




**BAIRD**

**Private Wealth  
Management**

# Baird's Retirement Guide for Women

Everything You Need To Know To Retire



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## Our Time

Retirement is supposed to be “our time” – when we’re no longer spending the better parts of our days building a career or raising kids (or both!). It’s an opportunity for us to share experiences with loved ones and pursue our passions without worrying about bills or balancing our dreams against an employer’s.

But for a lot of women, that’s not how retirement plays out. Research tells us that 60% of women do not expect their income to last throughout their lifetime, and 62% are worried they won’t be able to maintain their current lifestyle in retirement.<sup>1,2</sup> Why is that? Why aren’t women as confident about enjoying retirement as men?

Part of that answer lies in financial education. As a society, we’re not good at teaching our kids – especially our daughters – about money and investing, about the importance of saving for retirement when you’re young and can benefit from compounding. So when they become adults, they’re unsure and hesitant about investing, and they miss out on the potential to grow their wealth over time.

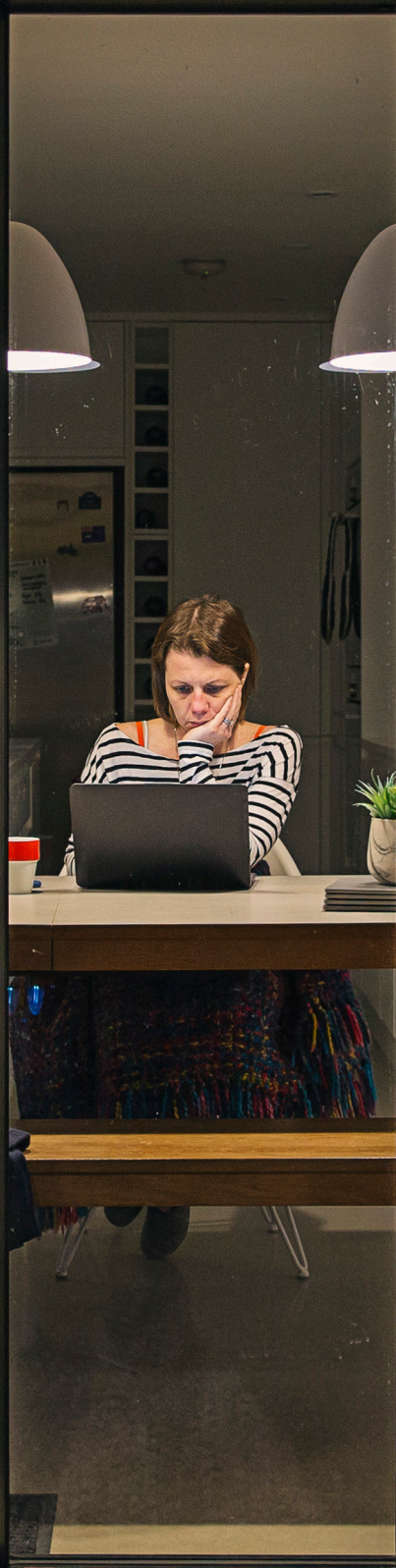
It doesn’t have to be this way. The truth is, you can take control and achieve the retirement you want. But becoming financially savvy around retirement doesn’t just happen. It starts by taking action – by learning how retirement works.

In the following pages, we’ll look at why women have been at a disadvantage when it comes to retirement planning, what expenses you should start thinking about now, the four components of wealth planning in retirement and some tips on maximizing your own nest egg. Our hope is when you’ve finished, you’ll have a good idea of where you are in your retirement journey and what steps you can take now so, when you’re ready, you can retire with confidence. And remember, if you need someone to help you create a plan or just want a sounding board to bounce ideas off of, we are here to help.

All my best,



Heather Osborn  
Financial Planning Manager  
Baird Private Wealth Management



# What Keeps You Up at Night?

While everyone has their own definition of what a perfect retirement means to them, they typically share a few common themes – more leisure time, less stress, the financial freedom to pursue opportunities you couldn't when you were younger. But for many, achieving that degree of freedom also involves a lot of sleepless nights, especially when you reach middle age and the prospect of retiring feels more palpable. Some of the questions you might be asking yourself include:

- **“Will I have enough to retire?”** When thinking about how much you put away or invested for retirement, it's easy to self-recriminate and wish you started sooner. (Once you're retired, this anxiety is often restated as, “Will I outlive my money?”)
- **“When am I going to retire?”** Are you afraid you're drawing down your retirement savings too early? Or what if you push off retiring: Will you have enough time, energy and mobility to still create the retirement you want?
- **“Am I spending too much?”** According to data from the Consumer Financial Protection Bureau, roughly half of retirees do not have the assets to maintain their pre-retirement level of spending five years into retirement.<sup>3</sup> Spending habits are exactly that – habits – and a lot of new retirees struggle to break their old spending habits once in retirement.
- **“Am I saving too little?”** The uncertain future of Social Security and skyrocketing costs of healthcare have put a premium on the need to build and maintain adequate savings.

- **“Is my portfolio growing quickly enough?”** It's important to get the investment risk/return ratio right. Too much risk in your portfolio increases the likelihood that a downturn in the market could significantly set back your plans. But if you ease off the gas too soon, you risk not generating enough return to support you in your later years.
- **“What about my loved ones?”** If there are people who rely on you for support, it's worth asking if you'll be able to provide that support in retirement. It's also worth considering your own needs – who would you turn to if you needed care?
- **“What if there are surprises I'm not ready for?”** As the saying goes, the best laid plans often go astray. A downturn in the market, an unexpected opportunity, a loved one in need – having financial flexibility could make an enormous difference in creating the retirement you want.

The truth is, it's natural to feel some uncertainty over retirement planning. While all financial goals have some degree of the unknown, the risks are greater when you need to plan for decades of life, typically with little or no income to cushion an unexpected setback. That said, just because so much is unknown doesn't mean you can't retire with confidence. You just need to be forward-thinking and establish a plan.

# How We Got Here

When it comes to retirement planning, it's important to recognize that, compared to men, women need to do more with less. There are lots of reasons for this discrepancy – some under our control, some not – but the takeaway is clear: To achieve the retirement you want, it's critical you take an active role – and the sooner the better.

## Women Tend To Have Less Wealth at Retirement ...

It's no secret that, even when accounting for potentially mitigating factors, women earn less than men – barely 82 cents on the dollar.<sup>1</sup> While an 18-cent gap might not sound like much, it can have profound, far-reaching consequences on retirement savings over the course of a career.

