How to Manage Your Retirement

A GUIDE TO:

Financing Your Retirement

EDUCATION GUIDE

THE Vanguard GROUP®

Planning now can make a difference later.

Whether retirement is imminent or you're already retired, now is the time to work closely with your financial advisor to develop a plan for financing the years ahead.

This guide will help you make the most of consultations with your advisor by providing insights into issues that need to be considered.

Step 1: Your Current Situation

Step 2: Adjusting Your Portfolio

Step 3: Withdrawing Your Assets

Step 4: Monitoring Your Plan

You’ve made it!

You’ve worked hard, you’ve saved, you’ve planned. Now your retirement years stretch before you, and they can be the most enjoyable years of your life.

But for the first time you’ll be spending rather than accumulating assets. That’s why it’s important to work with your financial advisor to create a financial plan designed to help make your assets last.

Your financial advisor will create a plan designed to help make your assets last.

Some of the work will be familiar because the same principles you used to build your nest egg—balanced, diversified, low-cost, long-term investing—also underlie how you should continue to invest during retirement.

But you’ll also face some new decisions that will call for your advisor’s guidance: What kind of investment mix will suit your risk tolerance while still allowing your assets to keep up with inflation? How much can you safely withdraw from your portfolio each year? How do you minimize tax impacts on your resources?

Careful advance planning and ongoing consultation with your advisor can help you answer these questions and enjoy the kind of retirement that you’ve always envisioned.

Step 1 Your Current Situation

For many people, retirement can last a long time. Current life expectancy for American men is about 74 years; about 80 for American women.* But these averages understate an important fact: The longer you live, the longer you can expect to live. For example, if you live to age 65, the chances are good that you'll live to age 85.

Consequently, there's a reasonable possibility that your retirement could last 25 to 30 years. That's why it's critical to work with your financial advisor to make sure you're prepared. Your advisor will aim to keep your portfolio on track and reduce financial risks so you can concentrate on enjoying these years.

Keep an Eye on Cash Flow

As part of your preretirement planning, you probably worked with your advisor to estimate your annual retirement income and expenses. Once you're retired, it's essential to continue to watch your cash flow and reestimate your income and expenses each year. This practice can help your advisor spot potential financial trouble and make adjustments that can help keep your retirement plan on track..

*National Vital Statistics Reports, Vol. 53, No. 6, November 10, 2004.

Estimating Expenses and Income

When you estimate your expenses, it can be helpful to separate them into nondiscretionary and discretionary categories.

- **Nondiscretionary**. These are basic expenses such as food, mortgage payments, insurance premiums, taxes, gasoline, and utilities.

- **Discretionary.** These expenses are optional—such as travel, new cars, hobbies, gifts, and charitable contributions.

To estimate your sources of ongoing income, include such things as Social Security, pensions, veterans' benefits, royalties, rents, dividends, and interest. Depending on your age, you may also need to include the required minimum distributions (RMDs) that you must take from your traditional IRAs and qualified retirement plans such as 401(k)s. Federal law mandates that you make withdrawals from these accounts after you turn age 70½.

Using your estimated expenses and sources of ongoing income, your advisor will be able to determine approximately how much you will need to withdraw from your investment portfolio each year to cover the probable income shortfall.

Review Your Insurance Coverage

Large, unexpected expenses can damage the best-laid retirement plans, but adequate insurance coverage can help protect you against many of these expenses. That's why you'll want to have your advisor make sure your coverage is sufficient for all your policies.

Medicare doesn't cover all health care costs. Your advisor can help you decide which type of health insurance best meets your needs.

During your retirement, you also may incur insurance costs specific to retirees. For example, retirees age 65 and older qualify for Medicare health insurance, but must pay a monthly fee for the coverage. And, because Medicare doesn't cover all health care costs, many people purchase "Medigap" insurance to plug the "gaps" in Medicare. Your advisor can help you decide which type of health insurance best meets your needs.

