BUSINESS

ARBOR OUTLOOK

The dilemma of poor millionaires

Margaret McDowell

"Rainy days seem to wind up sunny ... Long as you got a little spending money."
"Greenbacks" as performed by Ray Charles

If you had told me when I was a kid that one could have a million dollars and feel poor, I wouldn't have believed it. A "poor millionaire" is a phrase that sounds oxymoronic, but for retirees of a certain age, there is a huge difference between having money and enjoying income.

Low interest rates have denied retirees significant, safe income. And while future rate hikes are likely, the luxury of producing meaningful income through CD's remains problematic. Most retired millionaires who need income are attempting to use their investments to generate a paycheck to provide for or offset living expenses.

If a balanced portfolio is producing 2.5 percent in income through stock dividends and bond coupons, and you've got a million invested, that's $25,000 of income generated annually. Of course that's just the income component and doesn't represent your total return, which factors in potential growth. Let's say that your pension and Social Security combined brings you $40,000 annually before taxes. Together with the income generated from your investments, this $65,000 may come close to matching your annual cash flow needs.

But lots of folks don't have pensions these days. And let's say you're a widowed investor who is now living on one Social Security check instead of two. Just for our purposes here, let's assume your entire Social Security and pension income has dropped to $20,000 annually, and that the aforementioned investments accounts are still throwing off $25,000 a year. Well, the math is simple: now you're living on $45,000 a year instead of $65,000, and that's before your income is taxed.

So, for some in retirement, whatever money that is invested must stay invested and continue to produce income. The principal, or what some call the "Golden Goose," is withdrawn or taken out of the market to the detriment of your income needs. This is why some millionaires may feel poor. They have money, but spending those assets in early stages of retirement prevents them from maximizing their income generation in future years.

There may come a time, however, when it would be appropriate to "snack on your principal." Say you're 80 and have a $1 million investment account producing 2.5 percent in income annually. Combined with your $20,000 in Social Security and pension income, you could spend $20,000 of principal a year and likely never run out of money. And what remains of your investments would also still generate income, though a bit less each year as the account is decreased. This is why financial planning often requires nuanced calculations using uncertain inputs like life expectancy or health issues.

Margaret R. McDowell, ChFC, AIF, author of the syndicated economic column "Arbor Outlook," is the founder of Arbor Wealth Management, LLC, (850-608-6121 — www.arborwealth.net), a "fee-only" registered investment advisory firm located near Sandestin.