Security National WEALTH MANAGEMENT

Will Your Money Last?

Risks to retirement income

Topical Education for Today's Investor — PLANNING FOR YOUR RETIREMENT

With so much at stake when planning a retirement income stream, it pays to take a step back and see whether your plan takes into account the major obstacles to sufficient retirement income. When you take this big-picture view, consider the five major challenges most retirees face: the potential for outliving one's assets; the threat of rising living costs; the impact of increasing health care costs; uncertainty about the future level of Social Security benefits; and the damage to long-term financial security that can be caused by excessive withdrawals in the early years of retirement.

Understanding each of these challenges can lead to more confident preparation.

Examining the Issues

- **Longevity.** While most people look forward to living a long life, they also want to make sure their longevity is supported by a comfortable financial cushion. As the average lifespan has steadily lengthened due to advances in medicine and technology, the chance of prematurely depleting one's retirement assets has become a matter of great concern.

  Consider a few numbers: According to the latest government data, average life expectancy in the United States climbed to 77.6 years for a child born in 2003, compared to 47.3 years in 1900. But most people don't live an average number of years. In reality, there's a 50% chance that at least one spouse of a healthy couple aged 65 will reach age 92 (see table).[1]

- **Inflation,** or the tendency of prices to increase, varies over time as well as from region to region and according to personal lifestyle. Through many ups and downs, U.S. consumer inflation has averaged around 4% over the 50 years ended December 31, 2006. If inflation were to continue increasing at a 4% annual rate, a dollar would be worth 44 cents in just 20 years. Conversely, the price of an automobile that costs $23,000 today would rise to more than $50,000 within two decades.

  For retirees who no longer fund their living expenses out of wages, inflation affects retirement planning in two ways: It increases the future cost of goods and services, and it potentially erodes the value of assets set aside to meet those costs — if those assets earn less than the rate of inflation.

Perspectives on Longevity: Chances of Living to a Specific Age

		50%	25%
Male Age 65*	→	Age 85	Age 92
Female Age 65*	→	Age 88	Age 94

*Assuming individuals are in good health at age 65.

Sources: Employee Benefit Research Institute, July 2005; Society of Actuaries, 2000 Mortality Table.

- **Health care.** The cost of medical care has emerged as a more important element of retirement planning in recent years. That's primarily due to three reasons: health care expenses have increased at a faster pace than the overall inflation rate; many employers have reduced or eliminated medical coverage for retired employees; and life expectancy has lengthened. In addition, the nation's aging population has placed a heavier burden on Medicare, the federal medical insurance program for those aged 65 and older, in turn forcing Medicare recipients to contribute more toward their benefits and to purchase supplemental insurance policies.

  The Employee Benefit Research Institute has estimated that if recent trends continue, a typical retiree who is age 65 now and lives to age 90 will need to allocate about $180,000 of his or her nest egg just for medical costs, including premiums for Medicare and "Medigap" insurance to supplement Medicare. Because of the higher cost trends affecting private health insurance, the same retiree relying on insurance coverage from a former employer will need to allot nearly $300,000 to pay health insurance and Medicare premiums, as well as out-of pocket medical bills.[2]

  Social Security. The demographic forces that have led to an increasingly older population are expected to continue, putting more pressure on the financial resources of the Social Security system — the government safety net that currently provides more than half of the income for seven out of 10 Americans aged 65 or older.

  In fact, the number of workers supporting each Social Security beneficiary through payroll taxes is projected to decline from 3.3 to 2.1 by 2031. At that ratio there would not be enough workers to pay scheduled benefits at current payroll tax rates. If no action is taken to fix Social Security's financial problems, the system's trust funds may be exhausted by 2041.[3] These trends have raised uncertainty about how Social Security can be financed in future years and whether benefit levels and eligibility requirements may have to be changed as the population continues to age.

- **Excess withdrawals.** The decision about how much money may be safely withdrawn each year from a retirement nest egg needs to take into consideration all the risks mentioned above. But retirees also must consider the fluctuating returns that their personal savings and investments are likely to produce over time, as well as the overall health of the financial markets and the economy during their withdrawal period.

The stock market's sudden switch in 2000 from a prolonged bull market to a three-year bear market illustrates the dangers of withdrawing too much too soon. Withdrawing 7% or even more per year from a retirement portfolio during the bull market years might have seemed a reasonable rate. But the ensuing bear market in stocks raised the possibility that the value of a retiree's portfolio might be reduced as a result of stock market losses, increasing the chance that the retiree would outlive his assets. One strategy that may potentially avoid premature exhaustion of assets is to adopt a relatively conservative withdrawal rate of 4% to 5% a year.[4] Importantly, rather than relying upon any generic withdrawal strategy, it is very important to work with a financial advisor willing to understand your unique financial situation and goals, who in turn can develop a plan designed to help you achieve your specific objectives.

Addressing the Risks

While the risks discussed are common to most people, their impact on retirement income varies from person to person. Before you can develop a realistic plan aimed at providing a sustainable stream of income for your retirement, you will have to relate each risk to your situation. For example, if you are in good health and intend to retire in your mid 60s, you may want to plan for a retirement lasting 30 years or longer. And when you estimate the effects of inflation, you may decide that after you retire you should continue to invest a portion of your assets in investments with the potential to outpace inflation.

Developing a realistic plan to address the financial risks you face in retirement is critically important when recognizing the aforementioned risks. An experienced financial advisor can provide useful information, as well as valuable perspective on the options for successfully managing what may stand in the way of your long-term financial security. With expert advice from a financial advisor focused on helping you achieve your specific dreams and goals, you can enjoy the benefits of a strategy designed to support the life you envision.

For more information, please consult with your financial advisor.

Points to Remember

1. Today's retirees should assess several threats to enjoying a financially comfortable retirement. These include the potential for outliving their assets and the corrosive effects of inflation on future income.

2. A sound retirement income plan needs to address specific risks, such as longevity, rising health care costs, and excessive withdrawal rates, that can lead to premature depletion of assets.

3. Demographic trends are likely to put added stress on government-run programs, including Social Security and Medicare, which help retirees balance their budgets.

4. The goal of retirement income planning is to create a sustainable, predictable stream of income that also has the potential to increase over time.

5. Working with a financial advisor focused on developing a clear understanding of your specific needs is critical to creating the best chance for success in meeting your retirement goals.

Important Additional Notes

1 Source: Society of Actuaries 2000 Mortality Table, Scale G.

2 Source: Money, May 2005.

3 Source: Social Security Administration, March 2005.

4 Source: Standard & Poor's. This example is a compilation of all 30-year holding periods from 1926 to 2006, based on a portfolio of 60% U.S. stocks and 40% long-term Treasury bonds, with annual withdrawals adjusted for actual historical changes in the Consumer Price Index. The example is not intended as investment advice. Please consult a financial advisor if you have questions about choosing a withdrawal rate and how it relates to your own financial situation.