September 30, 2011

Fetching the Retirement Dream

The news that baby boomers are entering retirement age (65) this year, and that nearly 10,000 of them celebrate that milestone on a daily basis, is nothing but stale. The question is not as much about whether people wish to retire but about having a financially secure retirement life. Studies have shown that, in the wake of the 2008-2009 financial crisis, the confidence levels, of both workers and retirees, in having enough money for a comfortable retirement life is at a 21-year low[1].

Consider Mr. and Mrs. Doe, 58 and 55, both hold management level positions at their companies, making over $200,000 combined. Between their retirement plans and investment portfolios, they have amassed a healthy sum of $1.5 million, plus a few real estate holdings. How do they feel about retirement?

Or Mrs. Jones, 69-year-old widower who was left with a $2 million life insurance payout to live on for the rest of her life, how should she cope with her retirement life?

Budgeting as the Foundation

Financial planners can never emphasize enough the importance of having a sound budget and sticking to it, much like a doctor telling you the need for a continued exercise routine. More than ever a retirement budget is a critical step to a comfortable retirement lifestyle. Gone are mandatory, work-related expenditures such as payroll and Medicare taxes, professional dues, gas for commuting, wardrobe replenishing, etc. But you are likely to see increased spending on healthcare, vacationing, and leisure activities. As a result, your budget needs a complete overhaul when you reach retirement.

Being realistic and pragmatic about your budget plan will remove stress. You need not trade quality of life for savings; instead, following your budget will help your goals bear fruit. For example, downsizing your primary residence not only cuts household costs but also reduces the need for upkeep of the empty nest. Many people we talk to have either moved to or are contemplating the idea of moving to a different town or state. Moving out of the city limits or to a suburban area could yield a smaller property tax bill. Washington State does not have an income tax, which has attracted many Oregon residents and businesses. For keen and veteran travelers, a growing number of retirees have residences in other countries—Latin America, SE Asia—where the cost of living is lower. This does not translate into a marginalized lifestyle; in fact, people who live overseas are often inspired and have a new appreciation for life.

Living Debt-……and Carefree

Living debt-free is another key component of retirement planning. Mortgage payments and other housing-related expenses easily account for over 30% of a household budget. Adding in other loan repayments—credit cards, auto—only puts more stress on your retirement lifestyle. It is best to start retirement without any outstanding commitments. Achieving this, however, requires a comprehensive long-term plan. Living within your means, avoiding credit card debts, and developing a spending discipline are sound strategies. If becoming debt-free is not possible in the near future, try consolidating

[1] EBRI 2011 Retirement Confidence Survey. http://www.ebri.org/pdf/surveys/rcs/2011/EBRI_03-2011_No355_RCS-11.pdf

your debts to one with a lower interest rate and refinancing your existing mortgages (it is likely that interest rates are going up in the future).

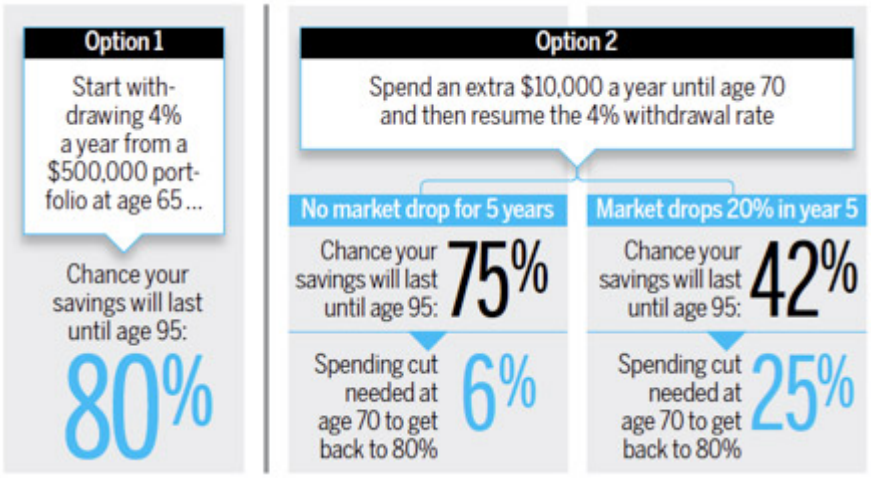
Putting Your Money to Work

Because savings plays such a vital role toward retirement, you need to take full advantage of your savings opportunities. For those still in the workforce, participation in a retirement plan (401(k), IRA, etc.) is very important. Companies sponsoring a 401(k) plan often provide salary deferral matching, which is equivalent to a 3-4% salary gain. If you have begun retirement, savings can still be found everywhere but come in different, less-common forms. Coupon clipping, senior discounts, last-minute hotel and travel deals, to name a few, can help you save as much as 25% in certain categories. Having more time at your disposal also provides more savings as you can tackle various household chores yourself: gardening, doing home repairs and even taking on home improvement projects that you would pay someone else to do before.

Establishing a Withdrawal Plan

If you do have money squirreled away for a comfortable retirement life, congratulations! Now, you need to have a proven and systematic withdrawal plan to accompany that. Decades of research has shown that a 4% withdrawal rate would give you an 80% or better chance that your investments would last for 30 years or longer. With the strategic use of cash reserves during market cycles, the probability of success increases.

Figure 1. Will Your Investments Last?



Note: Assumes 6% rate of return in the first five years. All portfolio withdrawals except the $10,000 extra increase at 3% per year.
Sources: Money Research, T. Rowe Price

Of course, beginning retirement does not mean you should liquidate everything and turn to cash because inflation will eat away purchasing power. Instead, you should have ongoing discussions and an understanding with your financial advisor about proper asset allocation strategies. Get educated and be proactive about your investments and learn how they can affect your retirement life.

A Few Other Thoughts

If you are still short of your goal, you may consider postponing retirement or continue to work part-time. Although the idea of staying in the workforce may be less than desirable, there is a silver lining: by

delaying retirement and hence Social Security benefits, you will be entitled to a permanent increase in those benefits when you actually begin taking them.

There are some "unexpected" benefits of retirement. These range from eating more healthily, as you are likely to prepare more meals at home, to having more time to spend with family. Suffice it to say that the benefits of a comfortable retirement go beyond monetary readiness.

If you think it is time to visit your dreams, do not hesitate to give us a call!

- *Henry Yu, CFP®*