RETIREMENT

aka UNEMPLOYMENT
for 25-30 YEARS!

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Retirement is wonderful if you have two essentials:
much to live on and much to live for.

~ Unknown

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FOREWORD

The Importance of Planning

Asking a financial professional about the importance of planning is like asking a fireman about the importance of water. The analogy has been stated in so many different ways: how can you hit the goal if you do not have one to shoot for; fail to plan and plan to fail; or to arrive at your destination, you need a roadmap, etc.

The Retirement Dilemma

Have you ever received a pink slip? Do you recall that feeling? A change in management, a corporate restructuring or just plain fired — losing a job or closing a business can bring the compounding effects of both financial and emotional panic. Depending upon your “station” in life and your ability to withstand weeks or months without income in the face of fixed expenses can be life changing.

Al loved his job; it was exciting and challenging every day. He loved providing a service to those he was responsible for, he loved the feeling of control as he handled and maneuvered the gigantic piece of equipment used in his line of work for more than 29 years, and the pleasure he enjoyed from his work was unlike many will ever experience. There was only one problem: He was a commercial pilot. For pilots, one day you are flying high above the clouds, soaring from city to city, and the next day, you turn age 65 and it's all over. He was done without a choice, rules of the sky.

Imagine being unemployed, by choice or not, for 25 to 30 years; that's retirement. It comes for us all. Some have the opportunity to choose when they want to retire, while others like Al have automatic retirement, or become disabled, or lose a job and, due to their age, can't get back into the workforce. Many of us, fortunately, will be able to pick a date and choose to close the door on the work phase of life, but no matter what the case, retirement brings life changes.

Life changes, but the expenses of life keep coming. The water bill will still come next month, the cable bill, groceries, property taxes, and the list goes on. Income will be needed next month, just like last month, but what level will your income need to be to replace the paycheck that was providing for your lifestyle? Plus, thanks to inflation, your expenses will increase over time, and you won't have the ability to control them. Planning to face those expenses on a fixed income can be a challenge, and it's a test that you cannot fail. The failure to plan for the inevitable period of your life when you can no longer work and need income to sustain you for 25 to 30 years, is a mistake, pure and simple.

Building the Estate

I am a confessed football nut. My infatuation started very young with a desire to play the game, but I did not live in an area where there were youth teams. Playing organized football for me began in 9th grade, when my mother finally gave in and let me play. It became a passion that lasted through my sophomore year at the University of Alabama, where I was fortunate to play two years for Coach Bear Bryant. This game taught me many life lessons I still use and live by daily. If you are around our office, you will frequently hear me using the game of football as an analogy in one way or another.

Preparation for the game of football requires hours of practice and personal sacrifice on behalf of the players, coaches and their families to achieve the goal of the team — to win. But to win, on game day, the execution must be sound. Preparation and execution is the core of financial planning, as well. Preparation not only can lead to success, but it can also help execute a plan that avoids unnecessary exposure to the risk factors that can unravel years of saving.

Preparation for retirement begins many years in advance of that day when you receive that proverbial gold watch. During what we call "the accumulation phase" of life, you are saving for the future. No matter what rule you use, whether it is the rule of saving 10 percent of your income each month, or saving in a 401(k) to get that company match, or accumulating alternative assets such as real estate to provide rental income, time is the most important component in the process. Using the advantage of compound interest coupled with the element of time can make this phase of life successful. Save for the rainy day, save all you can, because with the advancements in medicine, these days your retirement could last as long as 25 to 30 years.

Protecting the Estate

There is also a degree of planning you must do during the accumulation phase of life to stay on track and keep your estate moving down the road toward retirement.

Some of that planning may need to be purely defensive in nature to assure the completion of the first phase in your plan. Adequate life insurance can help make sure your plan completes itself for the benefit of those for whom you feel responsible, if you leave the game early. Liability insurance can provide a safety net for unforeseen accidents and situations that can derail your plan, and for that reason, we often recommend clients have an umbrella policy. Lastly, health insurance helps assure that you arrive without having a large slice of your retirement base spent on costs associated with staying healthy, to get there in the first place.

Along the way, there can also be pitfalls of the legal nature. A relationship with an estate planning attorney can provide the type of protection needed to help you get to the finish line. As I will explain in the estate chapter, documents like wills, trusts, and powers of attorney are essential in protecting the nest egg you are building.

Distributing the Estate

Retirement requires the transition from growing and accumulating assets to turning them into a sustainable and reliable stream of income. Preserving assets during years of retirement while facing various forms of risk, inflation, taxes, and out-of-pocket health care expenses creates challenges that require advanced planning.

For years, I have spoken in retirement seminars, taught workshops on various topics, taught classes on Social Security planning, addressed church groups and community functions. In every venue that I have spoken, I continually survey the audience with one simple question: "Do you have an income plan?" I am always astonished by the responses, or should I say, the lack of responses. While almost everyone saves and plans for retirement, very, very few have a plan for how they will take income from their accounts for the next 25 to 30 years. Add the different types of risk we must also consider, and the planning process now becomes more complex. I have chapters devoted to both taxes and health care, so let's take a look at how risk can play an important role in the retirement process.