In addition, Medicare provides little help if you require long-term assistance with everyday activities. Consequently, many retirees purchase long-term care insurance to try to prevent having their savings devastated, should they require such care. However, long-term care insurance can be complicated and expensive, so be sure to consult with your financial advisor before you make such a purchase.

There is one type of insurance that you may no longer need after you retire—life insurance. Unless others are depending on your pension or other income that would cease when you die, or you have major debts such as a mortgage or loans for children in college, you may want to consider canceling your life insurance policy.

If you own a cash-value life insurance policy, you have several choices: Cash it out and incur taxes; exchange the cash value of the policy, tax-free, into an annuity; or keep the policy for estate planning purposes. Your advisor can help you determine the best way to handle your life insurance.

Maintain Some Liquidity

When you have unexpected expenses, a small liquid account—usually a money market account—can help you avoid having to sell portfolio assets at an inopportune time. Check with your advisor to determine the liquidity level that makes sense for you.

Consider Annuities

Many retirees purchase annuities to generate ongoing income that supplements Social Security and pensions. Annuities are insurance products designed to pay income as long as you live. Certain annuities allow you to include another person as recipient of the income after your death.

Some annuities make fixed payments, while others make payments that are increased over time. Some generate variable income based on the performance of the underlying mutual funds you select. Keep in mind that variable annuities are subject to market risk.

The trade-off for many annuities is that, upon your death, any remaining principal stays with the company issuing the annuity, and is not available to your heirs. The upside is that, if you live long enough, you may exhaust the principal and then some.

Your advisor can help you determine if an annuity is appropriate for you.

Organize, Share, Simplify

Your plans for retirement involve more than just financial calculations. You also need to make sure that those you care about understand your plans and have access to important information.

Get organized. Your advisor can help you organize your personal and financial information to ensure that it's readily available to your family or friends in the event of your disability or death. Beneficiary designations are especially important to update, because these designations supersede instructions in your will. Make sure important documents and records are easy for your family to locate. These should include your will; trust documents; insurance policies; a detailed listing of your assets, including account numbers and dollar amounts; and a durable power of attorney.

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Involve your family. Because many of your financial decisions affect your spouse and other family members, you should prepare them to step into your shoes if necessary. Discuss the issues with them and make sure they are familiar—and comfortable—with your financial advisor.

Simplify your finances. Your advisor may recommend consolidating your assets with a single company. This can make it easier for him or her to track your financial situation and calculate your required minimum distributions each year. It can also reduce your paperwork at tax time. In addition, it can ease the transition should a family member have to take charge of your finances.

Step 2 Adjusting Your Portfolio

Before you begin drawing income from your investment portfolio, your advisor may adjust the investment mix so it is more appropriate for your new circumstances.

For your own peace of mind, you may want to talk with your advisor about some commonly held misconceptions regarding retirement portfolios.

Myth: Stocks are too risky for retirees. Not necessarily. If you were comfortable with a certain proportion of stocks in your portfolio before you retired, chances are good that you'll be comfortable with that same proportion for some time during your retirement. Although your advisor may recommend reducing the proportion of stocks as you move further into retirement, you may still want to maintain the growth potential that stocks can provide.

Your advisor may adjust the investment mix so it is more appropriate for your new circumstances.

Myth: Bonds are the best investment for retirees because they produce income. Yes, the interest that bonds generate can be an important source of income, and bonds can provide the balance and diversity critical to all portfolios. But your advisor may also suggest keeping stocks in the mix. Although past performance doesn't guarantee future returns, retiree portfolios usually need the kind of inflation-beating growth that stocks have historically delivered over time.

Myth: For safety, stick with short-term reserves. Short-term reserves, including money market funds, bank certificates of deposit, and Treasury bills, do offer stability and relative safety. As a result, they're a great place to store cash temporarily or to use for liquidity. But, historically, short-term reserves have barely kept ahead of inflation and typically yield far less than other types of investments. So most retirees should not keep a significant portion of their assets in these kinds of accounts.

