of reinvigorates the VA [variable annuity] sell point?

Dennis Heinke: The DOL, it's mixed/unmixed. Ultimately it's good. It's good for the investor to have more fee transparency. It's a really difficult process to get there, which is obvious with all the complications we read about in the press today. I'm personally agnostic. If we need to put together a new structure or a new vehicle or a new share class in order to deliver the right cost-compensation structure, we'll do it. We want to make sure that the advisor has the best capability to run their business that we can deliver. And we get it to them as quick as possible.

There's one element on DOL that I think is very interesting: the QLAC [qualified longevity annuity contract]. In the 401(k) plan we've got guidance of how you can put annuities into the plan. We haven't seen adoption. But I think that's the first step of the way there. I think it's a great solution. I like it as a part of the portfolio. And I think it really does add value to a portfolio. Once we have some guidance from regulators, then we can start to build products that implement it. We're on the way. We're on the right path. And ultimately, the DOL's moves, while painful today, gets us down the right path.

Gillian Kemmerer: You're from the innovation hub, San Francisco. You manage innovation. What do you see as the most important modern innovation in retirement- income right now?

Dennis Heinke: I'm going to take a step back and actually simplify a little bit. I'll talk about target-date funds for a moment. Granted, it's not retirement income. But I've spent a lot of time researching the retirement markets. And it really is phenomenal the growth that has gone into target dates. Why is that? It's because a target-date fund delivers the outcome in a very simplified fashion. Instead of talking about the equity and fixed income and requiring retirement investors to be armchair CFOs, you've given them a retirement date, an outcome date that they expect to get their assets. What's interesting is these products don't actually provide the assets on those dates. And there's no real segue into retirement. There are somewhat sincere and some definite problems with the target-date funds. But the lesson is that simplicity. They're delivering an outcome, they're taking away the requirement of being a CFA or a financial planner or an armchair CFO and allowing people to think in more real-term, real-life decision matrices.

What we cannot use in the target-date example is some of the complexity that's required for the retirement investor. I was talking about earlier how a retirement investor may have multiple different sources of assets or income. They may have a very complex situation where they have an active lifestyle for the next five years, maybe they have some school ambitions and they want to invest, maybe they want to buy a boat in the next two years. Those are not contemplated by the 23-year old who's put into a 2060 retirement fund. They are contemplating when preparing for retirement. So as the anxiety increases, I think what we need to do is deliver tools to the retirement investor that are as simple as a target-date fund, but can add to the flexibility required for that retiree.

Gillian Kemmerer: Excellent. You do a lot of inside research, so let's talk a little bit about some of the data that you've generated over time. Would you say that there are any high-level points that we may not necessarily assume about retirees that your research has shown us is the case? The RISE survey, if we just want to quickly refresh, was about the age at which retirees begin to stress. It was a lot earlier than what you expected.

Dennis Heinke: That's right. So just to walk through the mechanics, it's the emotional journey of a retirement investor. When you have a long time until retirement you are generally very happy. You are putting money away. You're saving for retirement. You're in a position of euphoria. The stress starts to peak between ages 45 and 55, at very specific points in your life when you're starting to plan for retirement. You're thinking about where you're going to get that paycheck replacement. You're looking at the complexity of the assets in your portfolio, the complexity of your spouse's assets and combining that into a real income plan. And then as I mentioned, the punchline is there's a euphoria again once you've got it figured out. Even if your replacement ratio is below 100%, the retirement investor is happy because they have planned it. They have figured it out.

Gillian Kemmerer: What new asset classes or investment options really represent an opportunity to deal with the greater need for this flexibility that you've suggested in retirement-income planning?

Dennis Heinke: Let me change the vernacular. We always talk about asset classes. I was trying to describe an environment where the armchair CFO has to understand the asset classes. They have to understand style boxes, large-cap growth, small-cap value, stocks, bonds, global, US. Again I want to be focusing more on outcomes and the tools required to get to the outcomes. What I find interesting is your real CFOs, the institutional investors out there, they have tools that we frankly do not provide to the retail retirement investor; the 401(k) market is not allowed to use a lot of these tools. The vast majority of people who are saving for retirement simply don't have access to tools.

Now, granted, it's a good thing. You don't want people to be buying a hedge fund that could go defunct in the next six months. But can we access some of these tools? Maybe not hedge funds, but other real estate capabilities, other volatility-protection capabilities. There are functions or capabilities and structures in these product lines that can vastly improve them. Let me take a step back and talk about target date again. So one of the flaws with target date [funds] I actually set up when we started with the macro situation. So if we're eight years into a typical six-year equity market cycle, if we are at the end of a 20-year fixed income cycle, and the two asset classes that are underlying in a target date fund are stocks and bonds, we may have a problem.

