FIVE SIMPLE STEPS TO A COMFORTABLE, SAFE, SECURE AND FUN RETIREMENT

PROGRESS
WEALTH MANAGEMENT

Introduction

Retirement planning is a multistep process that evolves over time. To have a comfortable, secure—and fun—retirement, you need to build the financial cushion that will fund it all. The fun part is why it makes sense to pay attention to the serious—and perhaps boring—part: planning how you'll get there.

Retirement planning starts with thinking about your retirement goals and how long you have to meet them. Then you need to look at the types of retirement accounts that can help you raise the money to fund your future.

As you save that money, you have to invest it to enable it to grow.

The surprise last part is taxes: If you've received tax deductions over the years for the money that you've contributed to your retirement accounts, then a significant tax bill awaits when you start withdrawing those savings.

There are ways to minimize the retirement tax hit while you save for the future—and to continue the process when that day arrives and you actually do retire.

We'll get into all of these issues here. But first, start by learning the five steps that everyone should take, no matter what their age, to build a solid retirement plan.

KEY TAKEAWAYS

- Retirement planning should include determining time horizons, estimating expenses, calculating required after-tax returns, assessing risk tolerance, and doing estate planning.
- Start planning for retirement as soon as you can to take advantage of the power of compounding.
- Younger investors can take more risk with their investments, while investors closer to retirement should be more conservative.
- Retirement plans evolve through the years, which means portfolios should be rebalanced and estate plans updated as needed.

01

Understand Your Time Horizon

Your current age and expected retirement age create the initial groundwork of an effective retirement strategy. The longer the time from today to retirement, the higher the level of risk that your portfolio can withstand.

If you're young and have 30-plus years until retirement, the biggest problem you probably have is that you couldn't afford to retire given the amount you have saved so far. For this reason, you should probably have the majority of your assets in riskier investments, such as stocks because historically, they've grown faster. There will be volatility, but stocks have historically outperformed other securities, such as bonds, over long time periods. The main word here is "long," meaning at least more than 10 years. If you don't have the stomach for this, you may need to contact a financial advisor to find different ways of growing your retirement assets.

Additionally, you need returns that outpace inflation so you can maintain your purchasing power during retirement. "Inflation is like an acorn. It starts out small, but given enough time, can turn into a mighty oak tree," says Blaine Thiederman MBA, CFP.

"We've all heard—and want—compound growth on our money," Blaine adds. "Well, inflation is like 'compound anti-growth,' as it erodes the value of your money. A seemingly small inflation rate of 3% will erode the value of your savings by 50% over approximately 24 years. Doesn't seem like much each year, but given enough time, it has a huge impact. If we don't prepare for inflation, our retirement plans could be ruined by it."

In general, the older you are, the more your portfolio should be focused on income and the preservation of capital. This means a higher allocation in less risky securities, such as bonds, that won't give you the returns of stocks but will be less volatile and provide income that you can use to live on. Typically, 64 years and near-term retirees are less concerned with inflation than a 30-year-old and for this reason, typically invest with growth in mind but not at the forefront.

You should break up your retirement plan into multiple components. Let's say a parent wants to retire in two years, pay for a child's education at age 18, and move to Florida. From the perspective of forming a retirement plan, the investment strategy would be broken up into three periods: two years until retirement (contributions are still made into the plan), saving and paying for college, and living in Florida (regular withdrawals to cover living expenses).

A multistage retirement plan must integrate various time horizons, along with the corresponding liquidity needs, to determine the optimal allocation strategy. You should also be rebalancing your portfolio over time as your time horizon changes.

You might not think that saving a few bucks here and there in your 20s means much, but the power of compounding will make it worth much more by the time you need it.

02

Determine Retirement Spending Needs

Having realistic expectations about post-retirement spending habits will help you define the required size of a retirement portfolio. Most people believe that after retirement, their annual spending will amount to only 70% to 80% of what they spent previously.[1] Such an assumption is often proven unrealistic, especially if the mortgage has not been paid off or if unforeseen medical expenses occur. Retirees also sometimes spend their first years splurging on travel or other bucket-list goals.

“In order for retirees to have enough savings for retirement, I believe that the ratio should be closer to 100%,” says Blaine Thiederman MBA, CFP and Founder of Progress Wealth. “The cost of living is increasing every year—especially healthcare expenses. People are living longer and want to thrive in retirement. Retirees need more income for a longer time, so they will need to save and invest accordingly.”

