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"Retirement Preparedness: It's Not All Bad News"

By Craig Pulliam, CFP® and Michael Comstock, CFP®

Around the third week of August this year, the website Bankrate.com released the results of a study on the retirement readiness of Americans. It's not a pretty picture according to their survey of 1000 adults. The results of the study (one of many conducted in the last couple of years) were covered in most national newspapers and financial websites.

The Bankrate survey claims that 36% of Americans have nothing saved for retirement, which is startling. Of course, the numbers are skewed significantly by the fact that 69% of 18-29 year olds have saved nothing; but it's still alarming that 26% of those 50-64 report they haven't saved a thing for their golden years. Maybe they believe social security will be sufficient. Who knows?

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Major studies from The Employee Benefits Research Institute (EBRI), Department of Labor, and Center for Retirement Research at Boston College (CRR), point to equally troubling scenarios . . . most Americans just don't get it, won't face what needs to be done, and are ill-prepared for life when they no longer are working. We've read these studies and concur that there is reason for concern. Planning for up to 3 decades or more in retirement is challenging, and we've seen what happens when people haven't saved enough, spend too much, and/or are hit with an unanticipated event, such as a severe illness or caring for a parent. It can be frightening.

Yet, for the majority of the people we work with, there are also aspects of these and other studies which give us hope and confidence that many of you *are* on track or will be. Consider inflation . . . the stealthiest of thieves. We know that health care costs have risen more than the overall inflation rate (average increase of 5.1% annually since 1982; Bureau of Labor Statistics, [BLS]), and that seniors (65+) pay a larger percentage of their income for medical care (13%) than those 55-64 (9%). That's scary math, right? More and more of your income being spent on something that's growing faster than the overall inflation rate.

However . . . on average, *overall spending does go down over time for retirees*. And it goes down significantly, according to the BLS (reported in their 2013 Consumer Expenditure Survey). Spending peaks about age 45, according to the survey, and then steadily declines: by 12% from ages 55-64, another 12% from 65-75, and dropping 25% more for those over 75. That's a decrease of 40% in spending from age 45 to 75 and beyond (owing largely to less spending for travel, entertainment, apparel, food and beverage, and a reduction in the number of people in the household). So, even as healthcare costs rise in retirement, these costs may be offset by lower spending elsewhere.

We understand that there can be big differences from client to client, but it's got to be encouraging that –during those years when you're not earning an income anymore- spending really does decline on average. But, let's also be clear though; don't kid yourself that you can start retirement spending just half of what you were earning pre-retirement (we've heard that, and it doesn't work), and understand that a long-term illness or similar event can throw your entire plan out the window unless you're prepared.

A 2014 CRR Study (Boston College) undertook a laborious analysis of the optimal "replacement rate" of pre-retirement earnings as a goal for post-retirement income and what the required savings rate might be for pre-retirees to produce this income stream. On average, the study found that a replacement rate (of pre-retirement annual income) of 73% ought to be sufficient. *But*, what should be encouraging to workers is that social security income will cover a large portion of that . . . resulting in just 35% of retirement income needing to be covered from personal savings (401ks, other types of saving). This percentage is higher for high income people than it is for low wage earners.

So what percentage of current income does a worker need save to accumulate the pot of money to fund a comfortable retirement? CRR tells us that saving about 15% of earnings should do it for middle income people, but they caution that this number can change dramatically depending upon starting and ending dates. Start saving at age 25 and work until 67, and they estimate you need to save just 7% of pay over your working years. Start at age 45 and work until 65, and the percentage is 27%. They key is try to start early, but even if you're older . . . start doing something. All the CRR estimates assume a 4% real return in your savings/investments.

Another topic we feel is worth mentioning is that while 65% of workers expect to work for pay after age 65, only 27% of retirees actually do work for pay (EBRI, March 2014). On the face of it, that's a big disconnect. However, EBRI goes on to report that the vast majority of retirees do this by choice because they enjoy working and want to stay connected and involved. Only a minority feel that they must work to

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make ends meet. So, at least for now, working -for the bulk of retirees- is a choice, not a must.

We are thankful that the financial and academic worlds have taken a greater interest in looking more deeply and creatively at retirement issues for our aging population than they did 20 or 30 years ago. Until recently, rules of thumb often provided the backbone of retirement planning. It was accepted that you ought to accumulate “x times” your annual pre-retirement income as a retirement nest egg; or that you can only spend 4% of assets during retirement to give yourself a fighting chance of an income that would last. Those should be nothing more than a way to start the conversation and maybe to highlight the issues. For most of us the variables are so volatile, and the issues so personal and distinct, that they require a more sophisticated approach.

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The updated data suggest that a comfortable retirement is within reach for many, many Americans. Dire predictions of our unpreparedness are not purposely distorting the facts, but they don’t tell the entire story about how people can surmount these shortfalls. We encourage people to get started early if they can and to be determined and disciplined . . . as it’s so much easier if you do. If you started later, plan on saving a higher proportion of income, and maybe working 2-5 years longer. The secret here is to control what *you can* control, which normally means your saving and spending.

So, we think the picture is brighter than many have painted it. We also think people like us have an important role in helping you find the right path. Having a real financial plan based on hard data, and on understanding the risks of a long-term illness, and of how social security works is critical. No less than Nobel laureate (economics), Robert Shiller, stated “…people make better decisions with financial advisers” (Forbes interview, 2013). Even no-load mutual fund stalwart, Vanguard, published a report (2014) that advisors can add up to 3+% to your annual returns, in large part through helping clients with discipline (the biggest factor) and implementing spending strategies along with proper investment allocation and selection.

It’s very likely you can get ready for retirement, and very likely you can make it through and have some fun doing so. They key is putting together a team. A team with a plan who knows the territory ahead.

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