As we'll explore shortly, some of the main sources of funds for retirement include employer retirement plans, Social Security and personal savings and investments. This 18% disparity has a significant impact on all of them:

- The discrepancy in take-home pay results in fewer funds available to be moved into savings or invested. That difference is magnified over time as wealth accrues and is reinvested year after year.
- It also results in fewer resources available to be put into an employer retirement plan, often the biggest source of retirement funding.
- Because Social Security is based on the wages earned over a career, women earning less than men can expect a commensurate drop in Social Security income.

So for most women, three of the main sources of retirement funding are underfunded, compared to their male counterparts. But it doesn't end there:

- While a college degree can create new opportunities for career growth and increased wealth, an education alone isn't enough to narrow the gender gap: Over the course of a lifetime, a woman with a bachelor's degree earns on average just 60% what a male college graduate earns.<sup>5</sup>
- The responsibilities of caregiving still tend to fall predominantly on women – and not just for raising kids. Adult daughters are nearly twice as likely as adult sons to be the primary long-term caregiver of parents.<sup>5</sup> Not only do they incur additional expenses associated with care, but that time spent out of the workforce is time not contributing toward retirement.
- According to U.S. Census data, women are four times more likely to be single parents than men, meaning more of their income is spent caring for children.<sup>6</sup>

As a result of gender discrepancies like these, women's average retirement savings are only 59% of those of men upon entering retirement.<sup>7</sup> In the long term, we have to do a better job educating women about investing and the importance of prioritizing retirement. In the meantime, we need to focus on strategies women can take now to build up their retirement savings and knowhow.

## ... Despite Having Greater Retirement Expenses

The gender gap can be especially acute in retirement, when women can expect to have a greater need for resources – and for a longer period of time. Consider:

- On average, women live nearly 5½ years longer than men, though as we'll discuss later, that statistic undercounts the true longevity gap.<sup>8</sup> Importantly, because they are more likely to be the surviving partner, older women frequently have to assume responsibility for their spouse's medical and long-term care expenses.
- In addition to living longer, women are more likely to be single longer. According to a 2020 Pew Research study, while younger men are more likely to be single than younger women, that trend begins to reverse by age 50. At age 65 and older, nearly half of all women are single, compared to just 21% of men.<sup>9</sup>
- Women are more likely to need expensive long-term care. Research shows that women are twice as likely to be living with a disability and nearly twice as likely to develop Alzheimer's disease.<sup>10,11</sup> Women are also more likely to be enrolled in hospice and account for 70% of nursing home residents and 75% of assisted living community residents.<sup>12</sup> Among those 75 or older, women are 60% more likely than men to need help with activities of daily living like bathing or feeding themselves.<sup>13</sup>
- Women are more likely to be caregivers. According to a recent report by the Family Caregiver Alliance, two-thirds of caregivers are women, who spend up to 50% more time providing care than their male counterparts.<sup>14</sup>

As much attention is placed on the income gap between men and women, there seems to be a general misunderstanding that men's and women's expenses in retirement are roughly equal. Recognizing that women can have much greater expenses in retirement should be top-of-mind for any woman – or couple – making decisions surrounding retirement.

# Retiring With Confidence

While women undoubtedly have extra challenges to overcome when planning and saving for retirement, research has shown that when they are educated on money and investing, they tend to be better investors than their male counterparts. According to recent studies:

- **Women tend to be better savers.** Research looking at personal banking behavior found that women put 9% of their paychecks into savings and 12.4% into their IRA and brokerage accounts, compared to 8.6% and 11.6% for men.<sup>15</sup>
- **Women tend to be better investors.** That same study found that women's portfolios earned 0.4% more annually than men's – a difference that could be worth hundreds of thousands of dollars over the course of a career. Part of this discrepancy could be explained by patience: A 2001 study in the *Quarterly Journal of Economics* found that male investors traded 45% more often than women, reducing their net returns by 0.93%.<sup>16</sup>
- **Women are taking more control over their family's investment decisions.** Baird's own research from 2021 has found that 85% of all women play an active role in managing their household's investments, and 43% consider themselves to be the primary decision-maker.<sup>17</sup>

- **Women achieved better investment results with less risk.** According to a 2016 study by the Wealth and Investment Management Analytics group, female investors achieved higher returns while taking on less risk compared to men.<sup>18</sup>

So why are only 17% of women reporting that they are "very confident" they'll be able to retire comfortably?<sup>19</sup> Why do more than one-third of younger affluent women report having a real fear of running out of money?<sup>17</sup>

The key to retiring with confidence – to putting those advantages to work for you and your future – is similar to achieving any large goal. It's about understanding where you are now, where you want to go and how to get there in the way that's best for you. The next section will focus on that journey – the advantages you bring, the obstacles you face – as you evaluate your financial readiness for retirement.

Importantly, as you think about retiring with confidence, be sure to also consider how your life might evolve in the coming years and decades, in unexpected and potentially unwelcome ways. How prepared are you to address any health concerns that often accompany getting older? If you are married, how prepared are you in the event of divorce or widowhood? Now is the time to learn and build up your confidence so that – if needed – you'll be able to stand on your own.

## More than half of all women age 70 or older are widowed or divorced.<sup>20</sup>

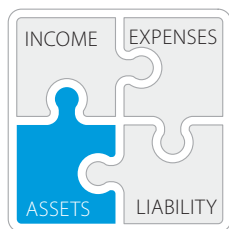
Percentages are rounded.

- Married 43%
- Unmarried 5%
- Widowed 39%
- Divorced / Separated 14%



# Understanding Your Wealth

Getting a handle on your own retirement readiness starts with evaluating your current financial health – call it the starting point on your journey to retiring with confidence. We break down your financial picture into four discrete components: retirement assets, income, liabilities and expenses. When you understand these four components of your personal wealth, you can start putting together a plan toward achieving the retirement you want.



## Assets

Your retirement assets are the financial resources you're bringing to support yourself in retirement – the money you'll live off of in your golden years. For most people, these will be what are known as qualified retirement accounts, such as an IRA or 401(k), though your personal savings and certain tax-free accounts could be included here too. Let's take a closer look at each of these.

### QUALIFIED RETIREMENT ACCOUNTS

Qualified retirement accounts are investment accounts that provide certain tax benefits when used toward retirement. The most common are defined contribution plans (such as 401(k), 403(b) or employee stock ownership plans) and individual retirement accounts, or IRAs. They both operate on the same basic principle – money is invested on your behalf and, so long as certain Internal Revenue Service rules are followed, can be withdrawn as needed while providing tax advantages along the way. The specifics around how and when you can withdraw funds from these accounts and the tax advantages will vary per plan, as do the penalties for early withdrawals

#### 401(k)s and Other Defined Contribution Plans

You might be familiar with a retirement plan known as a pension, where a business will pay a retired employee a monthly stipend for the rest of their lives based on factors like how long the employee worked at the company and their annual earnings. (Pensions will be covered later in this guide, when we talk about Income.) In the 1980s, companies started to phase out defined benefit plans like pensions and replace them with defined contribution plans like 401(k)s.

