Income Allocation vs Asset Allocation

Asset Allocation appeared as concept in the world of investment management in 1986. Three people, Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower published groundbreaking research that demonstrated an arguably better way to manage money.

Here's the gist of what they said: "…by replacing active choices with simple asset classes worked just as well as, if not even better than, professional pension managers". In simple English, it means if you want better investment outcomes, you should first allocate your money across different asset classes before you focus on specific investments with no regard to the asset class to which they belong.

As the idea evolved, it became the dominant methodology among many wealth managers. One should build a portfolio by first allocating money across a few select asset classes before spending time and energy trying to pick stocks or bonds. It asserted that results, net of costs, would be better than having someone actively choosing specific stock or bond positions. Some managers were able to outperform, but there was no way to predict in advance who it would be. The hero in one cycle often becomes the goat in the next.

In contrast, Income Allocation as a concept has been around for less than a decade. In my judgement, it's rising to prominence as a result of millions of people becoming retirees who are not prepared financially for the next 25 – 30 years. What follows is my attempt to give you some insight into why Income Allocation should be part of your retirement plan.

As a retired financial planner, I describe retirement as a transition from "working for money" to "money working for you". It may happen early, or it may happen late in life. It may happen rapidly as a point in time, or it may drag out over several years. For the great majority who remain alive, it will happen.

A recent article referenced a 2019 TD Ameritrade report that said 62% of Americans think they're behind the curve when it comes to saving for retirement. How do you catch up? How do you put that money to work today? How do you position it and make it possible in the midst of retirement to pay your bills? What key steps should you take to increase your chances of success?

As an investment advisor for many years, my focus was adopting best practices when it came to growing money for retirement. Asset Allocation was a driving force behind the decisions made to optimize the results for clients. The prevailing wisdom was to use Asset Allocation, grow your pile of money, and at some point, start withdrawing an income from your pile of money. We rarely thought beyond average life expectancy.

A new existential risk surfaces once you get serious about retirement. I wrote about this in a blog post recently titled Retirement and the 4% Rule. Just click on the name of the article and you'll find a chart there that shows the effect of the Sequence of Returns Risk. I encourage you to be aware of it.

I want you to learn about Jerry Golden, the founder and CEO of Golden Retirement Advisors, LLC. Jerry has developed a business model built around Income Allocation that includes a sophisticated online software application for people concerned about their continued ability to pay their bills during retirement.

Jerry's solution is to position one's money, or financial resources, based not on Asset Allocation but on Income Allocation. His approach results in a mixture that might include at its core, Social Security benefits. To which is added stocks that pay dividends, interest payments, income annuities, both with and without cost-of-living adjustments. Some people may have what are known as defined benefit pension income, though that's becoming rare.

It's possible you participate in a defined benefit pension plans. These are the plans used by legacy employers, plans started decades ago when people typically worked in one place for most of their adult lives. They were created to provide employees with a retirement income after years of loyal service.

Across the country, these types of plans are grossly underfunded. Cities and municipalities, hospitals and legacy companies are wrestling with what to do about them. General Motors, for example, just shut down a plant and put 20,000 workers out of work. It was also a convenient excuse to terminate the defined benefit pension plan covering many of those employees. GM no longer has to allocate billions of dollars to fix the problem. From a management perspective, it's a dollars and cents decision.

Over the years, defined benefit pension plans were replaced by what are known as defined contribution plans. You decide how much to put in every paycheck, and maybe the company will also contribute something. The net effect is to shift the investment risk away from the employer to the employee.

If you don't contribute, then any failure to have a retirement plan falls on you, the employee and not on your employer.

A few more words about Income Allocation and retirement. Much of what you find in the media is all about having a bigger pile of money when you retire. There is always someone willing to manage your money for a fee or offer you the best "thing" since sliced bread was invented.

As a student enrolled in Successful Retirement Secrets, you are now exposed to a new way to think about and plan for retirement. As I write this, I plan to include Income Allocation in the mix of lesson videos. I believe it's a critical piece of the pie leading you toward "a worry free and financially secure retirement". It tends to shift the question from "Do I have enough money to retire?" to one that asks, "Will I have enough income to retire?".

With people now increasingly living into their 90s, being able to pay your bills until your death provides an enormous benefit. With so many of us living longer and longer, it's now reasonable to expect a 25 – 30-year retirement journey into an unknown future. What are you doing now to offset the very real risk associated with Long Term Care costs? What are you doing to avoid the very real risk of market crashes? Will you run out of money before you run out of life?

My intent here is to put another arrow in your quiver as you journey through life. Don't stop putting money into your retirement buckets. Think about Asset Allocation to minimize investment risks. Think about Income Allocation to give you peace of mind and a greater sense of financial freedom as you journey through the rest of your life.

Tony Kendzior \ October 18, 2019