Quarter Notes

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Avoid these ten retirement planning errors

Here are everyday examples of decisions that may lead to retirement insecurity, rather than the financial independence that we all have as a goal.

1. Late start

The hardest time for people to begin saving for retirement is when they first enter the work force, when retirement is a long way off. Entry-level positions typically provide low salaries, and many will have college loans to pay off. Saving for a house down payment will be the next order of business, once the debts are paid.

As compelling as this thinking may seem, the biggest advantage that a young person has in saving for retirement is time. An old Wall Street adage has it that the key to investing success isn't timing the market, it's time in the market.

Reassessment

The poor jobs report in May had many economists going back to their mathematical models. Coupled with the ongoing uncertainties in Europe, the new data suggests that we may not hit the growth targets we'd been hoping for.

Planning for retirement can be like that as well. In this issue of *QuarterNotes,* we address a range of retirement issues, including how to respond when external events defeat one's expectations.

Your retirement planning is an area that we may be able to help with. Bring your savings and investing questions to us—we'll be pleased to be of service.

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2. Leaving the employer match on the table

Many 401(k) plans will match a portion of employee deferrals to encourage wider plan participation. The match could range from 25% to 100%. Where else can one get a 100% return on one's money, instantly? Even when the family budget is tight, one should defer at least enough to trigger the full employer match.

3. Wasting tax deferral chances

How much will you need to retire? Any answer to that question necessarily involves speculation and guesswork. "More than you think" is a good place to start. To meet that challenge, one needs to grab for every available advantage. The limits on 401(k) deferrals and IRA contributions now permit very meaningful amounts of retirement capital to be accumulated.

4. Putting too many eggs in one basket

Some retirement plans offer company stock as one of the investment alternatives, and such investments can work out very well. However, diversifying the account among several investment alternatives will reduce the risks. Should the employer suffer some reversals, one doesn't want the retirement account to be at risk as well.

5. Too cautious

A person who invested $10,000 in ultrasafe Treasury bills in 1991 would have seen that fund grow to $18,672 (ignoring taxes and assuming all interest payments were reinvested in T-bills) by the end of 2011. The same $10,000 would have grown to $45,012 if invested in the same way in large company stocks over the same period. The stock investments would have had some serious ups and downs, but over the long term stocks have provided superior investment returns. Those with long time horizons usually are well advised to have significant equity exposures in their accounts.

6. Too optimistic

But in the short term, stocks can suffer serious losses, serious enough to affect the timing of one's retirement. As the time horizon shortens, exposure to riskier, growth-oriented investments should be trimmed.

Still, retirement can last for a long time, and inflation is a meaningful risk for nearly all retirees. So some equity exposure is likely appropriate well into the retirement years.

7. Who is the surviving beneficiary?

One hopes that the retirement plan money won't be entirely exhausted when one dies. The remaining balance may be a critical resource for a surviving spouse, or a handsome inheritance for heirs. There can be important tax consequences to the choice of beneficiary—surviving spouses, for example, may be able to treat the account as their own. Consult with your tax advisors to learn more.

8. Failure to monitor the beneficiary

The law books are full of cases in which a plan participant failed to act after a divorce to remove an ex-spouse as a plan beneficiary. The ex-spouse may then get the account balance at the owner's death, instead of a surviving spouse or children. If a named beneficiary dies before the account owner does, the retirement assets will pass to the owner's estate, and distribution may be covered by the laws of intestacy.

9. Not coordinating the retirement resource with the estate plan

The estate plan of a married couple may include a credit shelter trust, a marital deduction trust, or a qualified terminable interest property trust. Where does a retirement account fit into this picture? The answer can't be taken for granted.

10. Failure to seek professional advice

Some plans now offer their participants the opportunity to get investment advice from an independent source. Plan participants are, at best, amateur investors. Giving them responsibility for the investment management of their retirement funds is a tall order. Access to professional advice should be seized when it is available.

