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5 Ways to Ensure You're Ready for Retirement

"Early boomers (those born between 1946 and 1955) may be the last cohort on track to retire with enough savings and assets to maintain their financial security through their golden years." (Source: *"Retirement Security across Generations,"* Pew Charitable Trusts Economic Mobility Project, May 16, 2013)

The Pew report, which projects income replacement rates for three cohorts — early boomers, late boomers (born between 1956 and 1965), and Gen-Xers (1966–1975) — paints a stark picture of Americans' preparedness for retirement.

Replacement rate is the percentage of current annual income that a person has in retirement; most financial advisors suggest a replacement rate of no less than 70%. Projecting couples' wealth upon retirement at age 65 given current levels of income and wealth, this is what Pew found:

✔ Early boomer couples are on track to replace 82% of their income in retirement.

✔ Late boomer couples are on track to replace just 59% of their preretirement income.

✔ Gen-Xer couples are the worst off, on track to replace only 50% of their income in retirement.

Granted, these are averages, and some couples and individuals are well on track toward comfortable retirements. Here are five steps to ensure you are on track:

1. Take advantage of tax breaks (the government's way of encouraging you to save for retirement). It is in the government's interest for Americans to save enough on their own to live comfortably in retirement, so that government programs don't have to foot the bill. For that reason, the government gives a range of tax breaks for retirement savings:

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Working with a Financial Advisor

Even if you feel you can design your own financial plan, a financial advisor can provide a second opinion, suggest options you may not have considered, or help in the following areas:

✔ **Setting your financial goals.** Properly designed financial goals should provide the motivation you need to control your spending. Specific goals should be developed that will provide help in deciding how to accomplish them.

✔ **Determining your current situation.** Assessing your net worth and how you spend your income will help you assess where you stand currently, which is important in determining what strategies are needed to pursue your financial goals.

✔ **Developing a plan.** A written financial plan can act as a road map in helping you pursue your financial goals. The plan should list strategies to help you achieve your goals and provide milestones.

✔ **Monitoring your plan.** At least annually, you should review your plan to determine whether you are making adequate progress and whether changes are needed to the plan. ❍❍❍

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5 Ways to Ensure

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✔ **401(k) and 403(b) plans —** Contributions are excluded from taxable income; distributions, including earnings, are taxable at retirement

✔ **Traditional IRAs —** Contributions are fully tax deductible for individuals and couples with no work-sponsored retirement plan, but deductions are limited for individuals and couples with work-sponsored plans and incomes over certain limits; distributions are taxed as ordinary income

✔ **Roth IRAs —** Contributions are taxable; qualified distributions, including earnings, are not taxable at retirement

2. Don't bank on a market boom. It's a double-edged sword: in order to grow your savings large enough to be able to live comfortably for the 20+ years you'll likely spend in retirement, you have to invest those savings in the market. But on the other hand, a market downturn can do significant damage to a nest egg.

The key is to be vigilant about your investments and to change your asset allocation as you near retirement. Generally speaking, you should have your money in more aggressive investments the further you are from retirement and more conservative investments as you get closer.

3. Create realistic retirement goals to make it easier to sacrifice today for the sake of tomorrow. As human beings, we are notoriously bad at thinking of the interest of our future selves. But sacrificing today is easier if you have a very clear, tangible concept of exactly what you're sacrificing for. So sit down with your spouse (or with whomever you plan to enjoy retirement) and think of the things you want to be able to do in your golden years. Budget how much those plans will cost (taking inflation into account).

4. Make retirement savings automatic. Another way to make saving easier is to make it automatic — many advisors refer to this as paying yourself first. If the money you've budgeted as retirement savings never makes it to your pocket, you'll be much less inclined to spend it. Some retirement plans can be set up this way: an employer-sponsored 401(k) plan, for example, can deduct your contribution from your paycheck.

5. Take an honest look at how much you'll need in retirement — and how much you have to save now to get there. The most important step you need to take is to determine, based on your current income and net worth, a dollar amount that will give you a replacement rate of 70% or more — and a strategy for saving. Please call if you'd like to discuss this in more detail. ❍❍❍

Financial Planning vs. Retirement Planning

According to the most recent (2012) Household Financial Planning Survey conducted by the Certified Financial Planner Board of Standards, only 31% of financial decision makers have a comprehensive financial plan. If the survey had asked respondents to define comprehensive financial plan, few probably could have; most people define financial plan synonymously with retirement plan. In reality, a retirement plan is just one component of a comprehensive financial plan, which also covers savings, investments, insurance, education planning, emergencies, and other financial goals.