Plan for Inflation

Your advisor will consider the impact of inflation on your financial plan because, unlike human beings, inflation never retires. Even at a moderate 3% annual inflation rate (the national average for the relatively low inflation period from 1986 to 2004),* you'll need income of about $270,000 in 20 years to buy what $150,000 buys today.

What's more, your personal inflation rate in retirement may actually be higher than the national average. Why? Because retirees tend to use more health care services and pharmaceuticals than the average consumer, and these costs have been rising faster than the overall inflation rate.

A Balanced, Diversified Portfolio Is Important

Inflation is only one factor your advisor will consider in evaluating your investment mix. Most advisors recognize that one type of investment alone—stocks, bonds, or cash—is not likely to maximize a portfolio's success. A mix of all types of investments can provide the balance of growth, income, and stability that allows a portfolio to better withstand the fluctuations in financial markets. So your advisor will aim to create a balanced and diversified investment mix and control risk as much as possible, rather than concentrate solely on producing the highest returns. But keep in mind that diversification does not ensure a profit or protect against loss in a declining market.

*Based on data derived from the Consumer Price Index—All Urban Consumers, U.S. Department of Labor Bureau of Labor Statistics, December 2004.

Step 3 Withdrawing Your Assets

One of the most important recommendations your advisor will make is how much you can regularly withdraw from your accounts without exhausting them. Although it's impossible to determine this with certainty—no one knows what the future holds for financial markets, inflation, or personal longevity—your advisor is likely to recommend one of two withdrawal methods.

Under both methods, you sell assets to produce retirement income. Your assets include not only the interest, dividends, and capital gains you've reinvested, but your principal as well.

Your advisor may recommend that you sell assets once or twice a year and place the funds in a money market account that has checkwriting privileges. For convenience, you could also deposit ongoing income payments, such as Social Security and pension, in this same account.

Choosing Your Withdrawal Method

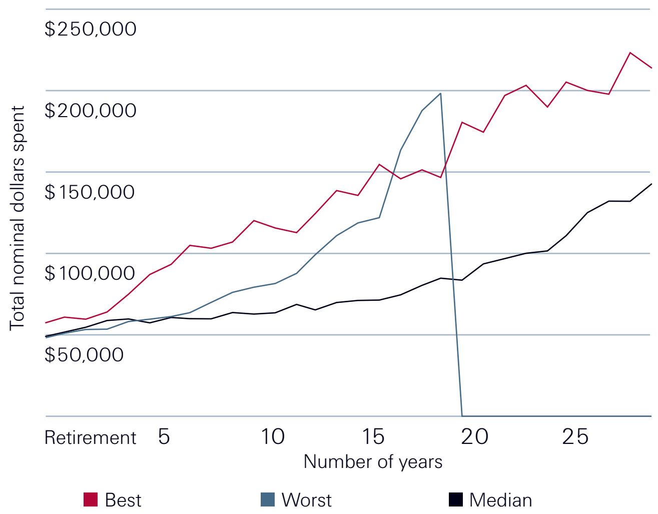
There are two basic methods for turning your assets into income, and each has advantages and disadvantages. As you consider the two methods described on the following pages, keep in mind that the income produced by Method 1 isn't tied to market conditions after the first year. However, the income produced by Method 2 is directly tied to the financial markets in every year. This means the annual income produced by Method 1 will be predictable and the income produced by Method 2 will fluctuate.

Method 1: Dollar-Adjusted Withdrawals

Using this method, you withdraw 3% to 4% of your portfolio the first year. Each subsequent year the dollar amount of your withdrawal increases by the previous year's national inflation rate. The percentage your advisor recommends for your initial withdrawal will be based on what you'll need in order to cover the difference between your income and expenses.

The graph below shows three hypothetical scenarios using the dollar-adjusted withdrawal method, and assumes an initial withdrawal of 4%. Subsequent withdrawals are based on actual inflation rates for the historical time periods used as models. The amounts shown are in nominal dollars, so keep in mind that their purchasing power would undoubtedly decline over the time period shown. Also note that, in the "worst case" scenario, you could run out of money after about 20 years. And, as you know, investment in mutual funds involves risk.