Let us be a resource for you

If you have questions about your retirement savings and how they should be invested, we are available to meet with you. Financial independence during retirement doesn't happen by accident. It takes a lot of very hard work, and the advice of your trusted professionals can play an important part as well.

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What will be your retirement age?

"Retirement ages will have to move to 70, 80 years old." That was the observation of Robert Benmosche, the CEO of American International Group (AIG), in discussing the elements needed to resolve the European debt crisis. Early retirements put too large a strain on pension and medical funding for retirees, according to Benmosche, who is 68. In Greece, for example, the average retirement age is reportedly 59.6 years. Lifting the retirement age is seen by many governments as an important step toward regaining solvency.

Retirement ages may be going up in the U.S. as well, though not via government mandate. In a recent survey of middle-class Americans reported by *CNN Money*, the median stated savings goal for retirement was $350,000. Unfortunately, the same survey reported that 30% of those in their 60s had saved less than $25,000 for their retirement. They don't have much time left to make up the shortfall.

To bridge the difference, fully three-quarters of the respondents said that they expect to work during their retirement. Some will work because they enjoy it, but for most it will be a financial necessity. And 25% said that they will need to work until at least age 80 before they can retire with financial security.

The upside of delay—better Social Security benefits

One may begin to receive early retirement benefits from Social Security at age 62, reduced actuarially based upon one's normal retirement age. If benefits are delayed, the monthly check goes higher, and such increases may continue until age 70. One approach to having a more financially secure retirement, then, is to delay the retirement start date as long as is comfortable.

A recent study published in the *Journal of Financial Planning* revealed another reason to delay the start of one's Social Security checks, one that is not intuitively obvious. The authors stipulated retirement at age 62 with wealth that ranged from $200,000 to $1.5 million. The question that they explored was how long the portfolio would last, given an inflation-adjusted withdrawal target of 4% integrated with a Social Security primary insurance amount of $1,500. How would the longevity of the portfolio be affected if the retiree deferred taking benefits, relying instead upon withdrawals from savings during the early years of retirement?

Dipping into the portfolio is better than taking benefits?

One might think that given the greater portfolio withdrawals in the early years, a benefit delay would exhaust the portfolio sooner. Not so, according to their simulations. Over the course of a 30-year retirement, they found:

- a two-year benefit delay by an individual with $200,000 of wealth would extend the portfolio's life by more than four years;
- a two-year delay with $500,000 of wealth resulted in only a two-year increase in portfolio longevity;
- at $1 million in wealth, there was no change.

Some will work because they enjoy it, but for most it will be a financial necessity.

What explains this surprising result? First, spending is not the same in each case. For the $200,000 retiree, the initial spending target at age 62 was $21,700, compared to $31,000 for the retiree with $500,000 and $44,500 for the million-dollar portfolio retiree. That means Social Security payments at the lower wealth level comprise a much larger proportion of retirement spending money. The increases that accrue from delaying Social Security benefits are proportionately more important.

The second factor was taxes on Social Security benefits. As one climbs further up the wealth ladder, the amount of Social Security benefits subject to income tax continues to rise, until it tops out at 85%. In terms of portfolio longevity, apparently the increased income taxation offsets the value of larger benefit payments.

Your assessment

Choosing a retirement start date is among the most important decisions affecting one's financial security. Do you have concerns about your retirement readiness? We may be able to offer valuable input. Call on us!

Just ask us

I was born in 1947, so I turn 65 this year. What is my "normal" retirement age for Social Security? What happens if I start my benefits this year?

Your full retirement age is 66, so you have to wait until next year to get your full benefits. This year you'll be entitled to 93.3% of full benefits. Note that the reduction in benefits lasts throughout your retirement, not just the first year.

Those born from 1943 through 1954 have age 66 as their normal retirement age. They remain eligible to retire at age 62, but their monthly benefits would then be reduced by 25%.

The retirement age will gradually increase to 67 for those born in 1960 and later years. They may take 70% of their benefits, beginning at age 62, or 86.7% at age 65.

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