You've got a risk asset—which by the way, all the target date [fund] managers are trying to compete to get a larger risk asset because that's been generating performance over the past decade. The only diversifying asset class is fixed income. But again, an institutional CFO has all these other capabilities, all these borrow risk factors that they can diversify that equity risk, all these protection capabilities to prevent the downside. And I think this is a really key element, asset, capability construct that we should be putting into our outcomes for retirement investors across the line. In an environment where the markets are stressed and your retirement asset base is extremely important, vol[atility] protection is absolutely critical.

Gillian Kemmerer: Income sustainability—how do you think about that?

Dennis Heinke: When I think of income sustainability I think about CPI [consumer price index]. And this has been worrying me since 2008/2009. We do have a ton of [monetary] stimulus around the globe. We've been in a low-inflationary environment. But we will have a hard time—given the equity and fixed income backdrop—to meet rising inflation that's going to come over the next decade or so. So what have we done? We tried to develop some structured products around the inflation thematic. Inflation protection is a strategy we designed. It is a multi-asset portfolio, instead of just buying TIPS which is the typical inflation protection asset. It does have real estate, it does have commodities. It does have some natural resources. And the problem with these products has been the volatility. If you think about commodities, it's a very volatile asset class. When stocks go down, commodities go down, real estate goes down. A lot of these assets become higher-risk. And in fact the products that are multi-asset inflation protection products have typically tanked in an equity correction; it's very simple to put a volatility protection overlay. So what we do is a lot of work around trying to protect the downside while delivering all the benefits of an inflation protection portfolio or an income portfolio. And this is where the structured products come in.

Gillian Kemmerer: What kind of product innovation do you believe is really needed in the retirement income space?

Dennis Heinke: I have mentioned it before; it's protection against the cycle. I am very worried about the setup, and I made that very clear. But to your point, sequencing risk is a very problematic issue. If you remember the press around 2009 it was that retirement investor who lost 50% of their assets and needs to work for another decade. And that is untenable. What we need to do is simply protect those assets. We need to prevent our industry from having the group think like we do currently on target-date funds where we just maximize the risk portfolio to generate that next level of returns, because we know we're going to be judged on historic returns. And that just marches us on the path of risk and sets us up for a very big drawdown the next cycle. It's protection on the next cycle.

Let me add one more: flexibility. It's very easy for a 30-year-old to buy the same target-date fund as every other 30 year old. When we're young, we buy a onesie. And as we get older, we need a small, medium and large, an extra-large and maybe we even go to the tailor and get a suit made. You need some flexibility and some customization as you're preparing for retirement. We talked about the complexity, all the different pieces of the puzzle that go into your investment portfolio, all the myriad of differences of what people are going to be doing in retirement. But what we're searching for as an industry is a single solution for everybody, and that's not going to work. I think the innovation needs to be flexible solutions that can be put together with a professional advisor.

Gillian Kemmerer: Let's talk about success for a moment because you've just referenced the idea that, you know, the impact won't necessarily be homogenous. When we think about an investment product that's benchmarked to the S&P 500 Index, do they beat it, do they not? But with retirees, their needs are so different. So how do you benchmark success when you think about your retirement products?

Dennis Heinke: We all get excited when we see the S&P 500 go up. And we get depressed when our portfolio's not keeping up. That's what we heard in those focus groups I talked about earlier. It worries me when an investor who is in retirement today can't get enough equities into their portfolio, because I know what that end game looks like, and it's not pretty. My benchmark of success is when those focus groups change, when the conversation with those end clients starts to be more realistic around their retirement-income needs, as opposed to, am I beating the S&P 500?

Gillian Kemmerer: For advisors that are listening to this program, what do they really need to understand prior to choosing the right solution for a client?

Frankly, advisors get it. The advisors I talk to understand the complexity. And in fact the institutional market is trying to emulate the advisor-sold part of the market where it is more customized, it is more bespoke. People need an advisor who understands their personal complexity. And that's what the 401(k) market is trying to do. It's difficult to do it for a population of your entire workforce, but getting more personalization as we approach retirement is critical. The advisors get it. The advisors understand the portfolio of context. They understand the complexity of each of their customers. And all I would say is advisors get to know those customers even better and help them prepare for retirement.

Gillian Kemmerer: So stay flexible and stay informed about your clients?

Dennis Heinke: Exactly.

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[1.](#) Source: The Franklin Templeton 2017 Retirement Income Strategies and Expectations (RISE) survey was conducted online among a sample of 2,013 adults comprising 1,009 men and 1,004 women 18 years of age or older. The survey was administered between January 5–18, 2017 by ORC International's Online CARAVAN®, which is not affiliated with Franklin Templeton Investments. Data is weighted to gender, age, geographic region, education and race. The custom-designed weighting program assigns a weighting factor to the data based on current population statistics from the US Census Bureau.