Risk

In the financial arena, there are many different types of risk. Being unprepared to face all of the different types of risk can spell trouble for even those who have implemented a financial plan unless they are considered. A plan not only provides direction, but it should also be defensive as well. Unfortunately, those who enter the retirement years on a DIY-basis can be devastated by not defending against the ramifications these risks can carry.

Market risk is created when we invest in securities that will move up and down with the stock market. Interest rate risk is created by using fixed interest rates relative to a changing market, such as we might encounter when investing in CDs or long-term bonds, as both can be adversely affected by rising interest rates. There is longevity risk, which is the risk of having a long life and outliving your savings. Health care risk can come with the expenses of health care in aging due to out-of-pocket costs that may not be covered by insurance. As you can see, there are many forms of risk that can affect the value and purchasing power of your retirement savings, both during the accumulation and distribution periods of your life.

I want to address two additional areas of risk that I feel can have profound effects on the distribution phase if not considered in the planning process. These are inflation risk and sequence of return risk.

We all know about inflation. That bag of groceries you buy every two weeks will cost more each year. The effects of inflation reduce our buying power; in other words, our money just doesn't go as far as it once did. My first job out of college required that I move to Chattanooga. I was responsible for visiting insurance agencies in Alabama and Mississippi to explain the merits of using our company's product line. Due to the nature of my position, I would need a newer car for travel. The first car I purchased was a new 1980 Buick. It cost $ 8,200. Today, that same car, or a comparable car, would cost $ 30,000 or more. That's inflation.

Over the past 10 years, we have not felt the obvious effects of inflation in our daily lives because it has been suppressed. The Federal Reserve Board has artificially held down interest rates to aid in recovery from the Great Recession. However, this curtailing of interest rates has negatively affected fixed income savers, and these savers are some of the hardest hit by inflationary pressure. Retirees experience the effect of inflation as the constant chewing into their budget, requiring more and more dollars to buy food, staples, medications and keeping cars up to date.

A nugget that I try to share with every group I address is: "It's not what you have, it's what you spend". Obviously, you can reach a level of wealth that spending would never affect in your long-term plan. However, for most of us, spending, due to inflationary pressure over time, can place adverse pressure on our estates. How much you spend can have long-term effects on the longevity of your retirement assets.

Consider the hypothetical case of James and Brian. They are brothers and both have been quite successful. James is 67 and Brian is 65. They each have about $1.2

million saved for retirement. Both are married and have adult children who no longer live in the home. But there is a difference. James spends about $6,500 monthly with approximately 25 percent of that monthly expense going to charity and his home has no mortgage. Brian's family spends roughly $12,000 monthly to maintain their lifestyle. Using this hypothetical data, our planning software reveals that not only could James continue to follow his passion of supporting his charity, but that he and his wife would likely have sufficient retirement assets to endure a long-term care event and still leave a legacy for their children, even if they lived to age 100. Brian, on the other hand, may have a problem in the future. Unless changes are made in spending habits, he and his wife could exhaust their retirement savings by their mid to early 80s. It's not what you have; it's what you spend in retirement. See, Brian's $12,000 monthly living expense today is able to be maintained due to his current work income. But during retirement, due to inflation and the lack of work income, that monthly budget need may turn into $20,000 monthly and then eventually $25,000 monthly and, at that level, the estate will be systematically eaten alive. Remember, it's not what you have…

Sequence of return risk is a totally different animal of its own. This type of risk can have disastrous implications on retirement funds even before you reach retirement. First, what is sequence of return risk? This risk is created by the volatility of market returns. I have devoted a chapter to volatility later in this book, but for now let's address this particular type of risk. How you receive returns (positive or negative) and when you receive those returns on your investments, particularly while using them for income, can have an effect on their longevity over time. Negative returns early in the income phase can damage the longevity of your retirement assets. I have met and interviewed many who retired in 2001 and those who also retired in late 2007. In both cases, their retirement collided with a market slide that damaged the assets of almost everyone, as trillions of dollars of market value was lost. The greatest damage occurred to those who needed income from those depleted market positions. Many had to return to work, while others had to change their lifestyle to compensate for the change in income.

We know that securities are going to fluctuate in value, as their prices can be affected by more than just the profitability of the company. Many have witnessed world events, both natural and man-caused, change the value of their portfolios overnight. As we approach retirement, in that final two to three years before we flip the switch and transition from a growth investor to an income investor, we can ill afford a downturn in the value of our portfolio that must supplement our income. The first five years into retirement become very important. I want to segment my client's assets into those that will be needed to provide income with minimal or no exposure to market risk and those that can be exposed to market risk to provide a possible hedge against inflation over time. This, of course, depends upon the size of nest egg and the income needed to provide for retirement as well as other sources of income such as Social Security or a Pension. We want to move to a focus on yield; the real money of the investment world. In retirement, you must have yield.

