TOUCHSTONE CAPITAL

UNCOMMON INSIGHTS

A CASHFLOW PLAN FOR TODAY'S REALITIES

IT'S NOT YOUR FATHER'S (OR GRANDFATHER'S) RETIREMENT ANYMORE.

Summer 2022

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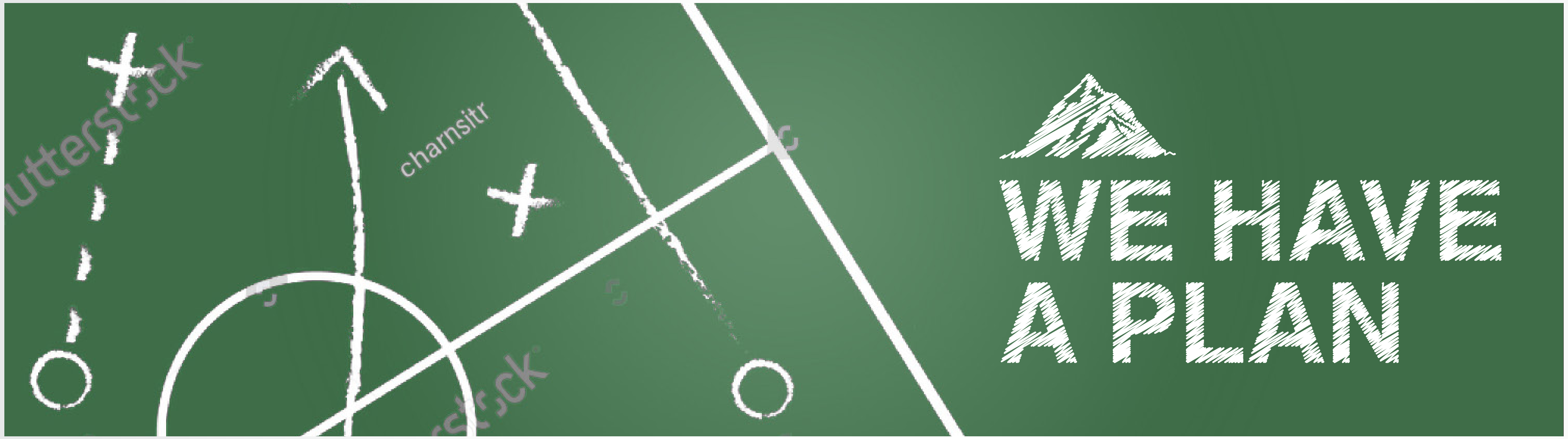

Uncommon Insights

As recently as the 1960s, when life expectancy was just 69 years, people would work most of their lives, retire at age 65 and live for a bit longer off their savings and Social Security. Retirement didn't require a lot of planning.

Achieving lifetime income sufficiency today has never been more challenging. In days long past, people were able to rely on the "three-legged stool" of retirement income sources that consisted of:

- Company Pension
- Social Security
- Savings

With company pensions now a thing of the past for most people, the stool is now teetering on two legs. If, as is the belief of many younger people, you don't think Social Security will remain viable (or you simply don't want to rely on it), the onus now falls squarely on each individual to create a reliable income source that can outlast them.

RISKS TO RETIREMENT INCOME

- Longevity Risk
- Inflation Risk
- Market Risks

The challenge is even more difficult when you realize that now we have to be able to accumulate capital at a rate greater than inflation and then sustain that rate of growth to generate enough income to protect our lifetime purchasing power. It is especially challenging as long as interest paid on savings or bonds remains below the real rate of inflation.

But that's not even the most challenging part. Once you accumulate your retirement capital, it is up to you to determine the rate at which you can safely spend down your assets, so you don't deplete them too quickly. Given the enormous complexity of determining an optimal spend-down, it leaves each individual in the precarious position of having to mange their spending in response to the performance of their assets. Essentially, trying to determine the lifetime income value of an investment portfolio is nothing more than a dangerous crapshoot.