Unlike a defined benefit plan, a defined contribution plan does not promise a monthly retirement benefit. Instead, both the employee and employer can contribute to the employee's individual retirement account, and those dollars are invested on the employee's behalf. Over time, these accounts are intended to grow through additional employer / employee contributions and potential investment gains into a valuable retirement nest egg. 401(k)s are the most popular defined contribution plan in the private sector; other defined contribution plans include 403(b) plans, employee stock ownership plans and profit-sharing plans.

Defined contribution plans allow your contributions to grow tax-deferred, which is to say that taxes are not applied to either

the employee contributions (which the employer withholds from your paycheck pretax) or on the growth of the investments. Taxes are only paid once money is withdrawn, ideally (but not exclusively) during retirement. There are also many federal regulations specifying how much you can contribute to a defined contribution plan, the circumstances under which you can withdrawal and any penalties for withdrawing early.

#### Divorce and Widowhood

Funds contributed to a defined contribution account during a marriage are typically considered marital property – unless there is an existing prenuptial agreement stipulating otherwise, each divorcing spouse is entitled to half of the value of the account. A divorce is one of the few instances that allows you to access your 401(k) early without a tax penalty.

In the event of the death of a defined contribution account holder, the funds will be directed to the designated beneficiary of the account. (The beneficiary is named when the account is set up but can be changed at the behest of the account holder.) If you are the designated beneficiary, you can withdraw the money from the account (and pay whatever taxes are due), roll the account over into an IRA, move the money into what is known as an inherited IRA or simply decline it.

#### Individual Retirement Accounts (IRAs)

Fortunately, tax-advantaged retirement plans are not limited to just those offered by businesses to their employees. You

### Strategies for Maximizing Your Defined Contribution Plan

- Take advantage of the employer match. Many companies will incentivize employees saving for retirement through an employer match program, where they will match a portion of what the employee contributes. (For example, the program might stipulate that for every dollar the employee contributes to their 401(k), the company will match it, up to \$5,000.) This is free money that can boost anyone's nest egg.
- Make catch-up contributions. The IRS allows individuals aged 50 or older to make annual catch-up contributions to many defined contribution plans, including 401(k)s. This could be an opportunity to make up for time out of the workforce or for periods where you weren't able to save as much for retirement.

can create your own in what is referred to as an individual retirement account, or IRA.

Much like defined contribution plans, IRAs are investment accounts that offer significant tax advantages as you build your retirement funds. While there are different kinds of IRAs, they generally come in two flavors – traditional and Roth. Here are three main differences between the two:

- **Eligibility.** Unlike a traditional IRA, with a Roth IRA, you must remain below a certain income threshold (based on tax filing status) to be eligible. That said, if you earn too much to be eligible to open a Roth IRA, you have the option of opening a traditional IRA and converting to a Roth later.
- **Contributions.** If your income falls below a specified threshold (again based on tax filing status), you obtain an immediate tax break on contributions with a traditional IRA, allowing you to lower your taxable income for the year in which you contribute. Roth IRAs do not offer an upfront tax break.
- **Withdrawals.** While you can withdraw from a traditional IRA after age 59½ without penalty, you pay current tax rates on the withdrawal, and you are obligated to start making withdrawals at age 72. With a Roth IRA, withdrawals after age 59½ are tax-free so long you've had the account for at least five years, and there are no required minimum distributions.

Whether it's a traditional or a Roth, the major benefits to having an IRA are the same as for defined benefit and contribution plans and health savings accounts – they have the potential to grow over time by accessing the markets and offer significant tax advantages.

### Divorce and Widowhood

Regardless of whether it's a traditional IRA or a Roth IRA, the rules surrounding the division of these assets after a divorce generally follow each state's community property state rules. If the IRA was opened during the marriage, it is considered marital property, while if the IRA existed before the marriage, only contributions made during the marriage with joint funds are considered marital property. In the event of the death of a spouse, your options will vary depending on such factors as your age, the age of the deceased spouse and if your spouse designated others as co-beneficiaries. Generally your choices are similar to those with a defined contribution plan: You can distribute the assets (with a penalty), roll the assets into a different retirement account or decline the assets.

### PERSONAL SAVINGS

Personal savings generally aren't considered a main source of retirement funds: With 2020 savings account yields topping out at 0.1% and money market accounts yielding less than 0.25%,<sup>21</sup> it's hard to benefit from compounding in those types of accounts, even over long periods of time. Still, there's a role for these types of accounts in retirement.

What savings and money market accounts lack in generating interest, they make up for in accessibility and flexibility. If you have a large, unexpected expense (such as a tax bill), tapping

your portfolio can raise all kinds of complications. (Which stock are you going to sell? What are the tax implications of selling stock? Does a stock sale impact your broader financial plans? How long will it take for the transaction to be completed? What fees will the sale incur?) A robust personal savings account lets you cover emergency or even day-to-day expenses without necessitating a stock sale. Given the importance of making sure your portfolio lasts, a personal savings account can be especially useful in retirement.

### TAX-FREE ACCOUNTS

Most retirement accounts offer certain tax advantages, such as tax deferrals or tax-free distributions, but very few are wholly tax-free. Some 529 education savings accounts can be entirely tax-free, if used as designed: Depending on the laws of your state, you can put money into your 529 plan and take it out without ever paying any state income taxes on that income.

One tax-free account that might be of particular use to anyone considering retirement is the Health Savings Account, or HSA. Investments in an HSA go in tax-free, grow tax-free and – so long as they're used for qualified health expenses – can be withdrawn tax-free. Plus, because the IRS doesn't require you to pay for healthcare expenses in the same year that you incur them, you can pay for your healthcare expenses out of pocket and then reimburse yourself from your HSA contributions years later.

Given the skyrocketing costs of healthcare, an HSA account can be a valuable addition to your retirement financial plans.

### Strategies for Maximizing Your IRA

- For both traditional and Roth IRAs, you are limited in how much you can contribute in a given year (currently \$6,000). Like 401(k)s, though, if you are age 50 or older, you can make an additional "catch-up" contribution of \$1,000 per year.
- While it's not the only reason to consider a Roth IRA over a traditional IRA, longevity is a significant one. The longer you live, the longer you would pay taxes with a traditional IRA – which could make tax-free withdrawals from a Roth IRA especially appealing to women with a long life expectancy.
- Typically, you can fund your IRA only with income you earn. A rare exception to this rule is what's known as a spousal IRA. A spousal IRA is a traditional or Roth IRA in the name of the non-working spouse that the working spouse can contribute to. There are certain eligibility requirements – for example, the married couple has to file their taxes jointly – but it is a strategy that lets married couples essentially double how much they could contribute to their IRAs otherwise.

