FINANCIAL DECISION PARTNERS LLC

Financial Planning & Investment Management

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- Planning for the Future -- What Motivates You?
- Three Key Retirement Income Considerations

Planning for the Future -- What Motivates You?

The truth is that there is ample motivation to make the most of retirement planning opportunities.

Reality Check

It used to be that Americans could count on a pension plus Social Security to get them through their Golden Years. But traditional pensions only account for an estimated 18% of the total aggregate income of today's retirees, and Social Security accounts for only about 36%.[1] Alas, the responsibility for the bulk of your nest egg now rests with you.

As you begin thinking about a comfortable retirement, consider that by most estimates you'll need at least 60% to 80% of your final working year's income to maintain your lifestyle after retiring. And don't forget that your annual income will need to increase each year -- even during retirement -- in order to keep up with inflation. At an average annual inflation rate of more than 3%, your cost of living would double every 24 years.

You'll also have to consider the likelihood of increased medical costs and health insurance premiums as you grow older. The average cost of a year's stay in a semi-private room in a nursing home, for instance, is now over $80,000 a year and could rise more than $130,000 per year by 2030, assuming an annual inflation rate of 3%.[2]

Getting a Leg Up

If this dose of reality makes you glum, cheer up -- you have some allies. Investment vehicles, such as your employer-sponsored retirement plan and individual retirement accounts (IRAs), allow you to put off paying taxes on your earnings until you begin taking withdrawals, typically during retirement when you may be in a lower tax bracket.

Additionally, time can be an ally -- or an enemy. Delaying the process of investing can significantly reduce your results. Consider this example: Jane begins investing $100 a month in her employer-sponsored retirement plan when she's 25. Mark begins investing the same amount when he's 35. Assuming an 8% annual rate of return compounded monthly, when Mark retires at 65, he'll have $150,030. Jane will have $351,428.[3]

While this is only a hypothetical scenario and there are no guarantees any investment will provide the same results, you can see the remarkable difference starting early may make. But no matter what your age, contributing the maximum amount to your employer-sponsored retirement plan and IRA each year could help you achieve the comfortable retirement that each of us desires.

Source/Disclaimer:
[1]Source: Social Security Administration, *Fast Facts & Figures About Social Security*, 2013.
[2]Source: Genworth Financial, Inc. and National Eldercare Referral Systems, LLC, *Cost of Care Survey*, 2013.
[3]Example is hypothetical and for illustrative purposes only. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing and the example does not represent the return of any actual investment. Your results will vary.

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Three Key Retirement Income Considerations

There are two factors that can determine whether you'll have a comfortable retirement: The amount of money you've saved and how quickly you spend that nest egg after you retire. The rate of annual withdrawals from personal savings and investments helps determine how long those assets will last and whether the assets may be able to generate a sustainable stream of income over the course of retirement. A number of factors will influence your choice of annual withdrawal rate. The following are three key considerations.

Consideration 1: Your Age and Health

As you think about what your withdrawal rate should be, begin by considering your age and health. Although you can't predict for certain how long you will live, you can make an estimate. However, it may not be wise to base your estimate on average life expectancy for your age and sex, particularly if you are healthy. The average life expectancy has risen steadily in the United States, reaching 78.2 years.[1]

Consideration 2: Inflation

Inflation is the tendency for prices to increase over time. Keep in mind that inflation not only raises the future cost of goods and services, but also affects the value of assets set aside to meet those costs. To account for the impact of inflation, include an annual percentage increase in your retirement income plan.

How much inflation should you plan for? Although the rate varies from year to year, U.S. consumer price inflation has averaged under 3% over the past 30 years.[2] So, for long-term planning purposes, you may want to assume that inflation would average in the range of 3% to 4% a year. If, however, inflation flares up after you have retired, you may need to adjust your withdrawal rate to reflect the impact of higher inflation on both your expenses and investment returns. Also, once you retire you should assess your investment portfolio regularly to ensure that it continues to generate income that will at least keep pace with inflation.

Consideration 3: Variability of Investment Returns

When considering how much your investments may earn over the course of your retirement, you might think you could base assumptions on historical stock market averages, as you may have done when projecting how many years you needed to reach your retirement savings goal. But once you start taking income from your portfolio, you no longer have the luxury of time to recover from possible market losses, as retirees and near-retirees during this latest market downturn have experienced firsthand.

For example, if a portfolio worth $250,000 incurred successive annual declines of 12% and 7%, its value would be reduced to $204,600, and it would require a gain of nearly 23% the next year to restore its value to $250,000.[3] When a retiree's need for annual withdrawals is added to poor performance, the result can be a much earlier depletion of assets than would have occurred if the portfolio returns had increased steadily. While it's possible that your portfolio will not experience any losses and will even grow to generate more income than you expected, it's safer to assume some setbacks will occur.

Your financial professional can help you determine a withdrawal strategy that can minimize the drain on your portfolio.

Source/Disclaimer:
[1]Source: Center for Disease Control, March 2012 (based on 2009 data, latest available).
[2]Source: Bureau of Labor Statistics, January 2014.
[3]Example is hypothetical and for illustrative purposes only. Your results will vary.

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