Retirement Income, Part 4

By Gary Case

Millions of Americans are entering into a dramatically different phase of their lives each year. As they transition from full-time work into retirement, they are moving from "accumulation"—building wealth through saving during their working years—to "distribution," drawing on those assets for income they can rely on for the rest of their lives. Their savings will also be the source for any legacies they may choose to leave.

This transition is more than just a move from work to retirement, it requires a major change in the way people manage their money. The "post-retirement" phase of people's financial lives poses new challenges that require a new mindset to manage. Although many principles and strategies of accumulating wealth remain valid during retirement, there are significant differences in how to apply those principles.

The consequences of not making prudent planning and investment decisions are real. On numerous occasions over the past few years people have come into my office stating that they have outlived their retirement savings. A 2003 post-retirement risk study by the Society of Actuaries found that the poverty rate among elderly widows was as high as 15%--nearly four times greater than poverty levels among elderly married couples. Lack of estate planning and inadequate life insurance coverage were two important contributors to the gap. Another factor was the fall in income caused by the death of a spouse can often be greater than the reduction of expenses.

The core principles for building lifetime wealth through financial assets are quite straightforward. Consider investing as early in life as possible; keep investing regularly; build a diversified/allocated portfolio appropriate to one's age and goals; then add an increasing share of less volatile fixed-income assets as retirement age approaches. These principles aim to avoid the risk of excessive caution early in life and excessive risk-taking close to and during retirement. They enable an individual to use time itself to overcome adverse short-term moves in stocks so as to capture the long-term growth potential they offer.

Overall, Americans have been educated about the accumulation phase, but at the point where individuals transition from building assets to drawing down their life savings, their situation becomes more complex—and the stakes of making correct choices rise. Moving from a situation where one can count on long-term averages to correct mistakes into a less forgiving world in which portfolio income must depend on current, real returns to support their lifestyle—retirees must plan based on probabilities, NOT averages. Next week I'll begin a review of probabilities during the distribution phase.

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