Total Annual Spending—Dollar Amount Grown by Inflation Spending Policy



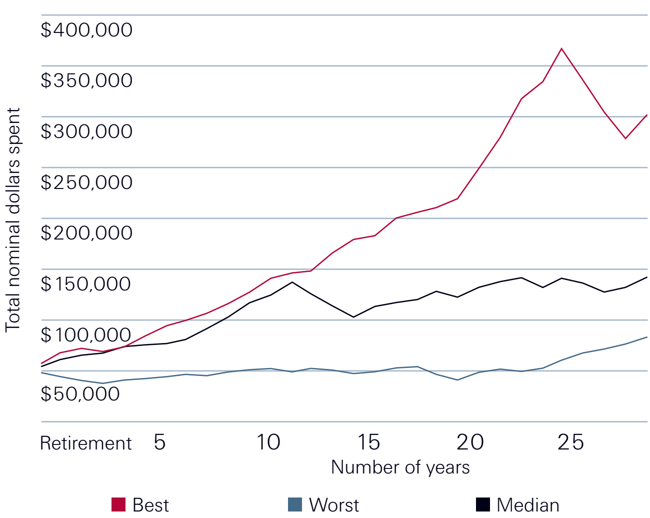
Method 2: Percentage Withdrawals

Using this method, you withdraw the same percentage annually from your portfolio. Recent analysis indicates that an annual withdrawal rate up to 5% or 6% is reasonable,* although the illustration below assumes an annual withdrawal rate of 4%. The percentage your advisor recommends will be based on the amount you'll need in order to cover the difference between your income and expenses.

Unlike the first method, annual withdrawals aren't adjusted for inflation. Instead, this method relies on long-term portfolio growth for increases in withdrawals.

The graph below shows three hypothetical scenarios using the percentage withdrawal method. The amounts shown are in nominal dollars, so be aware that their purchasing power would undoubtedly decline over the time period shown. Also keep in mind that investment in mutual funds involves risk.

Total Annual Spending—Percentage of Portfolio Spending Policy



*Source: The Vanguard Group, 2005.

Method 2 is easier to use and can mean your assets will last longer. But your income stream will fluctu-ate-significantly at times. This means during periods when your income drops you'll have to disci-pline yourself to spend less. On the other hand, during years when the market is performing well, you'll have the enviable task of deciding whether to withdraw the amount that exceeds your spending needs or leave it in the portfolio to potentially grow for future needs.

Analysis Assumptions for Both Withdrawal Methods

Age	65
Planning horizon	30 years
Taxable assets	$250,000
Tax-deferred assets	$750,000
Asset allocation	60% stocks and 40% bonds
Marginal tax rate	35%
Capital gains tax rate	15%
Spending policies:	Method 1: 4% of initial balance ($40,000) grown by inflation annually Method 2: 4% of annual ending asset balance

Unlike stocks and bonds, Treasury bills are guaranteed as to the timely payment of principal and interest. Past performance is not a guarantee of future results. Asset allocation mixes and index performance are not illustrative of fund performance. You cannot invest in an index.

These hypothetical examples do not represent the return on any particular investment. "Best" and "worst" scenarios are based on the historical sequence of returns from 1960 to 2004 that produced the highest and lowest ending balances, respectively. The "median" scenario is based on the median ending asset balance for each asset class from 1960 to 2004. These scenarios are based on historical performance, and past performance is not a guarantee of future results.

For comparing the past performance of the asset allocations, the Dow Jones Wilshire 5000 Total Market Index was used as the benchmark for common stock returns. This benchmark was not established until 1971, so the S&P 500 Index is used for the period from 1960 to 1970. The Lehman Brothers Government/Credit Index serves as the benchmark for bond returns from 1973 to 2004. This benchmark was not established until 1973, so the S&P High Grade Corporate Index is used for the period from 1960 to 1969 and the Citigroup High Grade Index is used from 1969 to 1972. The Citigroup Smith Barney 90-day U.S. Treasury Bill Index is used as the benchmark for the returns on cash. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

A cash flow analysis that uses a constant annual rate of return can differ significantly from an analysis that uses returns that vary from year to year, even if the average annual returns for both analyses are exactly the same. The interplay among the specific paths of investment returns, inflation, and your particular withdrawal pattern will have a decided effect on your assets. Therefore, it is important to examine your portfolio under different return and inflation conditions.