What is a financial plan? If you imagine your life like a road trip, your financial plan is the map that guides you from point A to point Z, making all the stops you had envisioned along the way (those are your goals) without ever running out of gas. Your financial plan hinges on the goals you set — living within your means today, as well as saving for near-term goals like a family vacation or new car, for medium-term goals like children's college educations, and for long-term goals like retirement.

What is a retirement plan? A retirement plan is one component of a complete financial plan; if your financial plan is your master road map, your retirement plan is like a map inset, providing the details to get you from where you are now to your retirement and to live the kind of lifestyle you want once you're retired. Your retirement plan takes into account your age, your current financial situation, and your goals for retirement. It includes, most basically, how much you need to set aside in what kind of investments (as well as the help you'll get from pension plans, Social Security benefits, and health care benefits).

While financial planning and retirement planning are not the same, you cannot have an effective retirement plan without a comprehensive financial plan. Why? Because if you don't have a financial plan in place to meet unexpected, short-term, and medium-term goals, your chances of achieving your long-term goals (retirement) are slim. At the same time, unless you truly plan to work until the day you die, a retirement plan is an essential component of a comprehensive financial plan.

It is important that you keep both your financial plan and your retirement plan up to date. Both plans are based on assumptions about your current situation, including income, expenses, goals, investment returns, and tax rates. When those factors change, your plans need to change. Please call if you'd like to discuss this in more detail. ❍❍❍

Giving Your Kids a Head Start with Financial Planning

When it comes to their kids' financial independence, many parents don't give it much thought. Here are six steps to get you started.

Step 1: Start early — It's important to start talking with your kids about financial responsibility early. Once your children are old enough to have some responsibility and able to perform small tasks, give them a list of household responsibilities and pay them a weekly allowance for completing those chores.

Help your kids make decisions with the allowance money they earn: How much should go into savings? How much should they spend? Developing an understanding of these concepts gives kids the financial confidence that will eventually lead to financial independence.

As your kids grow, teach them by modeling financial responsibility. Have budget discussions around the kitchen table with your children present. Share with them the family budget and talk about the times when you have to make financial trade-offs.

Step 2: Set goals — Encourage your kids to set goals; goals are, after all, the driving force behind any financial plan at any age. Whether they want a toy or a car when they turn 16, their financial plan will be driven by the goals they set. Teaching your kids to think ahead financially, to defer the instant gratification of spending today in order to achieve tomorrow's goal, will dramatically increase the likelihood that they will become financially independent adults.

Step 3: Develop a budget — When your children are ready (typically in the preteens), help them create and manage a budget. Whether they earn money from chores around their house or from work outside the home, give them the responsibility to pay for certain things. Help them understand the basic concept that expenses cannot be greater than income. Help them live within their means, suggesting ways to tailor expenses.

Sit down with your children at least once a month to go over the budget. Look at where they spent their money in the previous month or week. How do they feel about those spending decisions in retrospect? Do they wish they would have done things differently? When you have these kinds of conversations with your children, you're showing them how to think about money and how to make decisions.

Step 4: Build credit — Developing credit is a very important part of financial planning. Good credit will enable your children to buy a car and a home at reasonable interest rates. Unfortunately, credit is one of the areas where young people tend to have the most trouble.

There are a number of ways to help your children prepare for the responsibility of a credit card:

✔ Prepaid credit cards function in much the same way as debit cards do — not letting the cardholder spend above the prepaid amount — but at the same time are reported to the credit bureaus like a true credit card, allowing the cardholder to build up credit.

✔ Once your children have mastered the science of living within their monthly budget, you may allow them to take out a low-limit credit card.

Step 5: Save — A savings account is a great way to get your children into the habit of saving (and it is a habit, as well as a mindset). As they get older, you might look into higher earning, low-risk investment accounts, money markets, or government bonds as ways for your children to save toward longer-term goals. These kinds of accounts do not require huge upfront investments and typically have higher rates of return than savings accounts. They're a great start to understanding the different types of investment vehicles and the trade-offs of each.

