Stop Kidding Yourself about Retirement Planning

We're frequently amused by the plethora of rules of thumb that the personal finance industry throws at the investing public. Perhaps the most infamous are varying versions of: "you'll need 80% of your peak pre-retirement income during your retirement." You'd be surprised by how pervasive this inadequate rule of thumb has become. Worse yet, prolific use of this rule in retirement calculators on the web seems to validate its utility.

Well 80% might work for somebody, but here's how retirement works in the real-world in which our clients live. Soon after retiring they start traveling, they take up hobbies that are expensive (which may or may not stick), they might help out their children here and there, and they definitely spoil the grandkids a little. In those first few years they can easily spend 110% – 130% of their annual pre-retirement spending. And in truth…we stand up and applaud their efforts.

Why do mostly conservative financial advisors (like us) approve of, if not outright encourage, their seemingly lavish spending? The reason is that both client and advisor know what purveyors of the 80% thumb rule do not. That is, invariably, retiree spending starts to slow down as retirement progresses. We're certainly not suggesting that the day you retire you should spend with abandon whenever it suits your fancy. We're simply asserting that investment portfolios and withdrawals must be structured and restructured to meet the changing retirement landscape as we age, not based on a defunct rule of thumb.

As always, we prefer to look at data instead of conjecture. Examining federal consumption data confirms our suspicion that initial retirement spending can be higher than pre-retirement spending. Accordingly, findings indicate that spending declines as retirees grow older and travel and entertain less. The study found that retirement spending declines 20 percent between ages 65 and 75. And yes, that reduction factors in the rising health care costs that older Americans face today. The reality is that those rising costs are more than offset by other declining expenditures.

Consider that there exists a 50% chance that at least one member of a non-smoking couple will live to age 91. We use this data because it's taken from the year 2000 annuity mortality table. That means it's data that insurance companies use to make sure they write enough profit into their life insurance and annuity contracts, and therefore as accurate as you're going to find. Our point is that you are not likely to annually spend 80% of your peak pre-retirement income from age 75 to 91, so stop projecting your retirement needs that way!

Here's a rule of thumb: Plan for your unique retirement like a professional, forget rules of thumb intended for the masses, and focus on realistically funding your personal financial goals.