# Understanding Your Wealth



## Income

While the bulk of most people's nest eggs are funded with retirement assets, you can supplement them with retirement income. For more people, retirement income will be generated from working, monthly Social Security benefits, a defined benefit plan like a pension, annuities, portfolio dividends or owning a business or real estate. In retirement, even modest regular income can go a long way toward reducing how quickly you need to draw down your assets.

### WORK INCOME

For some, the idea of working while in retirement is a non-starter – after all, the point of retiring is to enjoy your lifestyle without the pressures and commitment of a career. Still, there are a lot of benefits – financial and otherwise – to working in some capacity while still being retired:

- **A reliable income stream.** Having a regular paycheck, even if it's not as large as what you earned while working, can supplement your retirement savings and decrease the need to draw down your nest egg. It might also help you delay filing for Social Security, which could result in bigger payments when you're in your 70s and beyond. Given current trends for women and longevity, a larger Social Security check in their 80s and 90s could be invaluable.
- **Additional contributions into a 401(k) or IRA.** Retirement plans typically can only be funded through earnings – the longer you work, the longer you can contribute. This can be especially important for women, who often enter retirement with a smaller nest egg than men.

- **Health insurance.** One of the biggest – and hardest to predict – expenses in retirement is healthcare. Many working retirees find that the health coverage is more important to them than the paycheck.
- **Structure and purpose.** Humans tend to be creatures of routine, and a lot of retirees struggle with the transition from a 40-hour work week to a 0-hour work week. Working even part-time gives them structure, something to do and a feeling of achievement, that they're still contributing and useful members of society.
- **Social interaction.** Working in retirement also allows retirees to broaden their circle of friends and stay socially stimulated. This holds true for married couples and especially those who are single.

It can also give you an opportunity to start a second career. Maybe there was a business you wanted to start, but you didn't have the time for during your working years – or you didn't want to jeopardize your financial goals on an exciting but risky new venture. Retirement could be an ideal time to explore your interests and try something you're really passionate about.

### Divorce and Widowhood

Unlike some of the other components of retirement funding, the decision to work in retirement is not impacted by marital status. That said, it's important not to underestimate the social and structural benefits of working as a widow or divorcee. As we get older, having a support network becomes that much more critical. A recent article in *Psychology, Health and Medicine* found that among people aged 65 and older, social engagement – and, notably, not family relationships – was associated with better quality of life and self-rated happiness.<sup>22</sup>

## Strategies While Earning Income During Retirement

- If you file for Social Security before reaching Full Retirement Age, your earned income in retirement could reduce your monthly Social Security benefit.<sup>23</sup> In 2021, for every \$2 above \$18,960, \$1 will be deducted from your monthly benefit. Note that you will receive higher monthly benefits after you reach Full Retirement Age if benefits are withheld because of your income.
- Similarly, if you earn a substantial income in addition to your benefits, you might be responsible for federal income taxes. Depending on your tax filing status and total combined earnings, up to 85% of your benefits might be taxable.
- Know that working during retirement could bump you into a higher tax bracket, causing you to pay more tax on your IRA or 401(k) distributions.



# Income

## SOCIAL SECURITY

Since 1940, Social Security has been helping workers navigate retirement after their careers have ended and paychecks stopped coming in. The program is relatively straightforward: The federal government withholds a percentage of each paycheck during your career (currently 6.2%, plus an additional 6.2% withholding from your employer), and in return, you receive inflation-adjusted retirement benefits that never run out. Generally, the more you earn during your working career (and thus the more that gets withheld), the greater the monthly benefit in retirement.


To qualify for Social Security, you need to have been working (and contributing to Social Security) for at least 10 years, and your benefit is based on the 35 years in which you earned the most income. Note that the average monthly benefit is roughly \$1,400 per month, so most people shouldn't rely solely on Social Security for funding their retirement.<sup>24</sup> You can file for Social Security as early as age 62 (for a reduced benefit) or as late as age 70 (for the maximum benefit).

## Divorce and Widowhood

The spousal benefit can also apply to divorced couples, but only if certain criteria are met. If you are divorced, you can claim the spousal benefit if (1) the marriage lasted at least 10 years, (2) you haven't remarried and (3) your ex-spouse is age 62 or older. You can also claim the spousal benefit even if your ex-spouse remarries or hasn't filed for Social Security. In the event of widowhood, you can collect your deceased spouse's full retirement benefit at age 60. Disabled survivors can collect survivor benefits beginning at age 50, and if the survivor is caring for children under age 16, the benefits start immediately.

# 22%

The average annual Social Security benefit collected by a 65-year-old woman is 22% less than that collected by a 65-year-old man.<sup>5</sup>



## Social Security

### Strategies for Maximizing Your Social Security Benefits

- Generally, the longer you can delay filing for Social Security, the better – you would get monthly checks sooner by filing at age 62 rather than what is known as Full Retirement Age (currently age 66 or 67, depending on when you were born), but those checks would be 30% smaller. Your lifespan is the key: Someone who lives into her 80s and 90s might be better served by waiting and maximizing her Social Security benefit.
- The Social Security program also provides spousal benefits that can be worth up to half of your spouse's benefit. If your own retirement benefit would be less than half of your spouse's, you would automatically get the larger amount.
- If you choose to file early, you can suspend your monthly payments upon reaching your Full Retirement Age and earned delayed retirement credits. Those credits can boost your monthly payments by as much as 8% per year when you resume.<sup>22</sup>

## PENSIONS AND OTHER DEFINED BENEFIT PLANS

As the name suggests, defined benefit plans provide the retired employee with a fixed (“defined”) monthly payment. Each organization will have its own formula for calculating the monthly benefit, but it’s typically based on such factors as years of service with the company, role and compensation. Most defined benefit plan benefits are taxable as ordinary income.

For retirement planning, the biggest advantages to defined benefit plans are that the monthly benefit is fixed and guaranteed. Because the amount is fixed, you know exactly how much you can expect every month in retirement, regardless of how the stock market is performing. Most plans are also insured by the federal government through the Pension Benefit Guaranty Corporation, so even if your company cannot meet its financial obligations, the PBGC will step in as needed.

If you have a defined benefit plan, it’s especially important to understand the details, including eligibility requirements, vesting and what happens to your pension if you retire early or switch jobs. In some cases, your pension benefit might be reduced when you begin to take Social Security.

### Divorce and Widowhood

If your spouse has a pension and you are a beneficiary, you can request a summary plan description from your spouse’s employer. That description would provide a list of benefits, including potential survivor or other benefits in the event of the death of your spouse. If you and your spouse divorce, you still might be able to secure a portion of your spouse’s pension benefit through a qualified domestic relations order. Contact your spouse’s plan administrator for a list of all QDRO requirements.