Which Assets Do You Tap First?

As you require income, your advisor will guide you in choosing which accounts to tap. When you start taking federally mandated required minimum distributions (RMDs) from your traditional IRAs and employer-sponsored retirement accounts, you'll want to use these funds for your spending needs before you tap any other accounts. But until then, your advisor will base recommendations on two important considerations:

- Keeping your investment mix on target; perhaps using the withdrawal as an opportunity to bring it back into balance.
- Keeping your assets growing to the maximum extent possible.

These goals may appear to be conflicting at times. However, as a rule of thumb, bringing your investment mix back into balance is generally considered to be more important. Nevertheless, each retiree's situation is unique, so there are exceptions to this general rule.

Sell to Keep Your Investment Mix on Target. Your advisor may recommend that you start withdrawing funds from the portion of your portfolio that has become overconcentrated (or overweighted) in one type of investment. For example, if the stock market has grown rapidly and your target mix of 50% stocks and 50% bonds has become a lopsided 65% stocks and 35% bonds, your advisor may suggest selling stocks to adjust your investment mix, reduce the portfolio's risk level, and produce income at the same time.

Sell to Maximize Asset Growth. The next best thing to not paying taxes is paying as little as possible for as long as possible. Consequently, your advisor may recommend withdrawing your assets in this order:

- Taxable assets.
- Tax-deferred assets in traditional IRAs and employer-sponsored plans.
- Tax-free assets in Roth IRAs.

Here's the reasoning: In taxable accounts, you're paying tax each year on the dividends, interest, and capital gains that your assets produce. You also may pay taxes on the withdrawals themselves if your assets have appreciated in value. In tax-deferred accounts, you pay tax only when assets are withdrawn, even on gains. And for Roth IRAs, provided certain conditions are met, you pay no taxes at all— and you can even pass the assets on tax-free to your heirs.

Fine-Tune Your Withdrawals

Your advisor may recommend further fine-tuning your withdrawals, either to gain as much tax efficiency as possible, or to help you meet specific financial goals. Some examples of withdrawal tactics are:

- Sell taxable assets that have lost money.
- Sell taxable assets you've held longer than a year.
- Sell tax-deferred assets when conditions are right.

Your advisor also will check your investment mix after you sell assets, and rebalance your portfolio if necessary. However, if your primary goal is to maximize the amount you leave to your heirs, your advisor may recommend a different approach. In this case, he or she might recommend that you not sell taxable assets that have risen significantly in value.

Step 4 Monitoring Your Plan

Once you have a solid plan for financing your retirement, it's important to meet with your advisor regularly to make sure your plan remains on track. Your personal situation will undoubtedly change over the years, as will the markets, so your portfolio may need to be adjusted periodically.

Adjusting to Bear Markets

Your portfolio can probably withstand a market downturn, even over a period of a year or two. But it's natural to be concerned about the decreasing value of your portfolio during more prolonged downturns. Your advisor will help you adjust to hostile markets by recommending changes in your withdrawals or by suggesting measures to increase your income.

As you saw in the examples in Step 3, the percentage withdrawal method (Method 2 on page 12) has a built-in brake. If the markets are down, the amount you withdraw would "automatically" be reduced. This also means you would have to adjust your spending to the lower amount.

If you are using the dollar-adjusted withdrawal method (Method 1 on page 11), you would need to decide, with the help of your advisor, whether to withdraw less during a down market.

Consider All Your Options

As you periodically reevaluate your retirement financing plan with your advisor, you'll want to consider several other issues.

"Surplus" years. In good economic times, either withdrawal method noted in Step 3 may produce more income than you need. You'll then have to decide whether to spend the surplus, or, as your advisor may recommend for most years, leave it in the portfolio to potentially grow for future needs.