WHEN THEORY IS NOT REALITY

Then along came the **"4 percent rule,"** a 1990s invention by a financial planner to be used as a guide for spending down assets in retirement. The rule implies that retirees can safely spend down 4 percent of their assets each year without the risk of outliving them. The four percent rate was determined based on an analysis of:

- 50% Stocks / 50% Bonds
- Spend Down rates over 50 years *(1926-1976)*
- 30 years (adjusted for inflation)

Generally, retirees who adhered to the 4 percent rule in the 1990s more than likely found it to work brilliantly. The surging stock and bond prices of that period were a significant boost to the rule. But, during the 2000s, a period of stagnating stock prices, retirees were faced with the "sequence-of-returns risk," where spending down assets during declining stock prices put such a heavy strain on their assets that they had to either reduce their withdrawals or their lifestyle or risk depleting their assets.

Today's retirees are finding that rules based on historical data from 50 to 75 years ago don't necessarily apply to the 21st Century realities of expanding life expectancies, rising healthcare and long-term care costs, higher inflation, and low bond yields. There is just no way you can simply follow a rule or set a plan and forget it in today's world.

> "In theory, theory and reality are the same. In reality, they are not."
>
> *Yogi Berra*

ENTER THE SECURE CASH FLOW PLAN

Whether it's the 4 percent rule or any other conventional method to source income, investment advisors refer to it as the "withdrawal" rate. That's the rate at which an advisor would tell investors they should be able to take out X percent of their account value per year. However, there are a couple of dangerous limitations to that conventional approach.

1. MARKET VALUE CHANGES

It doesn't recalibrate based on changes in the market value of investments. If a withdrawal is needed during a period of declining stock prices, it will require liquidating a larger number of shares to meet the need. That results in a permanent loss of capital that could accelerate the depletion of shares and the portfolio's sustainability for generating the required income.

2. SOURCE FROM SPECIFIC INVESTMENTS

It doesn't source the income down to the client account level, where specific decisions should be made to determine where the income should come from. In other words, with a blanket withdrawal rate, a fixed percentage of assets, say 5 percent, are liquidated across the board to generate the required income. That indiscriminate selling of assets could diminish the lifetime income value of a portfolio.

That's why we developed the Secure Cash Flow Plan, which guides us in sourcing income down to the individual client account. The plan allows us to take individual considerations and circumstances into account when determining which assets to target so that it won't diminish the portfolio's lifetime income value while still meeting the client's needs.

The objective of each client's SCF plan is to create reliable sources of income within the portfolio while constantly adjusting for changing market conditions or client needs. Each client's cash flow plan is reviewed and updated each year to determine the best way to source the income required to meet their needs.

SCFP BENEFITS

- YOUR income
- YOUR specific investments
- YOUR account
- Adjusting for market conditions
- Reliable income stream

TOUCHSTONE CAPITAL

SECURE CASH FLOW PLAN

Name: John Smith
Date: 1/1/2022
Account #: ABC123456
Advisor: Ted Kerr

Advisor Use Only

SWP Frequency:	Monthly
SWP Amount (monthly):	$1,911.00
SWP Amount (annually):	$22,932.00
SWP Date (annually only):	
Estimated Annual Fees:	$19,296.80
Total Cash Need (SWP+Fee):	$42,228.80
Total Annual Income:	$18,018.80
Add'l Income (if any):	$8,248.00
Net Cash Need:	$15,962.00
Red/Yellow/Green:	Green

Red = Above 6% I Yellow = 4.1% I Green = At or below 4%

Set Dividends to Cash

- ☐ NONE / NO UPDATES TO PLAN
- ☑ ALL POSITIONS

Or only certain stocks marked below

☐ DHIL	☐ NRC
☐ FFIV	☐ SNA
☐ FAST	☐ STRA
☐ GNTX	☐ RGR
☐ IDCC	☐ TROW

Other Securities

- ☐ ______
- ☐ ______
- ☐ ______
- ☐ ______
- ☐ ______
- ☐ ______
- ☐ ______
- ☐ ______

Additionally Sell:

☑ **Security to Sell (ticker):**	EILDX
Additionally Sell $:	$2,000.00
Frequency to Sell:	Quarterly
Description of Intent:	______

☐ **Security to Sell (ticker):**	
Additionally Sell $:	
Frequency to Sell:	
Description of Intent:	______

