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Financial Concepts

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The Pleasant Burden of Living Longer

It's the proverbial good news, bad news story: Americans are living longer. The good news is not only that we're living longer but that we're staying healthier longer, too, so we're able to enjoy those longer years. But the bad news is that unless we've planned well enough to avoid running out of money, we might have trouble financing those extra years.

First, here are the facts. According to the latest federal statistics, average longevity for U.S. men and women is at an all-time high: 75.3 years for men and 80.4 years for women. But, if you make it to age 55, you can expect to live until you're 79 if you're a man and 83 if you're a woman; and if you're 65, you can count on making it to 82 (male) or 84 (female). Odds are that this trend is going to increase. Some life scientists are forecasting that within another two generations, life expectancies in the industrialized nations of the world could reach 100.

Think of what this means. If you retire at age 55, you could already spend almost the same number of years in retirement as you did earning a living.

Meanwhile, there's pressure on the retirement-income end of the equation. Stock market values have declined in the past few years, interest rates are near historic lows putting the squeeze on fixed incomes, fewer and fewer employers offer pension plans, and demographics are working against the health of the Social Security system.

In 1950, when Social Security had been around for less than 20 years, there were 16 people working for every retiree (Source: Social Security Administration, 2010). Today, that number has dropped to 3.3 workers

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Discussing Your Estate Plan

Many people are uncomfortable discussing how they will distribute their estate with their heirs. However, if you don't discuss your estate plan, disagreements and conflicts could erupt once the details of inheritances are revealed. For instance, siblings may resent each other if distributions are not equal. Children may resent a spouse from a second marriage if they feel that spouse is using up their inheritance. At that time, you won't be able to explain your thoughts and wishes regarding your estate's distribution.

Discussing your estate plan will give you an opportunity to inform your heirs about your estate's distribution and why you decided to do it in that manner. You can go into specific detail, informing heirs how each asset will be distributed, or you can give a general overview of your estate plan. If you have selected one heir as executor or trustee, explain why you chose that individual. As an alternative, you can leave a personal letter with your estate planning documents explaining these items.

Even if you reveal your plans to heirs, you may also want to include a personal letter. In that letter, include information about death and other benefits, special wishes, who should receive personal effects, your cemetery and funeral preferences, and the location of your safe deposit box and important documents.

Preparing the letter will also force you to organize your records and make sure all important documents can be easily located. Since the information is likely to change, review the letter at least annually. ❍❍❍

The Pleasant Burden

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per retiree; and by 2025, it will reach — and remain at — about two workers per retiree. That means there's a chance that benefits will have to be reduced, unless taxes increase.

The bottom line is that whether you are still working or already retired, you need more than ever to have a sound financial plan to cover your retirement income needs. Here are the considerations:

If you haven't yet retired:

❍ Can you retire as young as you previously planned or hoped, or should you postpone it by working full-time? And should you consider easing into full retirement by several more years earning income part-time?

❍ How many years do you need to plan for? A conservative plan would cover you at least until you reach the age of 85.

❍ Are you saving enough every year? Remember that once you're older than 50, the federal government increases the limits on how much you can contribute to tax-deferred retirement plans.

❍ Which is better for you: a traditional tax-deferred retirement plan that requires you to pay taxes on your withdrawals or a Roth IRA/401(k) that you fund with after-tax income but pay no taxes at all when you make withdrawals?

❍ What asset allocation strategy will achieve the growth rate you will need to reach your nest-egg goal?

❍ What provisions should you make for long-term health care?

If you're already retired:

❍ If you're able, should you find a source of part-time income?

❍ Do you need to pursue higher interest rates on your bond portfolio? If so, how much risk should you take to get them?

❍ Should you increase your portfolio exposure to stocks to potentially raise your long-term growth rate?

❍ Should you consider making adjustments to your lifestyle, particularly for discretionary spending on such items as vacations, club memberships, dining out, and entertainment?

We may or may not have passed the bottom of the current economic and stock market cycle, in which case market and fixed-income returns will or won't go up from here. Whatever the case, our increasing longevity means you need to change your assumptions about how big your nest egg has to be and how you manage it to meet your long-term goals.

Please call if you'd like help with this analysis. ❍❍❍

When Should You Retire?

The "traditional" retirement age is 65. But some people want to retire early, say, at age 55. Others look at how much they'll get from Social Security. Then there's the matter of your retirement portfolio. With recent stock market fluctuations, many people are wondering if they might have to put off retiring far longer than they had expected.

