



The Volatility Buffer Concept

Bert Salazar, Managing Member

The Volatility Buffer Concept is one of the most creative retirement distribution techniques available in the retirement planning arena. When properly addressed and executed, it provides a conduit and safeguard against asset volatility due to market and/or interest rate corrections during retirement.

Volatility Buffer Concept

The Volatility Buffer Concept is a distribution straddle technique for clients wishing to preserve and enhance their retirement income while protecting existing assets from stock market erosion and sequencing of returns.

Most financial planners and advisors fail to educate their clients on the impact of market volatility and sequencing of returns when dealing with longevity planning – the Rules of Engagement totally change when clients shift from accumulation of assets to distribution of assets – during accumulation years, it is about the accumulation rate, but during retirement years, it is about the distribution rate and issues like taxation, inflation, asset volatility, and timing of market and interest rate losses can create havoc in traditional investment portfolios and retirement accounts.

For this reason, we at Cambridge consider volatility buffer and distribution straddle techniques a critical part of retirement planning. No one can forecast a financial outcome, so being prepared is key to financial independence for clients that may spend 20 to 30 years in retirement.

In the following two samples depicting sequencing of returns on identical accounts, you will notice that Option I and Option II have the same amount of assets, the same amount of income distribution, the same amount of market returns, and the same 15-year period, yet the outcome is completely different between the two options – in Option II, life insurance is not used for death benefit purposes, but it is used as asset insurance in order to protect against market volatility and distribution from retirement accounts during negative years.

The value of this client’s IRA at retirement is \$2,000,000! Do not be alarmed because the following concept will apply in every situation regardless of the asset amount and/or account value – obviously, client insurability is very important and the sooner the technique is implemented, the quicker the volatility buffer accelerated growth can position the client in an enviable retirement situation. Remember, retirement is about the distribution of assets and the ability to create distribution alternatives depending on interest rate and/or market situational performance on an ongoing basis.

Option I:

Age	Beginning Year IRA Value	Pre-Tax Distribution from IRA	IRA Value after Pre-Tax Distribution	Hypothetical Market Return	Year-End IRA Value
65	\$2,000,000	-\$150,000	\$1,850,000	-14.66%	\$1,578,790
66	\$1,578,790	-\$150,000	\$1,428,790	-26.47%	\$1,050,589
67	\$1,050,589	-\$150,000	\$900,589	37.20%	\$1,235,609
68	\$1,235,609	-\$150,000	\$1,085,609	23.84%	\$1,344,418
69	\$1,344,418	-\$150,000	\$1,194,418	-7.18%	\$1,108,658
70	\$1,108,658	-\$150,000	\$958,658	6.56%	\$1,021,546
71	\$1,021,546	-\$150,000	\$871,546	18.44%	\$1,032,260
72	\$1,032,260	-\$150,000	\$882,260	32.50%	\$1,168,994
73	\$1,168,994	-\$150,000	\$1,018,994	-4.92%	\$968,859
74	\$968,859	-\$150,000	\$818,859	21.55%	\$995,324
75	\$995,324	-\$150,000	\$845,324	22.56%	\$1,036,029
76	\$1,036,029	-\$150,000	\$886,029	6.27%	\$941,583
77	\$941,583	-\$150,000	\$791,583	31.73%	\$1,042,752
78	\$1,042,752	-\$150,000	\$892,752	18.67%	\$1,059,428
79	\$1,059,428	-\$150,000	\$909,428	5.25%	\$957,173
80	\$957,173	-\$150,000	\$807,173	16.61%	\$941,425

Option II:

Age	Tax-Free Withdrawal from Whole Life CV	Policy Death Benefit at Year-End	Pre-Tax Distribution from IRA	Hypothetical Market Return	Year End IRA Value
65	\$0	\$671,916	-\$150,000	-14.66%	\$1,578,790
66	-\$100,000	\$502,281	\$0	-26.47%	\$1,160,884
67	-\$100,000	\$333,527	\$0	37.20%	\$1,592,733
68	\$0	\$341,097	-\$150,000	23.84%	\$1,786,681
69	\$0	\$348,920	-\$150,000	-7.18%	\$1,519,167
70	-\$100,000	\$256,524	\$0	6.56%	\$618,825
71	\$0	\$259,076	-\$150,000	18.44%	\$1,739,676
72	\$0	\$261,670	-\$150,000	32.50%	\$2,106,320
73	\$0	\$264,317	-\$150,000	-4.92%	\$1,860,069
74	-\$48,410	\$218,417	-\$78,154	21.55%	\$2,165,918
75	\$0	\$218,438	-\$150,000	22.56%	\$2,470,709
76	\$0	\$218,349	-\$150,000	6.27%	\$2,466,218
77	\$0	\$218,154	-\$150,000	31.73%	\$3,051,153
78	\$0	\$217,871	-\$150,303	18.67%	\$3,442,439
79	\$0	\$217,519	-\$176,535	5.25%	\$3,437,364
80	\$0	\$217,096	-\$183,816	16.61%	\$3,793,962

You will notice that ending account values between Option I and Option II are enormously different – although the rates of returns and distribution amounts are the same, Option I has an ending account value at age 80 of \$941,425, where Option II has an ending account value at age 80 of \$3,793,962! How can that be possible? How can Option II have four times the account value that Option I has within the same time frame?

The answer is simple, yet it requires proper distribution planning – during negative years, this client is taking distribution out of his life insurance account since asset growth inside a whole life insurance policy is guaranteed – thus, client is allowing his IRA account to recover from previous year losses without having to compound the distribution problem. Once the IRA asset recovers during positive years, client commences distribution of said account again.

Please bear in mind that although client had a negative year at age 73 of 4.92% in the portfolio, client is required to take RMDs (Required Minimum Distributions) at age 70 ½, therefore, he took out \$78,154 from his IRA and the remainder of \$48,410 from his whole life insurance contract.

Moreover, a \$150,000 IRA distribution in a 33% federal income tax bracket produces \$100,000 of next income proceeds – a \$100,000 distribution from a whole life insurance policy is the equivalent of \$150,000 from an IRA since no taxes are assessed due to cost basis and/or loans.

During ages 78 through 80, the client is required to take more than \$150,000 because his IRS RMD (Required Minimum Distributions) calculations and account growth have increased his required distribution under the IRS code.

At the end of the day, retirement distribution and longevity living is predicated upon the right assets, producing the right amount of income, distributing at the right time, protecting against the risk of living too long, protecting against the risk of living with a disability, and creating the proper volatility

buffer straddle to mitigate dire consequences while safeguarding loved ones with incremental survivor benefits.

The golf clubs seldom win a tournament if ever...it is always the swing and the management of the golf course that will guarantee success! Play the retirement game to win!

As an Economics Advisor, I assist my clients in changing the way they see things, because when they change the way they see things, the things they see change.

Bert Salazar, Managing Member

Cambridge Financial Partners, LLC

2000 Ponce De Leon Boulevard Suite 500

Coral Gables, FL 33134

Bert.Salazar@CambridgeFPLLC.com