☐ **Security to Sell (ticker):**	
Additionally Sell $:	
Frequency to Sell:	
Description of Intent:	______

☐ **Security to Sell (ticker):**	
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☐ **Security to Sell (ticker):**	
Additionally Sell $:	
Frequency to Sell:	
Description of Intent:	______

LAYERS OF INCOME

The plan is built primarily on an income stream floor consisting of dividend income and bond interest. That naturally occurring income is the first and most reliable layer of income that doesn't change much from year to year. For cash flow requirements above that, we create another layer of income by targeting assets based on their value in the portfolio.

We try to always take a "sell high, buy low" approach to cash flow management. For example, we're more likely to target overvalued stocks rather than stocks that are down in price or undervalued. That opportunistic harvesting of stocks ensures we minimize losses while maintaining a reliable source of future income. The **stock gains layer** and the **dividend and bond interest layer** combine to create not only a reliable income source but also one that captures portfolio growth.

TARGETING THE RIGHT ASSETS AT THE RIGHT TIME

It would be easy to justify selling an underperforming stock to our clients, one that is down in value. But that could do more harm than good to the portfolio. Our portfolio is designed with the knowledge that not all investments go up or down in sync, that they're not all correlated with one another. Some years a stock will outperform the others, and in other years it will underperform.

An example of targeting the right stock at the right time is T. Rowe Price (TROW), a stock we really like. It was targeted heavily for income sourcing in 2021 because its stock price had more than doubled since 2020, from about $90 to well over $200 a share. As of October 20, 2002, the stock was selling as low as $100/share. We still own TROW and are looking at its price decline as an opportunity. As we try to do with all our income sourcing decisions, we were essentially executing the proverbial "sell high" approach to maximize income for our portfolio while maintaining its underlying future income value.

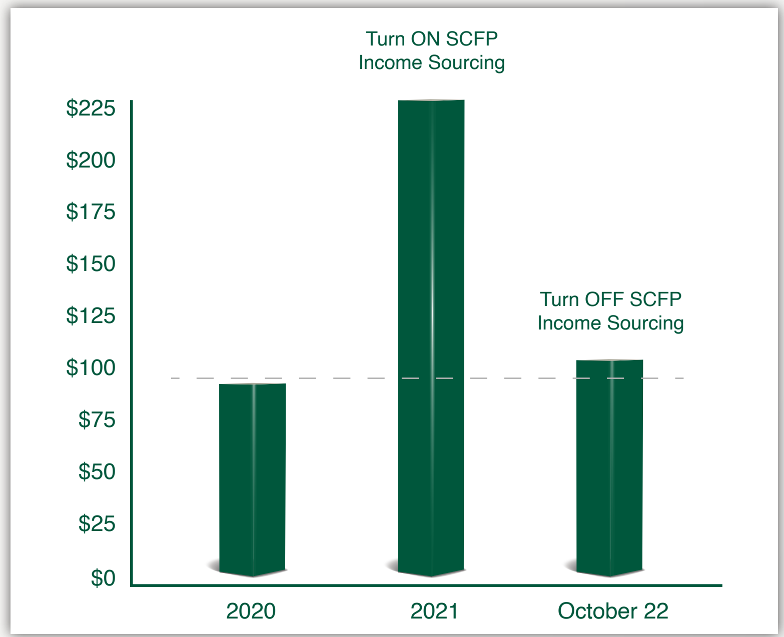
TARGETING THE RIGHT ASSETS AT THE RIGHT TIME -

"BUY LOW, SELL HIGH"

"T. Rowe Price was targeted heavily for income sourcing in 2021 because its stock price had more than doubled since 2020, from about $90 to well over $200 a share. As of October 20, 2022, the stock was selling as low as $100."

Rather than panic, we view this as an opportunity to target the right assets at the right time. The Cash Flow Plan allows us to target specific securities at a time of "sell high," getting the "most bang for our buck," and retain securities that are not worth selling at that time.

