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# Cadence clips

FOCUSED ON WHAT MATTERS MOST.

## Retirement Planning - More Than Just Numbers

Knowing how much of a nest egg you need to retire comfortably is important, but it's not all there is to retirement planning. To keep things simple, think about the process as having three distinct steps; creating the vision, crunching the numbers, and implementation. There's a lot of thought that needs to go into that first step. What are your day to day experiences going to look and feel like when you do make that epic jump into phase two of your life? The answer to that question is a huge part of what makes everyone's retirement plan unique. Only then can you begin the process of crunching numbers to find out what it's going to take to prepare your finances for the transition. Sounds pretty basic so far, but the devil's in the detail when it comes to that last ongoing step of implementing and managing the plan that you come up with. Let's dive a little deeper…

**Creating the Vision**

Psychologists and retirees agree that in order to fully enjoy your retirement, you need to have a vision for what you want it to be ahead of time. You can have strong finances and still have a difficult retirement because it's not enough to just retire from something; you also need to retire to something. The first step in the process, therefore, is to envision how you would like your retirement to be. What do you enjoy doing that you would like to do more of? What do you think you'd like to do that you've never had time to try? What activities make you the happiest now, and how can you have even more of that when you no longer have to work?

Once you have an idea on how you would like to live your retirement life, you can start to think about when you would like that to start. As nice as it would be to get that vision started right now, we do have to be realistic. It usually makes sense to think about a more ambitious retirement age that is a bit younger than you were initially thinking as well as an age that you can't see working beyond. This way you can explore what it will take to accomplish anything within the range of ages when it comes to the number crunching step, which is next.

**Number Crunching**

Now's the time to put some real figures to that vision you've developed. One of the first steps is to think about how much it will cost you in today's dollars (the planning software you use will have to adjust these expenses by whatever inflation assumption you feel comfortable using). Breaking down expenses monthly is usually the easiest way to think about it since that's how we pay most of our bills. It can be helpful to group retirement expenses into three categories since some will be very similar to your current expenses while others may vary widely according to that vision:

1. Fixed and Necessary – These are the expenses that you will incur regularly that vary little month to month, like housing payments, real estate taxes, and healthcare premiums.

2. Variable and Necessary – These are the expenses that you need to incur but the amounts can vary from month to month, like grocery bills, gasoline and heating oil usage, and clothing. These are all expenses you will have, but you have more direct control over how much you spend month to month.

3. Discretionary – These are the expenses that you enjoy and could live without if you had to, but are also the ones that will make your retirement the most enjoyable. These are your trips and your hobbies and your adventures.

## Number Crunching – Resources & Assumptions

After creating the vision for your retirement and gaining a rough idea of what it will cost you, it is time to assess what you have to work with to make it a reality. Here are some things you'll need to know:

- How much do I have saved?
- How much can I save going forward?
- Are there any opportunities to increase savings that I haven't taken full advantage of, like employer matches on retirement savings?
- Are there expenses I can reduce to increase my savings?
- How much social security am I expecting to receive?
- Are there any other sources of income in retirement (pensions, rental income, etc.)?

In addition to understanding the resources, some thought also needs to go into which assumptions you are comfortable making in developing your plan. Here are some examples:

- How much risk are you willing to take in order to grow your savings?
- What rate of return do you expect to earn on your investments?
- How much will your expenses increase due to inflation?
- How long will you live?

Be very careful not to use assumptions that are too optimistic. It's very easy to assume what you are most familiar with or what you have observed most recently will continue into the future. This is called "familiarity bias" and it can play a big part in making your retirement analysis look better than it really is. If inflation has been low, we usually assume it will remain so. If stock market returns have been good, it's usually easier to assume that they'll be strong in future years. Here are some common assumptions that you'll want to give careful thought to:

- According to data provided by the Federal Reserve database in St. Louis, moderate portfolio returns over the past 30 years have averaged over 11%; their average since 1928 is below 9%. We shouldn't expect to make as much over the coming decades as the most recent ones. From a planning perspective, it is more prudent to assume investment returns from a moderate portfolio to be closer to 7%.

- Healthcare-related expenses have averaged 5.4% over the past 30 years according to the Bureau of Labor Statistics. Since the amount of people receiving Medicare benefits may double over the next 30 years, it is safe to assume healthcare-related could climb.

