

Safe Money Advisory

"Major Flaws in Retirement Investing"

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It's an established fact that people at or near retirement suffer from two major flaws in their investment philosophy: first, continuing to invest at sixty-something like they're still forty, thereby exposing their savings to inappropriate risks; second, "bunching investments" in short maturities as if all their money will be used at the same time, thereby missing the opportunity of better long-term growth. Typical 65-year old couples face a 40% probability that at least one will see age 95. During the 30 years of retirement they will face risks (investment, health, natural disasters, etc.), inflation (5% annually will double prices every 14 years), and taxes (income, estate and others). These uncertainties mean that minimizing investment mistakes with retirement money is a must for most people.

What about risk? If you are near or at the end of your working career, you can't rely on an income to rebuild investment losses that reduce your principal. Yet, many people have their entire retirement nest egg positioned to suffer a loss of principal: stocks, bonds, mutual funds, variable annuities, real estate, a business, or other investments whose value fluctuates with economic conditions. A safer approach is to estimate the amount you can afford to lose, if any, and then "speculate" only with that amount. How much might that be? For the exact answer you'd have to be a fortune-teller because future risks, inflation and taxes are unknown. Even the sage advisors can't forecast the future even though they consistently offer an opinion – they just don't know they don't know. One way to "estimate" how much you can afford to gamble is to take your age (or the oldest if a couple) add 10 and subtract from 100. This is the *maximum percentage* you should risk regardless of the size of your nest egg. For example, a couple with the oldest being age 68 could afford to "risk" 22% ($100 - [68 + 10] = 22$) of their retirement nest egg. If stretching your money through retirement is a close call, don't risk any of it. And, if you have more than enough, risking principal may mean shortchanging your heirs, your favorite charity or church and more worry.

Inflation is totally beyond our control, yet it is the seed of our financial ruin if we fail to plan for it. The generic "rate of inflation" is misleading because it may not be the "basket" of things you buy. For example, retirees are not as concerned about the prices of college tuition, clothing, furniture, and other goods they already possess. However, one worrisome item for retirees is medical care because this generally becomes a relatively larger budget item in retirement. Health care costs are spiraling out of control in response to the 76 million baby boomers now reaching retirement. This age wave stranglehold on medical costs is compounded because the typical American receives 80% of their lifetime medical care in the last two years of their life. Price increases are a ticking time bomb for fixed-income retirees; thus, both inflation and emergency access to your money must be part of your retirement planning.

It has been said that neither taxes nor death can be escaped; however, both can be postponed if we are careful. Postponing taxes as long as possible is very important for our retirement money because we reap triple compounding: interest on the money we have invested, interest on the earnings not withdrawn, plus interest on the money that otherwise would be paid in taxes. Retirees constantly complain about paying taxes on nest egg earnings even though they can choose equally safe investments that defer taxes until the earnings are actually withdrawn. Why pay tax on earnings you're not using? Why not get triple compounding with tax deferral? An added plus of tax-deferral on earnings is that more Social Security benefits escape taxes. It's hard to take advantage of tax-deferral if all your money is invested in short maturities or in bank CDs.

You can simultaneously battle risk, inflation and taxes, plus avoid the two common retirement investment mistakes discussed above. Here's how. Divide your income and financial assets into three piles: one, your on-going income like Social Security, pension, rental income, etc.; two, determine the percentage of your retirement money that absolutely should not be exposed to principal loss (if uncertain, use the age plus 10 formula); three, what's left, if any, can be used to "play the market" and "hope for the big win" knowing that you may strike out but survive financially. The second pile will supplement pile one and should be accessible for emergencies. Divide pile two into maturities of 5, 10 and even 15 years because (a) you'll get a better return by committing for longer periods, (b) the triple compounding of tax-deferral increases in power the longer the investment, and (c) you'll worry a lot less knowing that you've got rock-solid investments waiting for you at every future milestone in your retirement. This is a guaranteed way to assure that you never outlive your retirement nest egg.

While this may seem mind-boggling to the retirement-minded, there is an army of qualified retirement advisors that can help. You should view their involvement as "insurance" against making mistakes like bunching your retirement money in the wrong maturity, selecting investments that can plummet in price, missing out on the power of tax-deferral, and overlooking one of the many retirement-friendly investments that have become available in the past few years. Each new decade witnesses the birth of new safe-money investments and the burying of outmoded investments that are no longer appropriate: it is hard to stay current in an area as complicated as retirement investment-planning without professional guidance. The solution is to learn all you can on your own and then engage the services of a professional with whom you feel comfortable. Otherwise, you run the risk of continuing the investment habits that worked well during your working years but which are far too risky for your current lifestyle. Old habits are hard to break, but if you don't ...

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