T. ROWE PRICE - STOCK VALUE



BY SOURCING INCOME FROM TROW IN 2021 AT PRICES OVER $200/SHARE, OUR CLIENTS SAVED OVER $500,000 BY 10/20/22

FINAL THOUGHTS

We live in very different times than our fathers and grandfathers. Conventional rules and approaches to creating lifetime income sufficiency don't apply in today's realities. As we've experienced in just the last few years, things can turn on a dime. One day we're enjoying one of the most robust economies in history, and the next, we're digging ourselves out from the sharpest economic downturn in history. Inflation is kicking up market volatility, and geopolitical conflicts threaten the global food and energy supply.

Everything has an impact on an individual's retirement cash flows. There is no more setting it and forgetting it. Cash flow planning now has to be dynamic, constantly gauging conditions, recalibrating, and adjusting to ensure a reliable and sustainable income. The Secure Cashflow Plan enables us to zero in on each client's income sourcing needs to make adjustments as often as necessary. It allows us to be nimble while still being thoughtful about how to source income.

We're not very active portfolio managers as we rarely make changes to our portfolios. But we are very active cashflow stewards to ensure our portfolio generates the optimum cash flow for the clients who rely on it.

Appendix A

RISKS TO RETIREMENT INCOME

- **Longevity** Risk
- **Inflation** Risk
- **Market** Risks
- Health & long term care risks
- Business and Public Policy risks
- Family issues

Number of Years Money Will Last - 3% Inflation

RATE OF RETURN (%)

WITHDRAWAL RATE (%)

	1	2	3	4	5	6	7	8	9	10	11	12
12	7	8	8	8	8	9	9	10	10	11	12	13
11	8	8	9	9	9	10	10	11	12	13	14	15
10	9	9	10	10	10	11	12	13	14	15	17	19
9	10	10	11	11	12	13	14	15	16	18	21	26
8	11	11	12	13	14	15	16	18	20	24	30	•
7	12	13	14	15	16	18	20	22	27	36	•	•
6	14	15	16	18	19	22	25	31	44	•	•	
5	17	18	20	22	24	29	36	•	•	•		
4	20	22	25	28	33	42	•	•	•			
3	25	28	33	39	•	•	•	•				
2	35	40	50	•	•	•	•					
1	•	•	•	•	•	•						

APPENDIX B
GLOSSARY

SECURE CASH FLOW PLAN (SCFP)

An income generating plan within a client's portfolio that adjusts for client needs and changing market conditions while efficiently utilizing the available investments in the account. It also identifies the need to minimize rapid account depletion.

SYSTEMATIC WITHDRAW PLANS (SWP)

The periodic withdrawal amount taken out of a client's account.

INCOME

Income generated in the investment account. Typically this value includes dividends generated by the investments in the account and it can include new money added to the account.

RED/YELLOW/GREEN

Classification of the strength of the income stream over a 1 year period of time. This is determined by how much of the account is taken out during this time. The color ratings help the advisor know if the account is being depleted too quickly. Each SWP account is reviewed each year and classified as follows:

- **'Red'** classification identifies a withdrawal rate of above 6% of the account value in 1 year. This rating may represent a concern for rapid depletion of the account value and action should be taken such as discussion with the client, modifying the SWP amount in the client's portfolio…etc.
- **'Yellow'** classification identifies a withdrawal rate above 4% of the account value in 1 year. This rating alerts the advisor of possible concerns in the withdrawal amount.
- **'Green'** classification identifies a withdrawal rate below 4% of the account value in 1 year. This is generally an acceptable withdrawal amount.

DIVIDEND

A dividend is a portion of a company's profit paid to common and preferred shareholders. Dividends provide an incentive to own stock in stable companies even if they are not experiencing much growth. Companies are not required to pay dividends. Currently, most of the UIP stocks pay a dividend.

- **Dividend Reinvestment -** dividends that are generated and reinvested into the security.
- **Dividends to Cash -** dividends that are generated and not reinvested but instead sent to the cash account for other uses such as fees or SWPs.

UNIQUE INVESTMENT PROGRAM (UIP)

Touchstone Capital's investment stock portfolios based on our unique (in-house research) investment criteria.

CASH NEED

The amount of cash needed from the investments in the account to provide for the fees and SWP amounts.

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