How Much Will You Need to Retire?

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"When will I be able to retire and not have to worry about running out of money?" If you haven't already asked yourself this question, you should. While straightforward, this question has complex answers and requires in-depth analysis.

> **A 66-year-old couple retiring today with a $6,000 monthly lifestyle could spend close to $3,000,000 during their retirement years. If your lifestyle requires 8,000 a month, you will spend nearly $4 Million during your retirement years. For every $2,000 increase in monthly expenses, you will need an extra $1,000,000 for your retirement years. (see table below). (1)**

From where will you get this kind of money?

Monthly Living Expenses	Projected Lifetime Expenses (2)
$4,000	$1,957,241
6,000	2,935,707
8,000	3,914,275
10,000	4,893,844

Several factors contribute to why you need to set aside such a large amount if you want to live your desired lifestyle and lower the chances of running out of money.

1. **Lifestyle** – Determining what you will spend each month is the first step. If you spent 40 years working Monday through Friday and now every day is like Saturday, how will you be spending your days? Traveling to places you have always wanted to see and participating in hobbies may infer greater expense, at least in your early retirement years. On the other hand, you may downsize to less expensive housing. It's important that you define realistic expense estimates for needs, wants such as travel, and wishes such as helping people and causes.

2. **Longevity** – Willard Scott of NBC's Today show used to do a regular "Happy Birthday" segment for folks turning 100 years old because of the scarcity of centenarians. Over time, there were more birthday requests than Willard could handle. On average, people are living not only longer but also better than ever. According to the Social Security Administration data, nearly 2

million people over the age of 90 are now receiving retirement benefits. While you may say "there's no way I'm living that long", do you really want to plan on running out of funds early? I suggest that you plan on living until at least age 90 unless health issues impede the likelihood of reaching that age.

3. **Investment Returns** – A retirement lasting 25 to 40 years requires considerable capital. The rate of return you earn on your investments significantly impacts whether you will run out of money. In addition, the volatility and order of those returns can have a dramatic impact on your success. Achieving just a 1% lower return with your investments over a long period can mean the difference in having sufficient funds to live comfortably versus depleting all your money and having to rely on family or the government.

4. **Inflation** – The classic definition is *the sustained increase in the general level of prices of goods and services*. Intuitively, you probably understand what inflation is. While you know what inflation is, you may be underestimating how much it will affect you. At just a 3% level, your cost of living is 43% greater than if inflation was zero over a 25-year retirement. Put another way, if inflation averages just 3% per year, (which is less than it has averaged for the past 30 years), your annual cost of living will DOUBLE in 25 years. (3)

5. **Income Sources** – You likely will have some form of regular pension income in the form of Social Security, a company pension or a government pension. If you have a company or state pension, that resource can significantly reduce the funds (capital) required from other sources. For example, if you receive a fixed pension of $4,000 monthly over a 25 year retirement, you would receive $1.2 million in benefit payments.

6. **Health issues and other potential issues** -- Within your budget, you should consider earmarking at least $1,000 monthly for health insurance, co-payments and out-of-pocket costs for medical needs. In addition, you should develop a contingency plan in the event of a long term care need such as dementia or Parkinson's disease. Without a contingency plan, these expenses can quickly wipe out the funds you had set aside for living in retirement. Given current trends, health care costs continue to escalate even higher and at a far more rapid pace than the broad rate of inflation.

7. **Types of investments and investment accounts** – In general, Roth IRA accounts offer superior tax benefits to all other investment accounts during retirement due to their tax-free status for earnings and withdrawals. However, during your working years, you must fund them with after-tax contributions which negate some of their advantage. In addition, stocks carry attractive tax features over many investment vehicles since their potential dividends and long term capital gains are subject to lower tax rates

than interest or other ordinary income. Income tax planning often contributes to the plan of accounts to draw from over time and has to be done on a case-by-case basis. (4)

Illustrated in the following table are the financial needs at various expense levels if you plan to retire at age 66. Following the initial table, I tweaked some facts to show how certain factors may have a dramatic impact on the wealth you require.

Assumptions

Longevity:	Good health assumed; Life expectancy until age 90.
Lifestyle:	You have no debt; you expect to spend about $6,000 monthly for your needs and wants.
Investments:	Your investment portfolio earns 7% average annual returns.
Inflation:	Averages 3% annually.
Income Sources:	Social Security only.
Portfolio:	50% of portfolio remains at death as buffer and inheritance.
Income Taxes:	Average rates are shown below in the table.