## ANNUITIES

Social Security and pensions aren’t your only options for generating income for life. Annuities can provide monthly or annual income as well, although they are a complicated retirement savings instrument that’s not for everyone.

All annuities are built on a basic premise: The buyer purchases an annuity, and in return, the insurance company would provide guaranteed payments back to the buyer. Within that structure though can be a wide variety of options. With a fixed annuity, you know exactly how much the payments coming back to you will be, which can simplify the planning process, while income from variable annuities will fluctuate with the market, increasing the potential for return but also risk. With an immediate annuity, you would pay the insurer a lump sum (like a retirement nest egg) and start collecting payments right away, while with a deferred annuity, you don’t start receiving payments until a specified date, which gives your investment time to grow. And the variations only grow from there.

Two of annuities’ biggest advantages are the potential for guaranteed income for life, no matter how long you live, and that taxes are deferred until you withdraw, giving you some measure of control for tax planning purposes. But they can also be very complex, carry substantial fees and are typically illiquid investments, often charging a hefty surrender fee should you decide you need to withdraw funds sooner than anticipated. Distributions are also taxed as ordinary income, as compared to the tax-friendlier capital gains rate. For these reasons, it might be prudent to first sit down with a Baird Financial Advisor and explore how annuities could fit in your financial plan.

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The biggest difference between a defined benefit plan (such as a pension) and a defined contribution plan (such as a 401(k) or employee stock ownership plan) is the source of funding: Businesses are responsible for funding and managing their defined benefit plans, while for defined contribution plans those responsibilities fall to the employee.



DEFINED BENEFIT PLANS



DEFINED CONTRIBUTION PLANS

# Income

## PORTFOLIO-GENERATED INCOME

In addition to providing a nest egg you can draw down from, certain investments in your portfolio can also provide income in retirement. The most common source of portfolio-generated income is through interest (typically from bonds) and dividends (typically from certain blue-chip stocks).

Interest income is generated by corporate and municipal bonds, mutual funds that invest in bonds, certificates of deposit and money market funds. Interest is paid on a regular schedule – typically semiannually, although some investments will pay interest monthly, quarterly or annually. While all bonds carry some level of risk, they are typically considered safer investments than stocks, and with that safety comes a more muted return in interest.

Dividend income, on the other hand, is paid out by stocks and mutual funds that own stocks. They are usually paid out quarterly, though some companies pay them out semiannually or annually, and dividends must first be approved by the company's board of directors. Investments in dividend-paying companies are often expensive (compared to the rest of the market) but also lower-risk: Companies that issue dividends usually are well-established and no longer need to reinvest much money back into their business. Dividend income is usually taxed at the same rate as capital gains tax rates, which are less than ordinary income tax rates.

You might be tempted to invest heavily in these kinds of investments and live off the income they generate. It's important to understand that none of these returns are guaranteed: Blue-chip companies might choose to reduce or forgo a quarterly dividend, bonds can default or mature in a lower-yield environment than when you originally purchased them (meaning a newer bond might not return as much yield), high-yield bonds are riskier investments than lower-risk Treasury bonds. Plus the income they generate might not be sufficient to meet your spending in retirement.

## BUSINESS OWNERSHIP

For many business owners, their company is more than their life's calling – it's their source of income in retirement. A 2018 New York Life survey found that 42% of small-business owners anticipate using income from their business as their own "personal pension."<sup>25</sup> While business owners should absolutely plan to incorporate the wealth their company has generated into their future plans, there's risk in relying on business revenue or proceeds as a savings account to pay your monthly bills in retirement:

- One of the biggest risks in retirement planning is baking in continued good health – especially if you plan on continuing to run your business in retirement. The truth is, there's no way to tell how well, or how long, you'll be able to manage your business when you're older. Maybe you'll have the capacity to keep things running smoothly, or maybe poor health or declining energy will keep you from devoting the time needed to keep your business afloat. You don't want to have to continue running your business just to continue funding retirement.
- If you anticipate selling your business or are relying on continued business growth to sustain you in retirement, you're opening yourself up to seeing your plans derailed by everyday business challenges. Were economic conditions to change or a new competitor or technology cut into your profit margins, you might see your business income take a serious hit – leaving you with few options to make up for those losses.

That's why it's crucial to save for retirement as a small-business owner, even if you expect to continue running your business into your 60s and beyond. It also means giving serious thought to an exit strategy (transferring the business, selling it, taking it public) and setting up a more formal retirement plan, like an IRA or Solo 401(k). That retirement plan, coupled with whatever revenue you do make from the operation or sale of your business, could be enough to create the nest egg to help you retire with confidence.

# 46%

46% of small-business owners do not have a backup plan if they are unable to sell their business or if the proceeds are not sufficient for retirement.<sup>25</sup>

## REAL ESTATE

Real estate can also provide a steady income stream ahead of and even into retirement, even if you have no interest in managing a property yourself. There is a wide variety of ways to profit through real estate, from investing in real estate investment trusts to crowdfunding platforms to securing your own rental property.

A big advantage to real estate as a revenue stream in retirement is that it's typically not correlated with the stock market. One of the major risks of investing is when your portfolio isn't sufficiently diversified – when too many investments in your portfolio increase or decrease in value together. Having too much of your portfolio decline in retirement could be especially harmful, as most retirees have neither the time nor the revenue sources to recoup any losses. Because the income generated through real estate is not primarily correlated with stocks, it can be a helpful revenue source especially in a down market.

There are other advantages too. Not only do real estate assets typically appreciate over time, but as a landlord, you would benefit from having your renters pay off your mortgage for you. Eventually, renters could pay off the entire mortgage, leaving you with an additional retirement asset. Plus real estate properties come with their own set of tax benefits.

If you decide to manage a property yourself, though, be aware that this kind of “passive income” might not be passive enough for your lifestyle: Between identifying and evaluating renters, maintaining the property and collecting rent, renting out property might involve more of your time and energy than you're willing to invest.

