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Twists And Turns

By Mitch Anthony

I was recently getting a haircut when I couldn't help but overhear a most unusual conversation in the chair next to me between a stylist who appeared to be in her late 20s and her client, who appeared to be around the same age. The woman doing the coiffing said, "Well, I finally moved out of my parents' house and got my own place. It feels pretty good."

"That's ironic," her client replied. "My wife's parents are just getting ready to move in with us."

In this ironic twist, we see that not planning ahead carries much risk. But even if an individual were to plan ahead, he could encounter some unforeseen event with dire fiscal consequences and find himself in just such an unenviable position. This conversation reminds me of a pithy insight told to me by Christine Fahlund, senior financial planner at T. Rowe Price: "There were two promises you made to your children, one out loud and the other tacitly: (1) I'll help pay for your college (out loud), and (2) I'll never move in with you or ask you for money (tacit)."

I do not believe a monetary discussion around retirement is complete without discussing the inherent risks to your fiscal well-being in this stage of life. Yes, it's important to save and to delay distributions as long as you can, but it is also important to keep an eye on the radar of life and be vigilant regarding the obstacles that stand in your way.

Learn To LIVE In Retirement

The four major areas of risk one must navigate in the "retirement" stage are longevity, inflation, volatility (in the markets) and events that threaten one's financial security.

These four risks form the acronym L.I.V.E.—and to live well in a modern retirement stage, one must navigate each aspect and have a plan for surviving and thriving despite the risks posed in each arena.

Longevity: Dave Zander, a retirement consultant, shared this anecdote with me: "In 1985, Joe retired early at the age of 55 so that he could go fishing. He started receiving a pension check for $652.75 per month. Seven years later, he started receiving Social Security. Today, at the age of 85, Joe, who is in relatively good health, is still receiving his pension check of $652.75 each month and continues to go fishing almost every day. What I want to know is this: Is Joe going fishing these days because he wants to or because he has to?" The concept of money losing value over time (depreciation due to inflation) is not easily imagined for most people, but the value of your money over time is directly tied to your personal prospects for longevity. As the following figures illustrate, at 3% inflation your dollar is worth about 73 cents in 10 years, 54 cents in 20 years and 40 cents in 30 years.

3% Inflation If Your Initial Savings Were $1 Million
Value 10 years from today = $737,424
Value 20 years from today = $543,795
Value 30 years from today = $401,007

Inflation: Once people stop taking a paycheck they begin to pay more attention to inflation and spending power. They are suddenly confronted with such issues as cash flow, the impact of rising taxes, the impact of inflation, insurance and spending limitations that earlier seemed irrelevant.

People often aren't mentally prepared for this radical change-of-life pace and direction in their spending habits. When people are not financially or emotionally prepared for a new lifestyle, they become a bit disoriented when confronted with the reality that the day they stop taking a paycheck, the price of everything matters.

I was visiting my father in Las Vegas and we were hanging out. He asked if I wanted to go to a movie we had been talking about. I agreed, and he said, "Let's go to the early afternoon matinee." I thought to myself, "This theater is going to be empty on a Tuesday afternoon at 1 p.m." We walked into the theater and I was stunned to see almost every seat taken. I turned to my dad with a "What in the world?" look on my face as I saw a group of retired moviegoers awaiting the feature. He said, "You get $1 off on the Tuesday matinee."

William Feather said, "The reward of energy, enterprise and thrift is taxes." The reality people encounter soon enough when they stop cashing a paycheck is that taxes and gas prices continue to rise while their income becomes static. It is at this point that the thrift impulse goes into high gear and can start segueing toward fear or parsimony. We have all witnessed the progression in someone we know.

A practical issue the starry-eyed candidate for retirement often overlooks is the impact of inflation over time. If a 65-year-old has a $2 million nest egg growing annually at 5%, he can expect cash flow of $100,000 per year. When the money is adjusted for 3% inflation, its spending power is greatly diluted over time. This is a realistic projection for individuals entering the final quarter or third of their life, especially if they expect their discretionary spending to increase in retirement.

I can remember about 30 years ago a picture of Jack Nicklaus on the cover of a sports magazine with a headline about his winning $100,000 in a year. Players today win 10 times that in one tournament. What will that $100,000 represent in another 25 years? The poverty line? Who knows?

Volatility: Some years ago, I created an interactive illustration called “Retirement Roulette” that displayed stock market returns for the last 38 years in the 38 slots. Candidates broaching retirement could enter the amount of their savings and the distribution amount they wanted to receive each year, and then see their balance at the end of a 10-, 20- or 30-year period (factoring in market returns along with their withdrawals). The results were totally random. One could start with $1 million and take distributions out for $30,000 per year and at the end of 20 years have $2 million left, or one could be broke by year eight. It all depended on the vicissitudes of the stock market. The twists, turns and inconstancy of the market make for some wild rides that are not easily stomached by many in retirement.

The point of the exercise was to squeeze a 20-30 year investment journey into a 5 minute microcosm of emotion. The experience forces people to rationally consider exactly how much risk they can tolerate without sabotaging their quality of life. For many, the insecurity starts settling as soon as they collect their first Social Security check. They begin obsessing over financial details and investment returns—driving their family and their financial advisor crazy. These sudden retirees now have the time and opportunity to delve into the minutiae and can’t stay away from it. The sudden reliance on investment income as opposed to earned income can quickly trigger such an obsession. Now, the dream life of sitting on the beach and drinking mai tais is in reality obsessing over Investor’s Business Daily and drinking Pepto-Bismol.

Events: Unexpected or unprepared-for alterations in life get short shrift in the conversation around risks inherent in retirement. Events that are catastrophic, disabling, unplanned for or merely distracting upset many a retirement mirage. A spouse getting ill, a sizable investment loss, a child needing help, a parent requiring attention or monetary aid, a divorce or remarriage are all examples of events that must be considered in the retirement risks conversation. Many of the what-ifs can be addressed in the contexts of insurance coverage and/or estate planning, but too many people procrastinate or simply ignore the issues until the event is upon them and the sabotage on financial stability has begun.

I encourage you to challenge all your clients approaching the stage of cessation of paychecks to consider all the possibilities of life and to take a proactive approach. Sit down with your clients and help them to obviate the potential "event" risks ahead and you'll be doing more than helping them save more money—you may be helping them save their dignity.

Mitch Anthony is widely regarded in the financial services industry as an expert on building client relationships and has been recognized for his pioneering work in Financial Life Planning. His innovative tools for strengthening client relationships are available through his Advisor Insights™ at mitchanthony.com.