At $6,000 a month, you will need a portfolio of approximately $774,000 to $777,000 of either retirement plan assets such as IRAs and 401k plans funds or non-qualified investments (that is, those that aren't held in tax-qualified account of some sort). I have simplified the tax implications to make it easier to understand. (Your tax implications require a more detailed examination of your specific situation.) Also, in each scenario, I presume you pass and leave half of your initial portfolio to your heirs. In the $6,000 monthly expense example, you would leave roughly $387,000 to heirs at age 90. If you want to "die broke", i.e., have no funds left over at age 90, it reduces the portfolio required to roughly $680,000.

The table below incorporates the above outcome along with 3 other expense profiles, one with a lower monthly need and two with higher monthly needs:

Baseline Scenario			
Monthly Expenses	Non-Qualified Assets Only	Retirement Assets Only	Assumed Tax Rate
$4,000	$264,000	$262,000	15%
6,000	774,000	777,000	18%
8,000	1,316,000	1,326,000	21%
10,000	1,919,000	1,940,000	25%

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As alternatives to this baseline scenario, consider how required wealth changes if your average investment return is lowered from 7% to 6%:

Decrease returns to 6%			
Monthly Expenses	Non-Qualified Assets Only	Retirement Assets Only	Assumed Tax Rate
$4,000	$302,000	$304,000	15%
6,000	878,000	892,000	18%
8,000	1,488,000	1,521,000	21%
10,000	2,162,000	2,228,000	25%

The 1% reduction in the assumed return increases your capital required by roughly 13% under all the scenarios.

You may not feel like you will live to age 90 or beyond. Presented below, the table gives a gauge of the amount of capital required for an age 80 life expectancy. In spite of the shortened life expectancy, the amount of financial wealth necessary remains quite substantial. (The analysis is the same as the baseline case except for the age 80 life expectancy). In each case, about 25% to 30% less capital is required to support the shorter life expectancy.

Change Life Expectancy to Age 80			
Monthly Expenses	Non-Qualified Assets Only	Retirement Assets Only	Assumed Tax Rate
$4,000	$182,000	$186,000	15%
6,000	566,000	588,000	18%
8,000	968,000	1,017,000	21%
10,000	1,406,000	1,496,000	25%

Conclusion

The wealth required to support yourself may greatly exceed your expectations. It has been my experience that clients generally underestimate their wealth needs partly due to the longevity factor. If you are fortunate to have a substantial pension, these figures may be sharply curtailed. However, given the abuses of many pension systems over the years (like Detroit which recently filed for bankruptcy in July 2013); you should also think about contingency plans for your retirement planning.

Each of us has the responsibility for our own financial affairs, but you don't have to do this alone. Most investors don't have the training to work through these issues on their own. Scores of factors need to be considered when planning for your

income needs in retirement. Since it's impossible to accurately predict the future, you should develop a plan considers a range of possible variables. Using our own expertise as well as that of our professional network, we can help craft your plan.

So, what should be done now?

- ❑ If you have recently reviewed and updated your retirement plans, "congratulations". However, if your plan doesn't consider one or more of the above issues, it still may need to be reviewed and adjusted.

- ❑ If you completed some retirement planning a few years ago (or more), now may be a good time to review those plans to see if they remain valid. With so many variables involved, retirement plans do need to be reviewed periodically and updated.

- ❑ If you have never done any planning, now is the time to get going! As noted above, it takes a great deal to have a successful retirement. The longer you delay, the greater the likelihood you will need to work longer or be forced to live pinching pennies with a lower quality of life.

To get started, just ask us for a copy of our financial document checklist and our expense worksheet. You can also find copies of these in the resources area of our website.

Footnotes & Disclosures

1. The amount needed assumes that one spouse lives until age 90 and the other until age 93. According to the 2000 Annuity Mortality Table, these are the life expectancy figures for the average non-smoking couple. These figures also assume inflation averages 3% annually.
2. This chart assumes 25 years of expenses. It also assumes inflation averages 3% annually.
3. Source: Consumer Price Index, Bureau of Labor Statistics, U.S. Department of Labor.
4. Remember, stock investments involve substantial risks including the potential loss of principal.
5. Unless certain criteria are met, Roth IRA owners must be age 59 ½ or older and have held the Roth IRA 5 years or longer before tax-free withdrawals are permitted.
6. These are hypothetical illustrations and are not intended to reflect the actual performance of any particular security. The figures presented herein will vary greatly depending on investment results.
7. Future performance cannot be guaranteed. Investing involves risk and you may incur a profit or loss regardless of strategy selected.
8. Be sure to contact a qualified professional regarding your particular situation before making any investment of withdrawal decision.
9. Dividends are not guaranteed and must be authorized by a company's board of directors.

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