FAIRMAN GROUP
FAMILY OFFICE

Financial Planning | Investment Advice | Tax Preparation & Tax Planning

CAN I LIVE TO 100 WITH MONEY TO SPARE?

THOUGHT LEADERSHIP PERSPECTIVES

BY RYAN GELROD, CFA

HERE ARE SOME BIG PICTURE CONCEPTS THAT RETIREES OR FUTURE RETIREES SHOULD KEEP IN MIND WHEN THINKING ABOUT THEIR MONEY.

That goal sounds great; however, retirement and longevity planning can be difficult. While our future is filled with a host of unknowns (family needs, life span, capital market returns, inflation), they should never prevent you from creating a plan—one that can help you answer a myriad of questions:

- Can I retire?
- What will my retirement look like?
- Do I need extensive tax and estate planning?
- How should I allocate my investments?
- How will I draw down on my resources when I am no longer working?
- Will my spouse be financially secure when I am gone?

1) CAPITAL MARKETS: 6% IS THE NEW 8%

Prior to the financial crisis of 2008, retirees could build a reasonably diversified portfolio of 60% equity and 40% fixed income that would produce income above 4% and total returns of about 8%. In that environment, many retirees chose to spend the income portion of their portfolio and leave their principal untouched. This framework was a very comfortable and desirable situation for many people.

Post crisis, the Federal Reserve embarked on quantitative easing, which has suppressed interest rates on savings, driven down bond yields and caused companies to focus on either growth or stock buybacks, thereby limiting dividends paid to their stockholders. The result: many diversified portfolios now only produce income of about 2%—half the amount compared with our 'before 2008' scenario! In this environment, we believe that an investor should only expect total returns of 5-6%—well below the former expectation of 8%.

This situation requires investors to take a different approach, focusing on the total return (growth plus income) of their portfolios, rather than income alone. The retiree can then supplement the income of their portfolio by selling off a small portion of the principal (growth) to generate the funds that will be spent each year. This growth is most often taxed at favorable long-term capital gain rates.

Feeling the squeeze of this new reality, some retirees try to drastically increase the income produced by their portfolio at retirement. This focus can lead to a portfolio overloaded with High Yield Bonds, Master Limited Partnerships (MLPs) and Real Estate Investment Trusts (REITs). While these may be acceptable in moderation, a portfolio concentrated in only these asset classes could dramatically increase the risk level in a portfolio and jeopardize the success of a long-term financial plan. Alternatively, we believe that a fully diversified approach, which includes an appropriate level of high-quality bonds to provide stability, will help retirees achieve a much more stable lifestyle.

2) WITHDRAWAL RATES: WE'RE LIVING LONGER; MARKETS ARE UNPREDICTABLE

Many investors may be familiar with the 4% rule, developed by William Bengen[1] in 1994. Bengen's study concluded that in all historical time periods, a retiree could withdraw 4-4.5% (adjusted annually for inflation) of a 60/40 portfolio and the funds would last at least 30 years. There is significant debate in the financial planning community about whether the 4% rule still applies. There are concerns that capital market returns may be less generous than they have been historically, and that a 30-year horizon is not sufficient for all retirees, given the potential for earlier retirement and increased longevity.

We believe that more detailed modeling tested through a wide variety of scenarios can provide retirees a much more complete picture of their retirement lifestyle and the possibilities it may present.

3) REPLACEMENT RATES: LIFE IS NOT LIVED IN A STRAIGHT LINE

Another rule of thumb that many retirees try to use is the concept of a replacement rate. Some advisers or studies suggest that if a retiree can replace a certain percentage, often 85%, of their previous income, then they will be comfortable throughout retirement. We believe this type of analysis is too generalized. While many costs may decline in retirement (saving for retirement, commuting or work attire), other costs may increase (recreation, travel and healthcare). Even more importantly, most retirees do not experience flat expenses throughout retirement. There is often an early phase of retirement that involves significant travel and recreation, and a late phase when medical costs can increase. We believe that modeling and stress-testing retirement scenarios is much more effective in helping retirees understand how their retirement may unfold, determine what they can do now to increase their likelihood of success and plan for how to efficiently use their resources to achieve their goals.

Retirement planning is a complex process that no longer adheres to old methods, outdated assumptions or simple rules of thumb.

LEARN HOW OUR FINANCIAL PLANNERS CAN HELP YOU EVALUATE THE COMPLEXITIES OF YOUR CURRENT AND FUTURE INDIVIDUAL SITUATION, DETERMINE WHAT IS POSSIBLE OVER YOUR LIFETIME AND CREATE A COMPREHENSIVE PLAN FOR SUCCESS.

[1]Bengen, William P. (October 1994). "Determining Withdrawal Rates Using Historical Data". Journal of Financial Planning: 14–24.

ABOUT FAIRMAN GROUP FAMILY OFFICE

Fairman Group Family Office is a fee-only financial planning firm, located in Chesterbrook, PA, offering financial planning, investment advice, tax preparation and tax planning services to individuals and families in the greater Philadelphia area since 2002. We are a fiduciary who serves you with skill, care, prudence and diligence through a disciplined and integrated process. We do not sell products or insurance and do not accept commissions, referral fees, loads/12b-1s, trails, or any other compensation from outside sources.