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How much is enough?

Saving for retirement is no easy feat. Predicting the amount of money needed for a comfortable retirement feels impossible. Often, the difference between what we have saved for retirement and what we should have saved to maintain our standard of living is not realized until it's too late. This variance, deemed the Retirement Income Deficit, is estimated at $6.6 trillion for the United States.[1] Overall, retirees are not being properly educated on adequate savings levels for retirement.

Retirement readiness is commonly determined using a "replacement rate" which is the amount of money needed for a retiree to maintain their pre-retirement standard of living. The replacement rate is typically estimated between 70% and 80% of current earnings (increased annually for inflation). David Blanchett, Head of Retirement Research at Morningstar Investment Management, released a working paper entitled *Estimating the True Cost of Retirement* aimed at exploring these assumptions in order to more accurately assess the savings needed for retirement.[2]

Blanchett explains that no simple equation can accurately calculate the needed savings specific to each retiree. Retirement savings should be based on actual consumption including pre- and post-retirement income and expenses as well as life expectancy. Using real data instead of these assumptions, Blanchett found that the actual replacement rate varies greatly, ranging from below 50% to more than 85% based on individual circumstances. Further, he discovered that retiree expenses do not change based simply on inflation but instead are correlated with household-specific consumption and income. Spending during retirement is not typically consistent with pre-retirement spending. Retirees adjust their lifestyles to better correlate with their total retirement savings. Households with higher pre-retirement consumption and low retirement savings will decrease spending in retirement. Not surprisingly, the opposite is also true. Those with lower consumption prior to retirement and more retirement savings will actually increase spending. [2]

In conclusion, generic assumptions cannot precisely determine the retirement savings needed to maintain a certain standard of living. The retirement replacement rate should be based on income and expenses before and after retirement as well as life expectancy. There is no magic number; the "true cost" of retirement is specific to each retiree and their unique circumstances. The best offense to protect against a savings shortfall is to start a savings plan early and continue throughout your career

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1 "The Retirement Income Deficit." Retirement USA. Web. 18 Dec 2013 <http://www.retirement-usa.org/retirement-income-deficit-0>.

2 Blanchett, David. "Estimating the True Cost of Retirement." Morningstar Investment Management, 05 Nov 2013. Web. 18 Dec 2013. <http://corporate.morningstar.com/ib/documents/MethodologyDocuments/IBBAssociates/Blanchett_True-Cost-of-Retirement.pdf>.