The most important question to answer is: how many years can you afford the lifestyle you want in retirement? The worst thing that can happen is that you run out of money in retirement. To give you an idea of what's involved in making that decision, here's a summary of the main considerations:

What is your lifestyle going to cost in retirement? This is the most basic parameter to determine. Is your house paid off? Are you going to travel and entertain frequently? Do you want to own two homes? What will the cost of living be in each of those places? What kind of uncovered medical expenses do you expect? Start by putting together an annual household budget for all of your expenses.

What sources of income will you have? Will it be only Social Security, or will it include other regular income, like from a pension, self-employment, rental income, royalties, and the like?

How much do you have accumulated, and what annual income can you generate from it? Sources of retirement savings often include IRAs, 401(k) plans, and taxable accounts.

Will your income cover your expenses? If so, you *might* be able to retire at the age you project. If the rate at which you withdraw money from your retirement portfolio is too high, however, you run the risk of depleting those resources before you die, which will likely result in making some very uncomfortable adjustments to your lifestyle.

If you determine that your income won't cover your expenses, there are three solutions:

❍ Delay retiring while you add to your personal savings and increase the amount you can collect from Social Security.

❍ Change the investment mix in your portfolio to potentially increase your rate of return.

❍ Aim for a less-expensive retirement lifestyle.

A thorough financial plan runs through all of these calculations and aims at a realistic answer to the question of when you should retire, based on all the details of your finances and the level of risk that's appropriate for you. Please call if you'd like help with this decision. ❍❍❍

Managing Withdrawals in Retirement

Once you've retired, you begin a balancing act between two imperatives: withdrawing enough from your retirement portfolio to cover your expenses and not taking out so much that you run out of money. So how do you get the rate of withdrawal that is just right?

Over the years, there's been a general rule of thumb: keep your withdrawals to between 4% and 6% of your total portfolio a year. Now that the past few years in the stock market fluctuated so much, some pundits are recommending reducing that rate of withdrawal to 3% to 3.5% a year.

While you will still want to consider your circumstances, these general rules of thumb point out that the appropriate rate at which you should take money out of your accounts is much smaller than many people imagine. Just as with every other issue related to retirement planning — like how much you should put away per year, how it should be invested, and when you can afford to retire — the withdrawal rate that's right for you can only be determined after an analysis of your entire financial situation.

But right off the bat, it's safe to say that whatever that rate is, ideally it should be less than the annual rate of growth your portfolio achieves, minus the rate of inflation.

For example, if your expected average rate of return is 7%, and you use the long-term average of about 3% for inflation, the maximum you should take out of your nest egg is 4%. This leaves the remaining 3% growth to keep your portfolio value even with inflation and supports your ability to continue to withdraw 4% a year indefinitely, as long as your portfolio keeps growing and inflation remains at the same average rate.

However, on a year-to-year basis, market returns and inflation fluctuate. Sometimes, as we've seen recently, market returns are negative. If you want to avoid shrinking the real value of your portfolio in these circumstances, you should adjust how much you take out of your portfolio for spending purposes during those years.

But does that mean when your accounts lose money in a bad stock market year you shouldn't withdraw any money from them? Strictly speaking, the answer is yes, but that's not always realistic. If it means forgoing some luxuries or putting off some discretionary expenses, holding off on withdrawals when market returns are below average might make good sense and help ensure that your portfolio lasts longer.

If it means that you're forced to cut back on necessities, you may have no choice but to take out the money you need. But then ask yourself: does that mean that your lifestyle is more expensive than you can really afford? Or that you need to alter your asset allocation in favor of higher-growth investments?

Whatever the case, it's to your advantage to have a financial plan for retirement — and revisit it at least once a year. Please call if you would like to discuss this in more detail. ❍❍❍

Avoid This Mistake

Finding a way to live decades in retirement without worrying about running out of money can seem like an overwhelming task. That goal depends on many variables and assumptions. If you're wrong on even one of those variables, funding your retirement could be in danger.

With all the potential for missteps, what is the one mistake you want to avoid at all costs? Dipping into your retirement savings. Unfortunately, since the funds in your 401(k) plan or individual retirement account (IRA) belong to you, they often seem like a tempting place to get funds needed for other purposes.

Tax laws don't help, since they often provide tax-advantaged ways for you to access those funds. Loans from 401(k) plans are not taxable events. When leaving an employer, you can withdraw money from your 401(k) plan (you will have to pay income taxes and possibly a 10% early withdrawal penalty). Contributions to Roth IRAs can be withdrawn at any time with no tax consequences. Withdrawals from traditional IRAs before the age of 59½ can be made under certain circumstances, such as to purchase a home or to pay for a child's college education, without paying the 10% tax penalty.