# 15 years

According to the nonpartisan Committee for a Responsible Federal Budget, Social Security has been running at a deficit since 2010 – and barring additional funding, projects to be depleted within the next 15 years.<sup>26,27</sup>

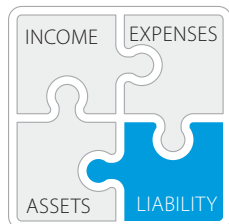
## Having Multiple Paths to Generating Income in Retirement

Our ability to build a suitable nest egg and retire with confidence hinges on how well we can build our resources – and, ideally, from diverse funding sources. The old adage “don't put all your eggs in one basket” is often cited with investing and asset allocation, but it also applies to how you fund retirement. Consider:

- Social Security can make up a significant portion of your monthly income in retirement . . . but it's uncertain how long the program will last. According to the nonpartisan Committee for a Responsible Federal Budget, Social Security has been running at a deficit since 2010 – and barring additional funding, projects to be depleted within the next 15 years.<sup>26,27</sup> While legislation out of Washington could prevent that from happening, it might be prudent to adjust your plans now so you don't have to rely on a full Social Security benefit.
- It's one thing to plan on working in retirement when you're still young – but will you still want to when you're 70? Or, more to the point: Will you still be able to? Results from the 2019 U.S. Census Bureau's American Community Survey indicate that more than one-third of people age 65 and older reported having some type of disability.<sup>24</sup>

A major component of retiring with confidence is making sure the funds you'll rely on in retirement will be there when you need them. The best way to remove that uncertainty is to build up the funds under your control – contributions to an employer's retirement plan (especially when they offer a match) and your own personal savings and investments.

# Understanding Your Wealth



## Liabilities

Liabilities are your debts – anything you owe. It can be in the form of a loan (like for a mortgage) or a line of credit (like credit cards), and it can have an interest rate that's fixed (unchanging) or variable (goes up and down based on the current federal funds rate). While some debt is considered to be better than others (think \$20,000 in student loan debt to advance your career vs. \$20,000 in credit card debt), it all has to get paid off sooner or later – and ideally before retirement, while you still have income to service it.

### MORTGAGES

A mortgage is often the largest debt people carry leading up and into retirement, and many try to time their last payment with their entry into retirement to free up cash flow. After all, it's a lot easier to stretch your retirement income and assets if you can remove that hefty monthly payment, and with 2017's Tax Cuts and Jobs Act reducing or eliminating many of the tax benefits to owning a mortgage, it can make sense to pay it off before retirement.

That said, while a mortgage is often the largest debt people have in retirement, it also tends to be the cheapest in terms of interest rates. If the cash you're using to pay off a mortgage can be used more productively (like paying off more expensive credit card debt) or would require a distribution that increases your taxable income, you might be better served keeping it even into retirement. It all depends on your particular financial situation.

As you weigh the pros and cons, be sure to also consider how you feel about debt more broadly. For some, having that burden lifted as they enter retirement is worth missing out on any potential advantages. It comes down to what gives you the most peace of mind.

### Reverse Mortgages

You might have seen late-night advertisements for reverse mortgages and wondered if they were legitimate. They are – but they're not for everyone.

A reverse mortgage is an option for anyone over the age of 62 who owns their own home. It essentially lets you take out a loan against the equity in your home – a loan you don't have to repay during your lifetime so long as you are living in your home and don't sell it. When the homeowner dies or moves out, the homeowner or heirs can refinance the loan or sell the home to pay it off, or the lender can sell the home to settle the loan balance.

In some cases, a reverse mortgage can be a useful tool in retirement, such as if you have extensive credit card debt. But there are significant risks that must be considered:

1. With a reverse mortgage, ***your debt increases over time*** due to the interest on the loan.
2. There are substantial costs involved, such as loan origination and interest payments.
3. If you need to move out of the house quickly (due to health reasons, for example), your property could be sold to pay off the loan.

If not handled carefully, a reverse mortgage can have major repercussions on your finances and what you leave to your heirs. Before considering this option, it's worth having a conversation with your Baird Financial Advisor and estate planning team.

### NON-MORTGAGE DEBT

Owning debt isn't necessarily a bad thing – without it first homes aren't purchased, businesses aren't started, cars aren't purchased (and so jobs aren't driven to). If not managed carefully and appropriately, though, it can lead to financial ruin – sometimes quickly. This is especially true in retirement, when you likely have less income to service it.

It's a lot easier to enter retirement confidently and enjoying meaningful experiences if you're not burdened by debt (particularly debt incurred to purchase assets that depreciate over time – think credit cards and car loans). Here are some tips to reduce your debt burden both leading up to retirement and once you're retired.

### Leading up to retirement:

- **Make a plan.** There are lots of ways to pay down debt, from the “snowball method” to the “avalanche method” to contacting lenders directly. Even if retirement is only a few years away, you can make a lot of progress in a short amount of time – but the sooner you get started, the better.
- **Pay attention to the percentages.** All else being equal, debt with higher interest rates costs you the most in interest. There’s no point in paying extra on a mortgage of 3% if you have credit card debt of 18%.
- **Don’t forget about retirement savings.** As much as you might want to own your house free and clear, it might make sense contributing more to an IRA earning 7% than paying down a mortgage on a 3% interest rate.

### Once you’re in retirement:

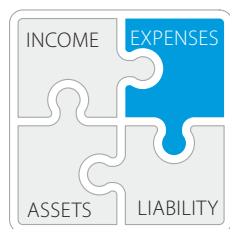
- **Account for debt in your retirement budget.** Entering retirement debt-free would be nice, but that’s not always feasible. Make sure your budget considers both servicing that debt and how to keep your monthly spending from contributing to it. Ideally, you want to be at a point financially where you use credit cards strictly for convenience or to earn reward points, not out of necessity.
- **Explore paying it down with retirement savings.** Depending on where you find yourself in retirement, it might be worthwhile to pay off debt with your retirement funds. There will likely be tax consequences from the distribution – plus it’s essential you don’t see an untapped credit limit as an opportunity to spend more – but in some cases it could make sense.
- **Try not to leave debt to your heirs.** The laws vary by state, but typically your debts don’t die with you – your estate would be responsible for prioritizing them ahead of your heirs. That’s a legacy most people wouldn’t want to be remembered for.

Paying down debt often goes hand-in-hand with managing your spending. In the last section of Understanding Your Wealth, we’ll look at your expenses, both now and what to expect when you retire.

**According to a 2020 Experian study, baby boomers carry more than \$6,700 in credit card debt and more than \$25,000 in non-mortgage debt.<sup>28</sup>**



# Understanding Your Wealth



## Expenses

Of the four components to your financial picture, your spending is arguably the one you have the most control over. Success or failure in this category isn't determined by outside forces like interest rates or market performance: Your spending is entirely up to you, and the decisions you make in this category directly affect the other three.

Spending in retirement can be broken down largely into four discrete categories: living expenses (including housing), transportation, healthcare, and food and entertainment.

### LIVING EXPENSES

These expenses comprise spending related to housing, like a mortgage, property taxes, insurance, utilities and repairs. It also includes regular maintenance – which is something a lot of retirees and preretirees overlook. If you plan on staying in your house for 20 or 30 years in retirement, for example, you need to plan for big-ticket expenses like replacing the roof and swapping out appliances. A good rule of thumb is to anticipate spending 1% of your home's total value on repairs each year, or more if you have an older property.

