

Do Income Replacement Funds Make More Sense Than Annuities?

It's getting to be the case that virtually any standalone investment product sold to individuals can be repackaged into a mutual fund. It makes a lot of sense – everyone already knows what a mutual fund is, and all that's left to explain is the objective, availability of capital, specific risks and fees.

Such is the case with income replacement funds that aim to replace annuities as a way for retirees to manage their spendable assets during the years they expect to be in retirement.

Aimed at the Baby Boomer Market, mutual fund leaders Fidelity and Vanguard are among others getting into this product, which are a bit like target-date retirement funds in that they start with a pile of stocks, bonds and cash that grows more conservative based on the dates you'll need to draw those assets. Essentially, that means if you're retiring in 2020 and you want money available through 2040, you pick a fund that's labeled for that withdrawal window, and you accept that such funds are invested properly for that timeframe.

Generally, after taking an expense fee, the fund pays the investor a rising percentage of their account value each year until the balance runs out in the termination year. The idea is that you'll get a relatively stable income stream that may keep up with inflation.

Unlike many annuities, however, you can cash out whenever you want.

It all sounds good, right? Beware of the following, and seek some advice from a financial expert like a Certified Financial Planner™ professional:

- There's no exact guarantee on how big the payments will be, unlike most guaranteed annuities that set fixed payments. That means that if the market slides, so will your payments;
- It is possible to outlive your money, so be very careful in planning how and for how long these payments will be made.

There's nothing wrong with investigating these mutual funds, and depending how much retirement savings you have and what your needs will be, they may be one of a series of options you use as interlocking parts of your overall portfolio to arrange a flow of income in your non-working (or partially working) years. But like all mutual fund choices, they are not one-size-fits all solutions, and it's good to get some advice that fits your situation.

Keep in mind that a qualified financial planner should go beyond telling you whether to put your money in an income replacement fund, an annuity or other investment choice. One of the big benefits of seeking qualified financial help is assessing how much income may be required in view of your various goals in retirement – whether you plan to work part-time, whether health issues might affect your income needs, or any one of a host of issues unique to an individual's retirement.

Back to income replacement funds. Keep in mind that investment products are a lot like new car models – sometimes it makes sense to wait a year or two to see that the kinks are out. Products attempting to address various financial concerns are being designed daily. By all means study the advantages of such products, but keep in mind that these products might be reconfigured to make later versions more attractive and always note that there are product costs to having “concerns or risks” addressed in product design which should be weighed against costs, and perhaps flexibility, of “active” oversight.

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