- According to the Social Security Administration, non-healthcare related inflation has averaged 3% over the past 30 years. In the 30 years prior to that, it averaged over 4.5%. It may be safer to assume non-healthcare inflation will be higher over the coming decades than its current level.

- Also, according to the Social Security Administration, social security cost of living increases have averaged 2.7% over the past 30 years. Since it is projected that in a little over 20 years the system will run out of the surplus it has built up as well as take in less than it must pay out, we may want to assume future social security benefits will be reduced; either by lower cost of living adjustments, a higher full retirement age, or other legislation action.

- The U.S. Department of Health and Human Services estimates that as many as 70% of people who are now 65 or older will need some form of long-term medical care not covered by Medicare. It would be wise to plan for the possibility of needing care.

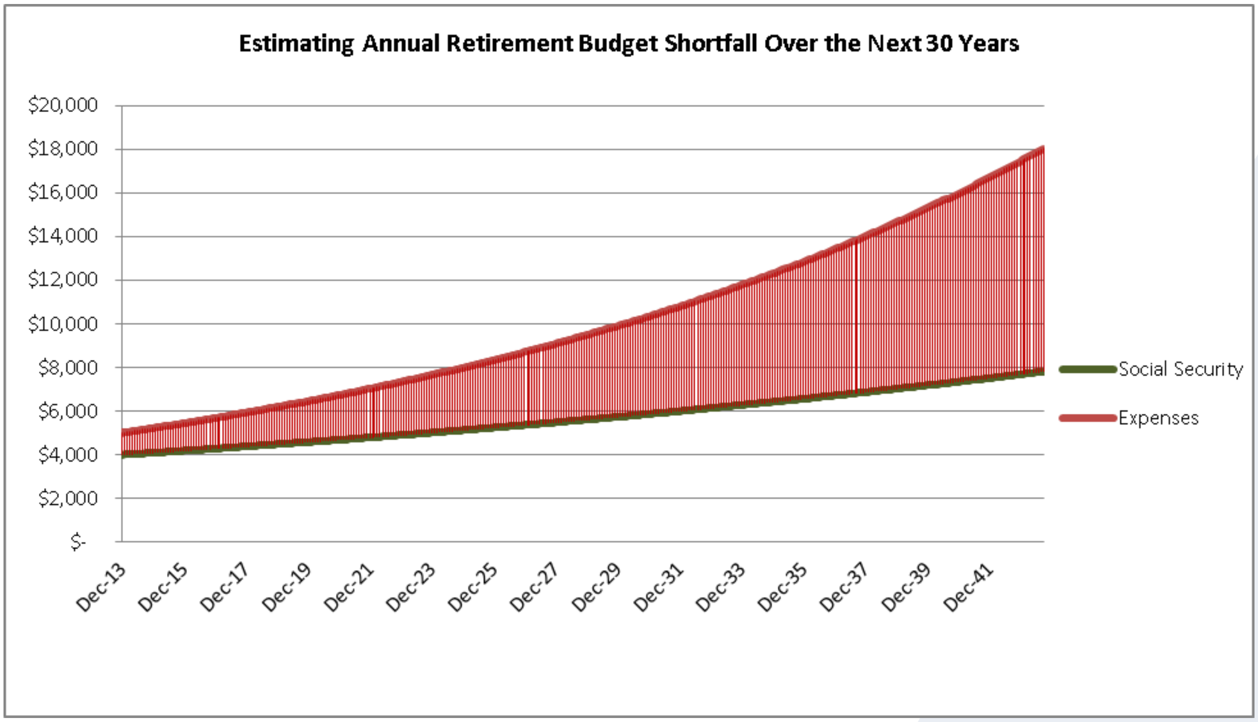
- Average life expectancy of a 65 year old is now around 85 years old according to the Social Security Administration. For a couple, there is a 50% probability one person will live to at least 92 years old. It makes sense to plan on living to at least age 90 unless your family history or medical circumstances suggest otherwise.