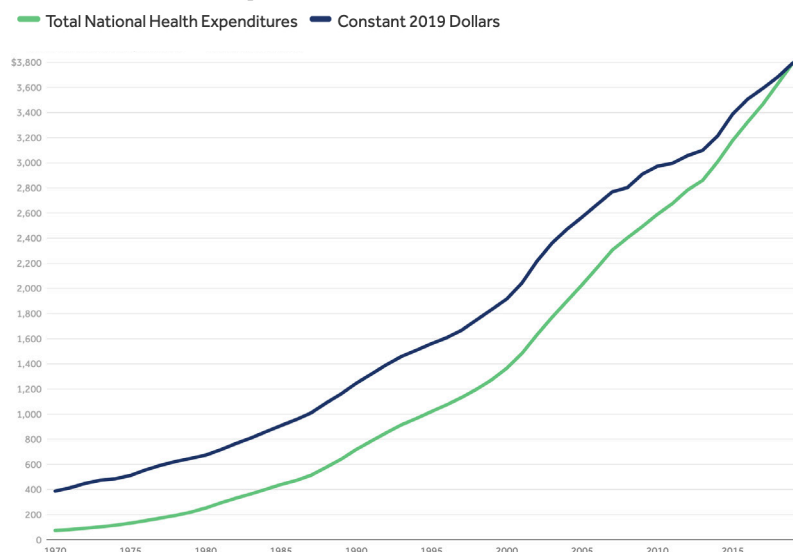
### TRANSPORTATION

For many people, the early years of retirement are characterized by lots of travel, either visiting family or just vacationing. If that sounds appealing to you, be sure to plan on budgeting for transportation. That means that transportation costs can be a major expense, especially early in retirement. That includes not only automobiles (which, like the roof, you might need to replace multiple times) and maintenance, but also gasoline, insurance and airfare.

As we discuss in the sidebar, when mapping out expenses, it might be helpful to remember that different phases of retirement have different financial needs. According to reporting by SoFi, people aged 65 to 74 spend \$7,851 per year on transportation on average, compared to \$4,963 per year for people 75 and older.<sup>29</sup> As you make your own retirement plans, consider what travel you'll like to do, but also where you'd like to live when you are less interested or able to make long trips in the car.

## HEALTHCARE

Total national health expenditures, US \$ Billions, 1970-2019



Healthcare costs have risen steadily over the past 50 years.

Source: KFF analysis of National Health Expenditure (NHE) data.<sup>30</sup>

Healthcare is one of the few areas where retirees outspend the national average. Whether it's due to chronic disease like arthritis or Alzheimer's, injuries from falling or just the body wearing down, retirees should expect to spend more on healthcare than they have at any other time in their lives. A 2015 National Bureau of Economic Research working paper reported that medical expenses tend to more than double between ages 70 and 90, and with average medical spending exceeding \$25,000 per year for those in their 90s.<sup>31</sup>

One way to combat the high price of healthcare in retirement is through lifestyle choices. For example, a study in the *New England Journal of Medicine* found that healthcare costs for smokers can be as much as 40% higher than those for nonsmokers.<sup>32</sup> A 2020 *Lancet* study reported that among 84 modifiable risk factors, high body mass index and high cholesterol resulted in the greatest healthcare spending among people aged 45 to 64 and those 65 and older.<sup>33</sup> Making lifestyle changes before entering retirement can not only create a higher quality of life, but it can also reduce how much you spend on healthcare.



Retirees aged  
65 to 74  
spend roughly  
\$53,000 per year.<sup>29</sup>

## How Spending Evolves in Retirement

When we think about retirement, it's often as if our golden years are one unchanging block of time. The truth is, your lifestyles when you first enter retirement will likely be vastly different than in your later years. This discrepancy is also reflected in retirees' spending: According to SoFi, retirees aged 65 to 74 spend roughly \$53,000 per year, while those aged 75 and older spend less than \$42,000 annually, on average.<sup>29</sup>

As retirees' needs change throughout retirement, so does their spending.

There are also financial steps you can take to help mitigate the high costs of healthcare. We previously mentioned health savings accounts, which offer tax-advantaged savings specifically for healthcare expenses. Long-term care insurance can also reduce your healthcare spending in retirement. This kind of insurance is intended to cover the costs of care when you have a chronic medical condition, disability or disorder, including hospice or respite care, residential care facilities and home-based care. However, you can't purchase a policy only when you need assistance: Chances are you won't qualify for long-term care insurance if you already have a debilitating condition. Most people with long-term care insurance buy it in their mid-50s to mid-60s.

## FOOD AND ENTERTAINMENT

Food and entertainment expenses include activities like eating in or dining out, going to museums or the movies, and hobbies. Just as with transportation, expenses in this category tend to decrease through retirement over time. According to SoFi data, people aged 65 to 74 spend \$6,992 per year on food and \$2,556 per year on entertainment. By comparison, those over age 75 spend only \$5,294 and \$1,889 annually on food and entertainment, presumably as interest in and ease of driving or flying diminishes.<sup>29</sup> While these are only national averages and might not reflect the retirement experience you're interested in, they're a good starting point as you consider your own plans.

# Where We Go From Here

## IDENTIFY YOUR SPENDING GOALS

So how do these four components of wealth – assets, income, liabilities and expenses – shape your own financial picture? What can you do now so that when it's time to retire, you can do so with confidence? A good place to start is by looking at your current spending – after all, what you spend in retirement will to some degree be informed by what you spend today.

While retirement will commonly have some bucket-list items, like traveling or starting a second career, many of your day-to-day activities will resemble the types of things you're doing now. Your favorite pastimes now will likely still be a part of your life in retirement, and if you like going out to eat for Sunday brunch, you'll likely still enjoy doing that down the road. Going through your monthly statements won't tell the whole story, but it will help your retirement picture come into focus.

But perhaps the most important thing to understand about retirement is that your ideal retirement is unique to you. Moving to a warm state and golfing three times per week isn't your only choice – your retirement might involve travel, moving somewhere close to the kids or taking up new hobbies. It might even involve not retiring at all – many people choose this time to start a second career, one that lets them explore activities that are more meaningful to them.