Stepped-up withdrawals. You may, of course, withdraw more than the guideline amounts using either method, but doing so can increase your risk of depleting your assets. Spending more than the recommended guideline is easy to do as you begin enjoying your freedom from the structure of daily work. The result, however, is less money working for you over the ensuing years, which can lead to a cash squeeze later in retirement.

Whether annuities fit in. Whichever withdrawal method you choose, your advisor may suggest purchasing an annuity designed to give you a lifetime income. Because an annuity can help smooth out your income, it can be especially useful in years of market turbulence.

Higher-return investments. Your advisor may suggest boosting income through investments that could potentially earn higher returns than those you currently hold. Some portfolios—particularly very conservative ones—might benefit from modestly increasing investments in different kinds of bonds and stocks. But, of course, higher returns also usually mean higher risks. So if you do decide to stretch for greater returns, work closely with your advisor to decide which investments would work best for your goals—and try to stick to low-cost investments.

Other ways to boost income or reduce expenses. There are a variety of ways to augment your income or reduce your expenses. You can move to a smaller home or a less expensive region. You can also sell nonfinancial assets or even return to work.

One thing you shouldn't count on as a source of income: inheritance. Many retirees expect an inheritance, and many do indeed receive it. But keep in mind that it's not unusual for money you expect to inherit to be depleted because of illness, bankruptcy, bad market performance, or other unexpected events.

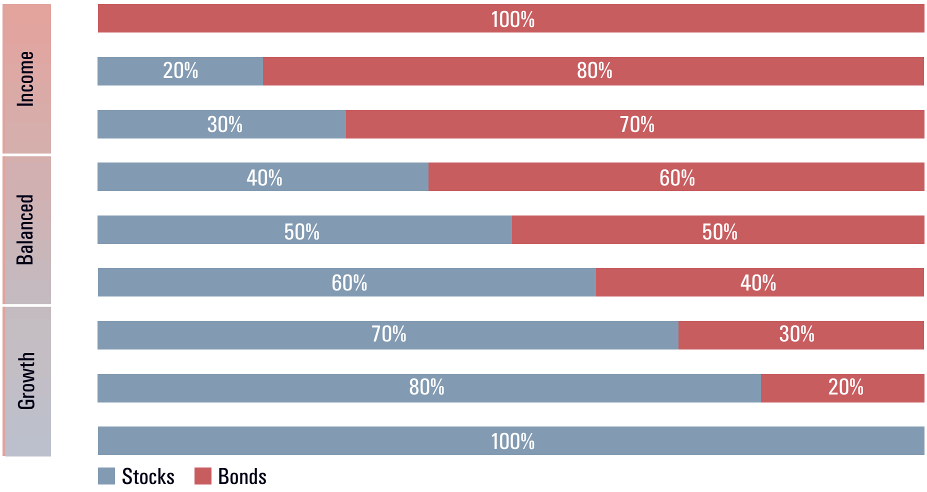
Rebalancing Your Portfolio

Work with your advisor at least annually—but not more than every six months—to review your investment mix. Your advisor may recommend rebalancing your portfolio if a particular type of investment has strayed more than five percentage points from your target.

Your advisor may also recommend rebalancing if your risk tolerance changes. An investment mix emphasizing stocks may be comfortable early in your retirement, but a mix emphasizing bonds might be a better fit later.

The chart on this page shows the type of investment mixes that may be considered by your advisor.

Possible Investment Mixes for Retirement



Notes

Notes

Your financial advisor is ready to help you keep your retirement goals on track. Whatever your retirement goals may be, your advisor is committed to helping you reach them.

Intermediary Services
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An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at $1 per share, it is possible to lose money by investing in such a fund.

For more information about Vanguard funds and Vanguard annuity products, contact your financial advisor to obtain fund and annuity contract prospectuses. Investment objectives, risks, charges, expenses, and other important information are contained in the prospectuses; read and consider them carefully before investing.

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