# Bridging The Income Gap For Early Retirees

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Last year, the number of baby boomers who entered retirement grew at the fastest annual clip on record, according to a Pew Research Center analysis, more than doubling from the prior year's rate of 1.5 million to a whopping 3.2 million new retirees.

Every year, more people retire than in the previous year, but the Covid pandemic upped the pace. If you couldn't work anyway and you were near retirement, why not take the plunge?

### The Income Gap

But retiring early has consequences. Unless a client has a terrific pension plan or a fortune in savings, they'll probably have to depend on Social Security as a replacement for employment income. Yet the youngest age at which you can draw Social Security is 62, and if you can put it off till age 70—at which point you must start taking checks—you'll maximize the monthly benefit. (The longer you delay Social Security, the larger your check will be.)

Either way, if you stop working before you start receiving Social Security, you could find yourself without a steady income for several years. So what are the options?

### Consider Annuities

To fill the income gap between early retirement and the beginning of Social Security payouts, some financial advisors recommend annuities. "The annuity can provide a safe and predictable income stream," says Ben Barzideh, wealth advisor at Piershale Financial Group in Barrington, Ill. "It feels like a paycheck, just like when you were working. It's not going to go down or go away."

But Barzideh doesn't recommend this solution for all clients. Sometimes he prefers a "tactically managed investment model" that shifts exposure levels based on relative risk, he says. Still, annuities can work for someone who doesn't want exposure to stock and bond market fluctuations, he adds.

Many investors, though, prefer to manage their own finances rather than "surrender their assets to an insurance carrier in exchange for a guarantee," says Philip Chao, chief investment officer and principal at Experiential Wealth in Cabin John, Md.

### Personal Preferences

It's a question of personal taste and temperament. "Do you want to self-insure or offload the risk to an insurance company?" says Chao. "Bottom line, it is about preference rather than utility function."

Not every retiree is disciplined enough, he says, to handle their own portfolio and take regular withdrawals. Mismanagement could end up being "much more costly than surrendering the needed amount to a carrier."

David Blanchett, head of retirement research at Morningstar Investment Management in Chicago, might agree. "Pulling money from savings isn't easy," he notes.

It takes discipline, and people have to be careful not to deplete savings they may need in the future. An annuity, on the other hand, can simplify the process of drawing income, he says, and may provide a more attractive payout than what you could get from fixed-income securities these days.

"Annuities truly are an effective tool to provide complete certainty that a client can cover a set amount of basic living expenses while waiting for Social Security to begin," says Eric Henderson, president of Nationwide Annuity in Columbus, Ohio.

Besides enabling clients to leave their savings untouched, he says, annuities allow them to invest those other assets more aggressively, if they wish, confident that the annuity is providing the security of guaranteed income.

**Weighing Options**

For some, annuities may seem like the only choice. Those who retire early "often have no alternative to meet their income needs," observes Jason Fichtner, senior fellow at the Alliance for Lifetime Income and a senior lecturer at Johns Hopkins University's Paul H. Nitze School of Advanced International Studies in Washington, D.C. "Bridging the income gap is a problem that annuities are uniquely qualified to address."

But even so, it's important to realize there are many types of annuities available. Advisors should tailor recommendations to individual client situations "as part of a comprehensive financial plan," says Fichtner.

The best annuity to bridge an income gap may be a fixed-term single premium immediate annuity (SPIA). "These offerings would pay out a steady stream of income for a set period of time," explains Todd Giesing, senior director of annuity research at data tracker Secure Retirement Institute in Windsor, Conn. After that time is up, the payments stop. But "the customer would have received all of their principal—and possibly more—back in payments," he says.

On the other hand, a long-term annuity will pay out longer and can "lay a foundation that Social Security payments will ultimately add to," says Frank O'Connor, vice president of research and outreach at the Insured Retirement Institute in Washington, D.C.

Whether it pays a variable or a fixed rate, an annuity with an added guaranteed lifetime income benefit would provide income you can't outlive. Many annuities also enable you to turn the income spigot off and on as needed.

"Once you start taking Social Security [you can] turn off the income in the annuity, which would allow future income to grow," says Laird Johnson, senior director of advanced markets at Equitable in New York. "Some of the [income] riders can be very flexible."

**The Non-Annuity Options**

Other advisors, however, are not so sure annuities are the best way to go. "The problem that I see today is that interest rates are still at multiyear lows, so the [annuity] payout will be significantly lower," says Luis Strohmeier, partner and wealth advisor at Octavia Wealth Advisors in Los Angeles. "Advisors really have to do their homework."

As interest rates rise, though, annuity payout rates will rise, too. Then again, so will bond yields. That's why some experts are sticking with bond ladders—buying bonds with different maturity dates to stagger payouts.

Russell Story at Story Wealth Management Group in Douglas, Ga., acknowledges that a set-term annuity "can be used when someone needs 'bridge income' while waiting for Social Security payments to begin." But sometimes a better option is withdrawing funds from nonqualified investments, on which you only pay taxes on the gains realized. "This is where planning can pay," says Story.

Alternatively, he says, you could take penalty-free early withdrawals from retirement accounts, as described in Section 72(t)(2) of the Internal Revenue Code. To qualify for that, you must take at least five equal payments over five years or over the time you have until you reach age 59½, whichever period is longer. The size of the payments allowed depends on the Internal Revenue Service's complicated life expectancy calculus.

With equity prices at record levels, shifting savings into lower risk assets may make sense. Tom Henske, a partner at Lenox Advisors in New York, says that 60-year-old clients who are looking at early retirement today should probably consider rebalancing their portfolios to move money out of equities after recent market gains. "They could use some of that savings in their qualified plans," he says, but "you'd really need to run the math on individual client situations."