As you think about your options, ask yourself what would make you content. Start with the activities and lifestyle that you would find personally enriching and build around them. Other considerations might include:

- **Where do you want to live?** Do you want to be close to family and friends? What kind of climate most appeals to you? It's worth giving some thought to taxes and cost of living in different locales, but you don't want to trade your happiness for a lower tax rate.
- **What healthcare needs do you anticipate?** While genetics aren't destiny, consider your family health history when making decisions around residence, travel, pastimes and finances. Health savings accounts can be an incredibly valuable tool for mitigating the high costs of healthcare: Not only are they funded with pretax dollars (lowering your taxable income), but any potential growth of your investments and qualified withdrawals are tax-free as well – all for expenses that are virtually inevitable.
- **How long will you live – and how long will you live alone?** Longevity data from 2020 point to women living on average 80.5 years, compared to 75.1 years for men. However, a closer look at Social Security actuarial data reveals the actual longevity difference to be much greater. After age 65, two-thirds of women outlive their husbands – and then go on to live an additional 11.5 years.<sup>34</sup>

- **Who are the people closest to you?** Think about the people and causes that mean the most to you. Your relationship with them could impact decisions on where you live, who makes financial and healthcare decisions in the event you are incapacitated, travel plans, how you might want to support them after you're gone and much more.
- **How do you currently handle surprise expenses?** According to a recent Society of Actuaries survey of U.S. retirees, 19% of retirees and 24% of retired widows experienced four or more major, unexpected financial "shocks" in retirement.<sup>35</sup> (The two most frequently mentioned expenses: home repairs and upgrades and major dental expenses.) How would you deal with a surprise bill currently – do you have reserves in place for such an issue (like an emergency fund) or do you just deal with them as they come?

You'll likely have additional considerations as you start thinking about your retirement, each of which with its own impact on your financial readiness. By thinking about this now, you can start identifying which are must-haves and which are nice-to-haves and creating a spending goal that matches your preferences. As you do, your financial needs in retirement will come more sharply in focus, and you can start thinking about spending goals that are appropriate for your preferred retirement lifestyle.

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# \$531,000

A recent actuarial report projected that a woman at age 40 in average health could expect \$531,000 in lifetime medical and drug costs, compared to \$417,000 for men.<sup>36</sup>

## Preparing for the Unexpected

As you think about your own retirement plans, it's worth considering what you would do if you were to face a large expense you weren't counting on, like an unexpected tax bill, a home or car repair or a major healthcare expense. For many retirees, the first call is to their broker to sell some stock – but selling stock can create its own problems, from tax implications to the potential of selling in a down market. It also decreases your retirement assets, and as we discussed, one of the top priorities for women in retirement should be preserving their wealth as long as possible.

One strategy to consider is increasing your liquidity. Liquidity is your ability to access cash when you need it. It's often used to describe assets: Liquid assets like a money market account allow you to tap into cash easily, while illiquid assets like real estate or private equity cannot typically be converted so readily.

Emergency funds, home equity lines of credit, credit cards – when managed wisely – are all liquid funding sources that can be helpful in retirement, but fitting them into a sound financial strategy in retirement takes planning. (As an example, if you wait until you're retired to apply for a line of credit, you're much more likely to get rejected, as you'll have no income to support it.) Your financial advisor can advise you on your liquidity needs and what kinds of funding sources are appropriate for your circumstances in retirement.



## Expenses That Disappear in Retirement

When you think about your current spending as it relates to your anticipated spending in retirement, it's also worth noting the things you're spending on now that will go away. For many people, retirement marks the end of such expenses as:

- **Mortgage payments.** Paying off your mortgage before you retire can free up a sizable amount of your monthly spending.
- **Pretax contributions and payroll taxes.** Many of the taxes that are taken out of a paycheck, like Social Security and Medicare, don't apply to retirement account distributions.
- **Career expenses.** Transportation to and from the office, business suits, parking structure fees – all of those go away once you stop working.
- **Financial support for the kids.** Typically at this stage of life, the kids are through college and off on their own, which typically results in less reliance on you for financial support. Don't forget about any life insurance policies you might have taken out for their benefit when they were younger. (You can stop contributing to any 529 college savings plans as well, unless you want to get a head start on helping the grandkids. Remember, you are allowed to change the beneficiary on your 529 plan.)

You'll likely find that retirement has plenty of expenses you'll be responsible for, so it helps to have some that disappear before you get there.

## IT'S UNDER YOUR CONTROL

Asking if you have enough to retire is – often literally – the million-dollar question.

It's important to understand that much of the answer is under your control. Four of the main drivers of a successful retirement are largely things you can start thinking about right now:

- **Age at retirement.** Knowing when to retire can be a delicate balance. If you choose to leave the workforce too soon, you might have to compromise on what your ideal retirement will look like. Working later can bring with it a greater degree of economic certainty, but leaves you with less time to enjoy your "golden years."
- **Longevity.** It's true, no one knows exactly how long they're going to live – which is why you should conservatively (and optimistically!) assume a long life. This is especially true for women, who at age 85 or older outnumbered similarly aged men nearly 2 to 1.<sup>37</sup>
- **Investing risk (i.e., growth).** Conventional wisdom holds that as you get older, you should start to move your retirement investments into less risky – but less rewarding – assets like bonds. And generally speaking, there's some merit to that argument: When you're in retirement and the stock market experiences a severe downturn, you typically have neither the income stream nor the time to build back your losses. But when it's common for women to live into their 80s and 90s, you might need to plan on 30 years of retirement income, if not more. There definitely is risk in going too conservative too soon and taking your foot off the gas prematurely.
- **Spending habits.** One of the most difficult challenges in transitioning to retirement is knowing how to adjust your spending. As important as budgeting is in your working years, it's even more important in retirement, when you don't have a paycheck to make up for unwise money decisions. All the personal finance advice from when you were first starting out – don't overspend, keep an emergency fund, don't charge on a credit card anything you couldn't afford to pay in cash – becomes especially important now.

There's a lot that goes into being financially prepared for retirement, and the sooner you start planning for it, the more options you'll have when you're ready to make that transition. Partnering with an advisor who understands your priorities, your circumstances and what you want to accomplish in retirement – one who takes a holistic approach to financial planning – is invaluable. Whether it's getting you started on your own retirement journey or serving as a second set of eyes on your existing plans, your Baird Financial Advisor is here to help – so when it's your time to retire, you can be prepared to enjoy every minute of it.

Let's get started on your journey so you can retire with confidence on your terms.

# About Baird

At Baird, we like to think we're different from most other financial services firms. Because we're privately held, we're free to focus on our clients' best interests instead of the short-term expectations of outside shareholders. And because Baird is employee-owned, we all have a personal stake in our clients' success.

But perhaps most important is the culture that's guided us since our founding in 1919. It started with a simple idea – that our clients always come first. But the more we came to know and care about those clients and the things that mattered most to them, the more we understood our business was about trust, partnership, shared values and better futures. That understanding carries with it a responsibility but also pride in knowing it brings out our best in everything we do – for our clients, for each other and our communities.

We'd like to share with you our story and how a true financial partner can make a difference in your life. Visit [bairdwealth.com](https://www.bairdwealth.com) and discover the Baird difference for yourself.



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