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Turning Retirement Dreams into Reality

Planning and Investing for your Golden Years

Your entire career, you are working towards retirement. Put into perspective, planning for your golden years is quite an undertaking. Fear of running out of money is one the greatest fears for workers nearing retirement. Ideally, your nest egg will carry you through retirement without fault, but achieving this ideal takes planning. As you near retirement age and embark on this journey, what steps can you take to safeguard your retirement future?

Five to Ten Years Prior to Retirement

Today, people are living longer, healthier lives than ever before. As you near retirement, it is important to ensure that you are prepared to live the long life you've saved for and envisioned in your golden years.

Planning for your Retirement Future

Instead of relying on conventional wisdom that says you need a specific percentage of your pre-retirement income during retirement, such as 70% or 80%, it may be more useful to evaluate the expenses you will have and create a retirement budget. One significant factor to consider in the construction of your expense plan and budget is life expectancy. Recent workers retiring at age 65 can expect to be in retirement for an average of 14 years, according to the CDC.[1] For those in even moderate health, planning for less than the average can result in running out of money too soon. The bottom line is, on average, people are living longer and that is a significant factor to consider in the planning process.

Many industry professionals suggest beginning your retirement budget by first considering the expense of essentials such as food, housing, utilities, and routine healthcare. You should plan on covering these non-negotiable costs with a guaranteed source of income that will pay for the rest of your lifetime, such as Social Security, pension benefits, or fixed income investments.

Long term care is a very real concern for a worker contemplating retirement. Federal data shows that approximately half of all Americans develop a disability requiring long-term care at age 65 or older. One in six will spend at least $100,000 out of pocket for long term care, in addition to regular healthcare expenses.[2] An unexpected, long-term expense of this magnitude can derail a well-planned retirement budget if not factored in initially.

[1] Based on data from the Centers for Disease Control & Prevention. 68.2 years is the life expectancy at birth for those born in the year 1950 in the United States, regardless of race or gender. http://www.cdc.gov/nchs/data/hus/2010/022.pdf

[2] Miller, Mark. Fresh Approaches to Paying for Long-Term Care. Morningstar. 26 May 2016. http://news.morningstar.com/articlenet/article.aspx?id=754371

Once you've included essentials and contingent expenses, focus on discretionary spending such as leisure. Pay special attention to how your expenses will likely change over time. For example, travel and leisure expenses will generally account for a larger portion of spending early in retirement and taper overtime while costs for healthcare will likely increase as you age.

One significant factor that cannot be ignored in a realistic budget is inflation. Most retired Americans over the past two decades have been lucky to experience a very low inflationary environment. In example, assuming the Federal Reserves' inflation target of 2% is met over your retirement, something that costs $5 today will cost nearly $6 in ten years. This is even more significant in higher priced items as something that costs $10,000 today would cost approximately $12,000 in 10 years and more than $15,000 in 20 years. The longer the timespan, the more pronounced the impact of inflation.

Considering your expenses and inflation, how much will you need to withdraw from your portfolio annually? Historical research from Fidelity suggests limiting withdrawals to between 4% and 5% is a good starting point provided that you have a balanced portfolio and are planning for approximately 30 years of retirement.[3] Some experts believe a beginning withdrawal rate of 6% - 7% may be achievable, especially if you anticipate your expenses will be higher in your more active years early in retirement. The percentage you choose should be based on your needs and ensure that your retirement income will not be depleted too soon.

Investing for those Golden Years

Now that you have a budget for your retirement life, how do you ensure that life will be funded when you reach retirement age in five to ten years? While protecting your retirement savings is even more important close to retirement, obtaining growth should also be a priority. Prudential suggests scaling back stock exposure to between 40% and 60% to hedge against inflation and reduce the effects of a market downturn on your portfolio. Comparatively, Vanguard's Target Retirement 2020 has a 58% stock allocation while the Fidelity Freedom Fund 2020 allocates 42% of assets to domestic stocks and 18% to international equities.[4] American Funds' Target Date Retirement Series allocates approximately 50% to equities at retirement. There is no set answer; your investment strategy as you near retirement should be based on your risk tolerance and the amount you've determined you need based on your budget. Remember, diversification is key and will help you to mitigate risk while reaping returns.

If you have not already, it is the perfect time to review your portfolio allocation and revisit your deferral election to ensure that you are contributing the most you can to shore up your future. Beginning in the year you reach age 50, aim to take full advantage of catch-up contributions if you are able. In 2016, this equates to an additional $6,000 which, given time, can grow to a substantial amount in retirement. Assuming 6% interest

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[3] How to build a diversified income plan. Fidelity Viewpoints. 6 April 2016. https://www.fidelity.com/viewpoints/retirement/retirement-income-strategies

[4] Holland, Kelley.How the first 5 years of your retirement can ruin the rest of them. MSN Money. 23 May 2016. http://www.msn.com/en-us/money/retirement/how-the-first-5-years-of-your-retirement-can-ruin-the-rest-of-them/ar-BBtmFAN?li=BBnb7Kz

and 10 years to grow, $6,000 today turns into more than $10,700. Continue deferring an additional $500 a month to maximize the catch-up contribution and you would have approximately $79,000 more in your nest egg in ten years.[5]

The First Five to Ten Years into Retirement

Welcome to your golden years! Now that you've reached retirement, all your previous planning is put into action. Envisioning your retirement years can swiftly turn from a happy dream to a daunting reality when you think about no longer having a source of income outside of your retirement savings and Social Security, but don't fret! You've planned for this. Reaching retirement does not mean that your retirement portfolio should stop growing for your golden years. How do you approach your portfolio when you're no longer receiving a paycheck?

A well-diversified, balanced portfolio leading into retirement usually needs little or no change as you embark on your golden years. While you may be apprehensive about the effect of any market downturns on your savings, an overly conservative portfolio can be detrimental to long-term growth. Similarly, it is important to include some investment alternatives with growth potential to help your portfolio keep up with inflation. On the other hand, accepting too much risk in an overly aggressive portfolio can be unfavorable in times of market volatility due to withdrawals necessary for your retirement needs. Remember, there is no one-size-fits-all answer. Each situation is different and you must find the balance of stocks and bonds to meet your needs in retirement. As long as your essential costs are covered and contingent expenses are planned for, Fidelity advises to consider using your investment portfolio to pay for the fun things you've dreamed of doing in your golden years. In the case of poor market performance or unexpected expenses, you could cut back on or delay these extracurricular activities while your guaranteed income sources continue covering your essentials.[6]

As always, diversification is immensely important to your investment strategy before and during retirement. Annually, set aside time to revisit your portfolio, budget, and spending plan to ensure that each factor is working for you and leading you on the path to a successful retirement.

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[5] Assumes that the catch-up contribution limit remains at $6,000 for the next ten years and interest is compounded once per year.

[6] How to build a diversified income plan. Fidelity Viewpoints. 6 April 2016. https://www.fidelity.com/viewpoints/retirement/retirement-income-strategies