As, by definition, retirees are no longer at work for eight or more hours a day, they have more time to travel, go sightseeing, shop, and engage in other expensive activities. Accurate retirement spending goals help in the planning process as more spending in the future requires additional savings today.

“One of the factors—if not the largest—in the longevity of your retirement portfolio is your withdrawal rate. Having an accurate estimate of what your expenses will be in retirement is so important because it will affect how much you withdraw each year and how you invest your account. If you understate your expenses, you easily outlive your portfolio, or if you overstate your expenses, you can risk not living the type of lifestyle you want in retirement,” says Blaine Thiederman MBA, CFP.

Your longevity also needs to be considered when planning for retirement, so you don’t outlast your savings. The average life span of individuals is increasing which makes this risk even more real. Some people say that their plan to handle longevity is to walk out into the woods with a pistol when they’re ready but the reality is, no one wants that day to come.

Actuarial life tables are available to estimate the longevity rates of individuals and couples (this is referred to as longevity risk).

Additionally, you might need more money than you think if you want to purchase a home or fund your children’s education post-retirement. Those outlays have to be factored into the overall retirement plan. Remember to update your plan once a year to make sure that you are keeping on track with your savings.

03

Calculate After-Tax Rate of Investment Returns

Once the expected time horizons and spending requirements are determined, the after-tax real rate of return must be calculated to assess the feasibility of the portfolio producing the needed income. A required rate of return in excess of 10% (before taxes) is normally an unrealistic expectation, even for long-term investing. As you age, this return threshold goes down, as low-risk retirement portfolios are largely composed of low-yielding fixed-income securities.

If, for example, an individual has a retirement portfolio worth $400,000 and income needs of $50,000, assuming no taxes and the preservation of the portfolio balance, they are relying on an excessive 12.5% return to get by. A primary advantage of planning for retirement at an early age is that the portfolio can be grown to safeguard a realistic rate of return. Using a gross retirement investment account of $1 million, the expected return would be a much more reasonable 5%.

Depending on the type of retirement account that you hold, investment returns are typically taxed. Therefore, the actual rate of return must be calculated on an after-tax basis. However, determining your tax status when you begin to withdraw funds is a crucial component of the retirement planning process.

04

Assess Risk Tolerance vs. Investment Goals

Whether it's you or a professional money manager who is in charge of the investment decisions, a proper portfolio allocation that balances the concerns of risk aversion and return objectives is arguably the most important step in retirement planning. How much risk are you willing to take to meet your objectives? Should some income be set aside in risk-free Treasury bonds for required expenditures?

You need to make sure that you are comfortable with the risks being taken in your portfolio and know what is necessary and what is a luxury. "Don't be a 'micromanager' who reacts to daily market noise," advises Blaine Thiederman MBA, CFP. "'Helicopter' investors tend to overmanage their portfolios. When the various mutual funds in your portfolio have a bad year, add more money to them. It's kind of like parenting: The child that needs your love the most often deserves it the least. Portfolios are similar. The mutual fund you are unhappy with this year may be next year's best performer—so don't bail out on it."

05

Stay on Top of Estate Planning

Estate planning is another key step in a well-rounded retirement plan, and each aspect requires the expertise of different professionals, such as lawyers and accountants, in that specific field.

Life insurance can also an important part of an estate plan and the retirement planning process.

Having both a proper estate plan and life insurance coverage ensures that your assets are distributed in a manner of your choosing and that your loved ones will not experience financial hardship following your death. A carefully outlined plan also aids in avoiding an expensive and often lengthy probate process.

The simplest way to evaluate if you have enough life insurance is to ask yourself if, the amount that would be paid to your family upon your death would pay for everything you think that you'd like it to.

Ask yourself questions like:

1. Will my life insurance pay for college for my children?
2. Will my spouse be able to afford daycare and the mortgage once I'm gone?
3. Does my spouse have any substantial debt that's hard to afford?
4. Do my circumstances warrant me buying extra life insurance?

Tax planning is another crucial part of the estate planning process. If an individual wishes to leave assets to family members or a charity, the tax implications of either gifting or passing them through the estate process must be compared.

A common retirement plan investment approach is based on producing returns that meet yearly inflation-adjusted living expenses while preserving the value of the portfolio. The portfolio is then transferred to the beneficiaries of the deceased. You should consult a tax advisor to determine the correct plan for the individual.