Another football term we use to identify this two-to-three-year window of time is called the "Red Zone". In football, when a team reaches the 25-yard line of their opponent, they have entered the Red Zone. Here, the field has shortened relative to the goal line and play becomes more challenging. Entering the Red Zone during retirement requires that you begin to become conscious of the preservation of your principal. The necessity of using income from those assets can damage the assets' ability to re-grow if they have suffered a loss in value. For years, while you were working, when the market crashed, you could leave the monthly statements unopened and save yourself the stress of looking at the drop in value, because you did not need that asset for income. In most cases, the value of the accounts recover — eventually. But when you enter the Red Zone, we have a shortened time horizon, or period when we will need income from those assets to supplement our base income. The possible negative effect of that unpredictable sequence of returns must be managed, or your retirement nest egg can be damaged. Furthermore, you may not need additional income, but, as you age, you must take required minimum distributions (RMDs) from IRAs or 401(k)s beginning in the year following the year in which you turn 70 ½ . Unless you plan for this possibility, not only may you have to withdraw or sell positions that have lost value to meet the RMD, but it will also be taxable as income. Ouch!

Spending in Retirement

Another nugget I share with those we advise is: "It's not the first 10 years of retirement that matters, it's the second 10 years of retirement that really count". See, in the second 10 years, the effects of continually taking income from your assets can begin to manifest. I have often heard people state, if they knew how long they were going to live, they would know how much they could spend without running out of money. If it could only be that simple. Not knowing what expenses we will encounter, along with some of the heartache the future may bring, are two of the great unknowns. We can only prepare and plan to be ready.

The Bureau of Labor Statistics tells us that, during the first 10 years of retirement — often referred to as the "go-go" phase — your expenses are higher and you spend more discretionary money. During this period, there is fun, travel, possible hobby-jobs and volunteering. And did I say fun?[1]

For 33 years, Kurt arose at 4 a.m. to be at work by 6 a.m. Now in retirement, he told me he stays up some nights until after midnight reading or watching television. He said at first, he felt guilty in not following his routine of so many years, but he only felt guilty for a couple of weeks. All is good now. That's his version of go-go!

In the second 10 years of retirement, many retirees enter the "slow-go" phase. Expenses begin to drop as we begin to slow down. However, inflation has been creeping up for 10 years and the same pool of money has to be used to fund your daily expenses. In this period of time, health care expenses typically begin to rise as well. More importantly, unless you have guarded a portion of your assets from market risk, you may begin to see the effects of market volatility on your portfolio when you need to take income from your investments.

I call the last station of life the "no-go" phase. Here, we may encounter advanced medical expenses, especially for a couple, where one of the two has an elevated risk of needing care. This health care level usually requires hands-on or standby assistance and is not covered by Medicare. Long-term care expenses are paid out-of-pocket

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[1] Ann C. Foster. Bureau of Labor Statistics. December 2015. "Consumer Expenditures Vary by Age." https://www.bls.gov/opub/btn/volume-4/consumer-expenditures-vary-by-age.htm.

or from an insurance policy that was purchased to provide benefits in an assisted living community, a nursing home or home health care. Furthermore, the loss of a life partner can also mean a change in income from Social Security or the loss of pension income.

While in the accumulation phase, you cannot spend every dollar you earn, or you will not be able to save for the future. In retirement, your goal is to keep your expenses such that you do not have to depend upon all of the investment returns on your assets to create your income, either.

Only 18 percent of workers surveyed by the Employee Benefit Research Institute in 2017 said they had a high level of confidence in their savings and ability to retire. That leaves 82 percent of the population with uncertainty about their financial situations. My thought has always been, how could you take the first dollar from your savings without knowing how much you can take over time (adjusted for inflation and taxes) without running out of money? This underlines the importance of planning. Later we will touch on what to look for in an advisor to assist you in making these and other planning decisions during that all-important transition period.[2]

Any investment plan will be exposed to risk. An income plan can add certainty, as it will account for risk. It will provide for both growth-focused positions as well as the preservation of assets, since the goal is to build a stream of income that you cannot outlive. While some assets will provide for income, other assets can be allocated for growth potential, without pressure, to provide income

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[2] Lee Greenwald. Employee Benefit Research Institute. March 21, 2017. "The 2017 Retirement Confidence Survey." https://www.ebri.org/pdf/briefspdf/EBRI_IB_431_RCS.21Mar17.pdf.

many years in the future. Above all, it is a plan. You can move forward with direction and confidence. The plan must be re-evaluated periodically so that both you and the advisor can stay on track when working toward a successful retirement.

In that all important second half of the game, just like football, you must protect the ball (your retirement nest egg), adjust your strategy when you enter the Red Zone (recognize that change is approaching), and have a game plan for success (develop an income plan)!

Contact Us

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