Investing When You Have a Large Pension

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QUESTION: If I am retiring with a nice pension, does that affect how I should invest my liquid funds?

Podnos: Some families are fortunate in having a large pension in retirement. I'm referring here to guaranteed payments for life from a prior employer. These pensions are very common with all varieties of government employees (including the military) and many large corporations.

The pension can be adjusted for inflation or not, and usually has provisions for a survivor's benefit if the primary pension recipient dies first. Different guarantors have varying reliability in terms of the likelihood that the pension can be paid over many decades. For example, if the employer was the Federal Government, they can print the money to pay the pension such that guaranteed payment is assured. On the other hand, many corporations that have entered bankruptcy (many airlines, General Motors, etc.) failed to honor their pension obligations. In the middle of risk are many municipalities that appear unable to fulfill their promises (Chicago, Illinois in general, some California cities, Detroit and more).

However, let's assume that the pension is likely to be paid. This has significant importance for how one invests their liquid capital. Take a couple that has a "safe" pension that will cover 60% of their desired retirement costs. Add Social Security and they have perhaps 80% of lifestyle expenses covered.

We can think of this pension/Social Security combination as the equivalent of a giant savings bond paying enough interest to cover 80 percent of their needs. So, how to invest their other savings? Even if we put one hundred percent in the stock market, one could argue that they have an 80% allocation to fixed income and only twenty percent allocation to stocks. This seems quite reasonable, especially if their main pension income is not inflation adjusted. The family may indeed need true after tax and after inflation growth of their liquid funds in order to compensate for the erosion of purchasing power of their fixed pension. However, each situation is different and needs to be assessed that way.

Assuming that the family needs growth in the liquid portfolio, they may still want to keep some fixed income there for market drops-to allow their 20 percent of retirement need withdrawals without having to sell at a loss.

All of the considerations discussed above need to be carefully thought over with additional variables being considered. The family retiring early and depending on the pension for perhaps four decades is very different than a family with the same circumstances other than a more advanced age. If the payor is not highly reliable, then actions should be taken for the contingency that the pension is reduced in later years.

Steven Podnos MD CFP is a fee-only planner in Brevard County. He can be reached at wealthcarellc.com or Steven@wealthcarellc.com.

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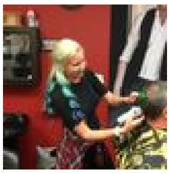

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