Step 6: Let go — In financial planning, if your kids never know what it's like to be truly self-reliant — if they never have the opportunity to make mistakes and fix them — they never will become financially independent.

Resist the temptation to bail your kids out every time they are in a financial crisis. When they run out of money before the end of the month, let them feel the consequences of having to eat a sack lunch while their friends go out. Next month, they'll think harder about spending more than their budget.

Please call if you would like to discuss this in more detail. ❍❍❍

Diversifying All of Your Assets

When asked how their assets are diversified, most people respond by indicating how much of their portfolio is divided between stocks, bonds, and cash. But looking at your overall financial diversification means more than simply looking at your investment portfolio — you need to examine all your assets. Some items to consider include:

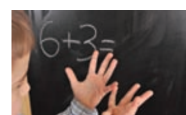
✔ **Your most significant asset is probably your ability to earn an income.** The predictability of that income will have a significant impact on your financial situation. If you work for a company in a volatile industry, your spouse might want to seek employment at a more stable company. No matter where you work, don't purchase too much of your company's stock, even if it is through a 401(k) plan. You may even want to avoid stocks in related industries. Since your current and future income potential is closely tied to the company for which you work, you want to diversify your other assets.

✔ **Keep an eye on the lookout for your home's value.** Your home's appreciation potential is often tied to economic growth in your area. If your area is dominated by a certain industry, the prospects for that industry can also impact your home's value. Thus, you may not want to own stocks in that same industry.

✔ **Adequately diversify your investment portfolio.** Typically, you do not know which asset class will perform best on a year-to-year basis. Diversification is a defensive strategy — it helps protect your portfolio during market downturns and helps reduce your portfolio's volatility. Diversify your investment portfolio among a variety of investment categories.

✔ **Consider international investments.** Since U.S. stocks have outperformed international stocks for an extended period, international investments have gone out of favor. But no one knows whether this trend will continue in the future, so it may be prudent to include international investments in your portfolio. Keep in mind that international investing may not be suitable for everyone. In addition to the risks associated with domestic investing, international investing has unique risks, including currency fluctuations, political and social changes, and greater share price volatility.

If you would like to discuss diversification, please call. ❍❍❍



Quick Math

Don't have a calculator handy, but need a quick answer to a financial question? Here are three shortcuts:

✔ **How long will it take to double your money?** Divide 72 by your annual investment return. If you are earning 8% annually on your investments, it takes nine years to double in value.

✔ **How much does it cost to purchase an item before taxes?** Multiply the cost by 1.7 if you are in the 35% or 33% marginal tax bracket, 1.6 in the 28% tax bracket, 1.5 in the 25% tax bracket, 1.3 in the 15% tax bracket, and 1.2 in the 10% tax bracket. These numbers also factor in Social Security and Medicare taxes, but not state income taxes. So, if you are in the 28% marginal tax bracket and want to spend $10,000 on a vacation, it will cost $16,000 before taxes.

✔ **How much will your retirement savings grow in 30 years?** Assuming an 8% investment rate of return, add a zero to the amount. Thus, if you have $100,000 today, it could grow to $1,000,000 in 30 years. This is a handy way to look at whether it's worth spending money on something. ❍❍❍

Financial Thoughts

Employee participation in 401(k) plans decreases as the number of investment choices increases. A plan with 11 options had a 70% participation rate, while a plan with 56 options had a 61% participation rate. Studies by behaviorial scientists suggest humans tend not to make decisions when confronted with too many choices (Source: *AAII Journal*, July 2013.)

Approximately 6% of individuals in their 60s have children who live at home, while 30% support adult children (Source: *AARP The Magazine*, August/September 2013).

In a recent survey, 19% of the respondents said that they have not made a cash purchase in the past 30 days (Source: *Money Magazine*, July 2013).

Approximately 63% of consumers spend more on technology bills than on utilities (Source: *Money Magazine*, August 2013).

Studies have repeatedly found that babies have little overall effect on parents' happiness. Parents raising children between the ages of three and 12 are happier than those raising infants and teenagers (Source: *Journal of Happiness Studies*, 2013). ❍❍❍

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