## Implementation

Getting you on track to reaching your retirement goals doesn't necessarily mean we're ready to celebrate financial success just yet. Up until retirement age, you'll need to manage portfolio allocations, savings rates, taxes, and more. As you transition into retirement, the ongoing management of your plan becomes even more critical. With your investment nest egg changing roles from grower to income generator, any mistakes or miscalculations are going to have a much bigger impact on the plan. Here are a few common retirement mishaps:

- Pulling money out of a portfolio that fluctuates wildly
- Underestimating inflation. Expenses are rising quicker than anticipated.
- Expected part-time work doesn't materialize or stops
- Taking large portfolio losses toward the beginning of retirement

To illustrate a typical retirement scenario, consider a married couple retiring today receiving $4,000 per month in social security benefits and incurring an average of $5,000 per month in expenses. We are going to assume that inflation and social security cost of living adjustments are slightly less than they've been the past three decades. As a result, the $1,000 gap that exists today becomes almost $10,000 per month in 30 years.




To cover this shortfall, the couple would have to retire with a little over $460,000 to make their money last 30 years if it earns 7% per year. Again, any unanticipated increase in inflation, any unanticipated decrease in social security cost of living, or any dramatic investment volatility would change those numbers. This is why care needs to be taken in both the assumptions we're planning with and the implementation along the way. It's one thing to go back to work because you're bored, it's quite another to go back because finances are tight.

## Implementation - Tips on How to Manage Retirement Income

- Because the planning process becomes much less forgiving once the retirement transition is made, we should elaborate a bit on some things to watch out for. Some important things to consider when structuring a portfolio for withdrawals are:

- The more volatile your investment portfolio, the more likely you won't be able to recover from down markets. Because you may be withdrawing from your investments at some point during retirement, keeping investment volatility low is just as important as what your investments earn.

- Retirement will last for decades. You will need to get both income and growth from your portfolio for it to last. This means some amount of your portfolio still needs to be exposed to stocks with a strategy on how to offset that volatility.

- You can create a monthly systematic distribution from your investment account(s) to your bank account to replicate receiving a paycheck. That way, you are less likely to have to sell a large block of your investments when the market is down.

People often ask us how much they need to have set aside to retire comfortably. The only way to answer that question with any confidence without going through the comprehensive process we've outlined is if we dictate the terms of that person's retirement. I don't know about you, but I certainly don't want a "cookie-cutter" retirement plan for the portion of my life that may end up lasting longer than my working career. So look beyond just the numbers. A successful retirement depends on so much more.

**Key Takeaways:**

- The first step to achieving a happy retirement is envisioning what you want your retirement to look like ahead of time.
- Many of the variables that will affect your retirement have been favorable the past 30 years, and it is safer to assume they will not be as favorable over the next 30 years.
- Accessing your money during retirement also takes planning. There are ways to make it safe, easy, and flexible enough to navigate financially difficult periods.
- During retirement, investment volatility is as important as investment returns. At times it can be more important.
- Overly simplified financial planning ignores many important elements that will affect you during retirement.

# Thoughts From The Investment Team

At the time of this writing, Russia has invaded Ukraine and has ignored the worlds request to get out. The economic impact on Ukraine looks grim, while the indirect economic effect on the rest of the world is still unclear. One thing's for certain, this is the last thing the world needs at the moment. The list of potential global "issues" was pretty long to begin with and with the instability in Ukraine and the potential for strained trade relationships with Russia as well as their potential sympathizers, the global economy and markets look to be on increasingly shaky ground.

Markets can look past some really scary stuff. They can rise regardless of how grim things appear to be. Weak economic results, sovereign insolvency issues, and wars don't necessarily mean the markets will suffer. Anyone paying attention the last few years learned this first hand. We are big believers that as investors, we need to be willing to step up in the presence of doom and gloom and take risk – these are the times when investments tend to be on sale and look most attractive over the long term. Early 2003 and 2009 are great examples of periods when most were scared to death to invest, but would have been handsomely rewarded had they done so.

On the other hand, we don't believe we should be willing to take on risk in the presence of doom and gloom when market prices don't look compelling. Future returns are all about the beginning price. If we pay too much for something, we're much less likely to experience satisfactory risk-adjusted returns going forward. With margin debt near all-time highs, the stock market relative to the economy very inflated, corporate profits as a percentage of the economy at all-time highs, and yields on junk bonds extremely low, there's no doubt in our minds that markets are anything but cheap. The loftier markets get, the more inherently unstable they become.

And so we're compelled to view these issues as potential canaries in the coal mine that could precipitate an undesirable chain of events. Although it likely won't be any one of them that leads to extended market turmoil, any one of them has the potential to tip that first domino.



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