Saving for retirement is a difficult task for most people, without making it more difficult by using retirement funds for other purposes. Even if the amount seems small, don't withdraw funds from your retirement account. For instance, assume you have $10,000 in your 401(k) plan. If you withdraw the funds and are in the 25% tax bracket, you'll have $6,500 left after paying income taxes and the 10% federal tax penalty. Keep the funds invested earning 8% annually on a tax-deferred basis, and your funds could grow to $100,627 after 30 years, before paying any income taxes. *(This example is provided for illustrative purposes only and is not intended to project the performance of a specific investment.)*

Please call if you'd like to discuss this in more detail. ❍❍❍

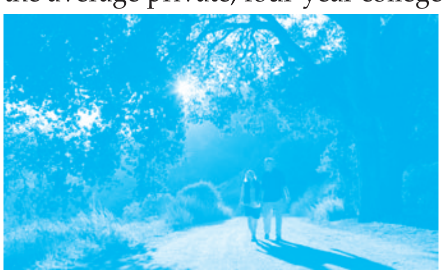
What's College Going to Cost?

According to the U.S. Census Bureau, in 1973, just 47% of those who earned a high school diploma went on to college. By 2007, the number had risen to 67%. And it's no wonder: over their lifetimes, people with bachelor's degrees earn nearly $1 million more than those with only a high school education, and their unemployment rates typically run 3 percentage points lower (Source: The College Board, 2010).

But as college campus enrollments have risen, so has another number: the cost of a college education. In fact, over the past 25 years, the combination of tuition and fees for a year in college has risen an average of 6.1% a year. That's nearly twice as fast as the general rate of inflation (Source: Bureau of Labor Statistics, 2010).

Tuition and Fees: Just Part of the Picture

According to the College Board, in 1987, tuition and fees for a year in the average private, four-year college totaled just over $7,000. In 2007, the number had ballooned to nearly $24,000 and jumped again in the current school year to $27,300. Throw in the cost of room and board, books, and personal expenses, and the fully loaded cost of a year at the average private university or college is now close to $40,000, and at "elite" schools the price is as much as $53,000 or more.



Meanwhile, the cost of public higher education — still a relative bargain with tuition and fees at "just" $7,600 a year this year — has risen faster: an average of 7% a year. Fully loaded, the average cost is around $19,000 a year for in-state students and $30,000 if your child attends a state university outside your home state.

"Sticker Price" versus Actual Cost

Educators note that because of the increased availability of student aid in the form of scholarships and need-based grants, most families don't pay the advertised price for college. While aid does soften the blow for consumers, on average it covers only about 35% of the expense. And even at this discount from the sticker price, the net cost of a college education is still growing faster than average family income.

Driving College Costs

What accounts for the galloping cost of higher education? Observers cite several factors:

❍ **Increased student aid**, particularly the availability of loans and family willingness to take them out.

❍ **Competition for the best students.** Successful students are a source of university fame and potential donations, and so universities compete to offer the best faculty, facilities, and amenities with ever-increasing budget expenditures.

❍ **Increased support staff.** To keep abreast of the demands of government reporting as well as the latest trends in technology, colleges and universities have hired ever-larger numbers of support staff.

Looking Ahead

Experts say that while the rate of inflation has declined recently, both for the general economy and college prices, they don't expect to see a change in the relationship between the two as long as the fundamentals above remain in place. If anything, there is recognition that U.S. higher education is vital to the future of our economy. ❍❍❍

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Did You Know?

Due to lower earnings and more time out of the work force, the average employed woman has a defined-contribution plan balance that is only 60% of the average employed man's balance. Among workers 50 and older, women had saved $63,000 less than men (Source: LIMRA, 2011).

Approximately 58% of investors with a retirement account or other financial investment reported making at least one change toward being more financially conservative. The top three changes reported by investors were increasing savings, shifting away from stocks, and increasing their anticipated retirement age (Source: Investment Company Institute, 2011).

According to a recent survey, 84% of affluent baby boomers expect their retirement to be different from their parents, with most saying they will maintain a more active lifestyle (86%) and enjoy a higher standard of living (72%). Approximately 70% plan to continue working after reaching retirement age (Source: Bank of America, 2011).

According to a recent study, the majority of working Americans over age 18 will not be able to afford to retire at age 65. At current savings levels, most Americans will need to work until at least age 73 to fund a financially secure retirement (Source: Nyhart, 2010). ❍❍❍