NAVIGATING THE TOP FIVE RETIREMENT RISKS

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Longer lives and better health translate into longer retirements and new concepts of what retirement should be. Many of today's retirees view retirement as a time to shift gears but not necessarily to slow down.

They keep their skills sharp in new job roles or by starting businesses. They continue learning new skills by going back to school as both teachers and students. Some choose to serve on boards of directors or to pursue creative and artistic passions.

However you define retirement for yourself, the bottom line is that you want to have enough money to live your life without constantly worrying that you'll run out. It certainly pays to be prepared and to stay on plan.

What to Look For

A successful retirement plan begins, of course, with making smart savings and investing decisions long before you contemplate retiring. But of equal or even greater importance is how you manage your money after you've left your primary career and begin to turn to your investments to provide the income that supports your lifestyle.

To boost the chances that your savings will let you live comfortably in retirement, there are five primary areas of risk that you need to address:

Timing and Withdrawals: The amount you withdraw from your retirement portfolio and when you do so are two of the main determinants of how long the portfolio will last. For example, taking large withdrawals during bear markets such as those in 1973–1974, 2000–2002 or 2007–2009 makes it hard for a portfolio to recover and grow.

To the degree possible, you want to minimize drawing on your capital in a weak market since you'll have less capital for the rebound. Your annual withdrawal rate should be smaller than your average annual return less inflation. Of course, to be conservative, you could bring it down even further, and your assets may continue to grow positively even though you're making withdrawals.

- *Market Volatility*: Related to the first risk, you need to position your portfolio to withstand inevitable swings in the market, and the way to do this is through diversification and asset allocation – holding a combination of stocks, bonds, cash and alternative investments that matches your risk profile. Returns on these investments should be non-correlated, so that when one area is down, another area is up. In retirement, you need diversification to perform a balancing act of having enough growth-oriented investments toward helping achieve acceptable long-term returns and bonds and other fixed income securities to provide steady income. Annuities could also make sense to provide at least a portion of your retirement income.
- *Longevity*: The good news is that you have a good chance of living to a ripe old age, but the risk here is essentially that you could outlive your assets. A woman born after 1973 has over a 20% chance of living to age 100[1].That means that if you retire at 65, you may need to plan for 35 years or more in retirement.
- *Taxes and Inflation*: Don't underestimate the ability of inflation to destroy spending power. Over the past 25 years, during which inflation has been fairly tame, the Consumer Price Index (CPI) – the cost of a basket of goods and services determined by the Bureau of Labor Statistics – has more than doubled. If inflation accelerates to 6%, prices would double in about 12 years.
- *Health Care Costs*: The CPI is often not the most accurate measure of your personal inflation rate, since you may spend disproportionately on health care as you age. These costs have traditionally run at double or triple the overall rate of inflation and are not under control. In addition, consider long-term care insurance as a way to help pay for some of the potential nursing home costs as you get older.

Writing the Next Chapter

Thanks to a combination of advances in medical technology and better lifestyle choices, Americans are living longer and more active lives. Nonagenarians (people between the ages of 90-100) are becoming commonplace. Enjoy your retirement years – however you decide to spend them. Spending some time with your financial advisor today can help you enjoy true financial security tomorrow.

[1] Department for Work and Pensions, 2011

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