The Retirement Survival Guide

How to Make Smart Financial Decisions in Good Times and Bad

Julie Jason

Contents

Introduction		vii
Part I:	Understanding the Basics	
Chapter 1	Achieving a Secure Retirement	3
Chapter 2	Your Personal Cash Flow	13
Chapter 3	Sources of Retirement Income	23
Chapter 4	Income from Social Security	33
Chapter 5	Will Your Money Last as Long as You Do?	47
Chapter 6	Can You Improve Your Situation?	59
Chapter 7	Enter the Financial Adviser	73
Part II:	Security for Sale: Evaluating Retirement-Income Products	
Chapter 8	Guaranteed Lifelong Income	93
Chapter 9	Creating Your Own Personal Pension	103
Chapter 10	The Promise of Gain with No Pain: Equity-Indexed or Fixed Annuities	121
Chapter 11	It's Not Too Late to Catch Up: The Guaranteed Minimum Income Benefit	137
Chapter 12	Guaranteed Withdrawals So You Don't Run Out of Money: The Guaranteed Minimum Withdrawal Benefit, or GMWB	159
Chapter 13	Certificates of Deposit: Not All CDs Are Created Equal	175
Chapter 14	Cashing Out of Your Home	187

Part III:	Investing in Your Future: Retirement-Income Planning and the Markets	
Chapter 15	Tax-Deferred Account Decisions	203
Chapter 16	Making the Stock Market Work for You	217
Part IV:	Pulling It All Together: Uncle Sam, Your Adviser, and You	
Chapter 17	Taxes in Retirement	237
Chapter 18	Taking Money Out of IRAs and Other Tax-Deferred Accounts	249
Chapter 19	Sales Tactics, Scams, and Bad Advice: A "Perfect Storm" of Disaster for Retirees	259
Chapter 20	Do You Need a Retirement-Income Adviser?	273
Chapter 21	The Finish Line	285
Part V:	More Retirement Resources	
Appendix A:	Prospective Adviser Notepad	297
Appendix B:	Client Reference Notepad	298
Appendix C:	Quick-Test Factors for Different Retirement Periods and Rates of Return	299
Appendix D:	Retirement Income Management: A Case Study	300
Appendix E:	Bibliography	321
Acknowledgments		322
About the Author		325
Index		326

CHAPTER 2

Your Personal Cash Flow

Do this exercise with me.

Imagine that you will retire this Monday. From that day forward, your paycheck will stop and you will have to pay your bills with nothing but your savings. How long will your retirement last?

Let's consider a few likely scenarios.

Say you normally spend $5,000 a month and that you have $60,000 in the bank. Because you will be able to pay for twelve months of living expenses, your "retirement" will last precisely one year before you must return to work.

Now re-examine the situation, but this time factor in taking that vacation you've been dreaming about, which eats up $10,000—two months' savings. Your remaining savings will last only ten months.

Of necessity, you reconsider.

You decide you'd like to stretch out your retirement as long as possible. How? You can't go back in time and save more, of course, but you can control your spending in the present—and into the future. Rather than spending $5,000 a month, you decide you can live on $2,500 a month by sharing living quarters with friends or family. Good move: it buys you an additional year of retirement.

This exercise is an example of a point-in-time retirement-survival plan. In real life, we would factor in the earnings on your savings, which would increase the value of the account over the period in question—but those earnings would also be reduced by income taxes. We would also factor in pensions and Social Security, as well as inflation (to account for the loss of purchasing power as time passes). In addition, we would consider your lifestyle and probable longevity, and make projections based on reasonable assumptions for these variables. All of these are important pieces of the puzzle, and we'll explore them together in this book.

You Can't Retire on Plastic

Despite the easy availability of credit cards, you can't retire on plastic. Unfortunately, debt is a problem that plagues many retirees: according to the Federal Reserve, almost seven out of ten households headed by retirees age 65 to 74 hold some kind of debt, including mortgages, loans, and credit-card balances (the median debt is $44,000). About four out of ten households headed by retirees age 75 and older have some kind of debt, with the median debt being $20,000.

Boomers and Budgeting

I'm convinced that people approaching retirement have a fear of budgeting. People who were born after World War II—the boomers—have been using credit cards and home-equity loans to buy consumer goods and pay for other "wants" as opposed to "needs," something previous generations simply did not do.

Boomers grew up with childhood memories of air-raid drills and fallout shelters. As teens and young adults, some blossomed into flower children,

pacifists, and nonconformists, with not a thought about money or the future. Freedom, nonconformity, spirit, and individuality were the ideals. Scrimping, saving, and budgeting were matters addressed by the previous generation that grew up during the Great Depression—boomers' parents and grandparents.

Yet here we are.

If you're a boomer, I won't ask you to renounce your spending habits. Instead, I'll show you a technique to prioritize and time your expenditures. But first let me share some insights about how to look at expenses.

Start with Your Expenses

What you need to know first is how much you spend on "musts" and how much you spend on "wants." Musts are the basics you need to survive and function, such as rent (or mortgage), utilities, medical expenses, food, transportation, and taxes. Let's call these "Essential Expenses." *The most financially secure retirees are able to pay for Essential Expenses with monthly income from Social Security and pensions or pension substitutes, such as immediate annuities.*

All other expenses are "wants." These expenses are not essential to survival, and may include entertainment, vacations, gifts, and the like. Let's call them "Lifestyle Expenses" (some people call them "discretionary expenses").

In contrast to Essential Expenses, which you must pay in full and on time, your Lifestyle spending is entirely up to you. That gives most people the power to control their financial destinies.

Hint: Categorizing your expenses is relatively straightforward: you must pay your rent or mortgage, or you won't have a place to live—hence that's an Essential Expense. By contrast, whereas you have the option of buying a second TV, you don't need one to survive—therefore that's a Lifestyle Expense.

What's the Difference? Vacations, gifts, club memberships, and tickets to entertainment or sporting events all belong in the Lifestyle category, as do magazines, new clothes, an extra pair of sneakers, fancy hors

d'oeuvres for your dinner party, flowers for your kitchen table, pottery classes, extra plants for your garden—you get the picture. These are pure indulgences, by which I mean you could easily live without them if you

A Closer Look:

Know Where You Stand

After they retired, Sandy and Ira deposited their Social Security and pension checks in their joint checking account to pay their monthly bills, but there was never enough money in the account to cover all of their living expenses. Month after month, they had to sell off investments to free up money to pay bills, which was unsettling.

Both looked for ways to save. Ira started giving up the things he enjoyed, such as playing golf with his friends. In conversations with Sandy, he frequently brought up how much things cost. Sandy began to worry; did they have enough money to last a lifetime?

The problem was this: Sandy and Ira lacked the information they needed to assess their situation. First they needed to understand where their money was going by looking at their expenses and categorizing them. Then they needed to look at their income to see where there was a mismatch.

After studying their cash flow, Sandy and Ira discovered why they felt they never had enough money. They were spending $1,500 a month on Essential Expenses (such as housing and utilities) and $500 to $700 a month on Lifestyle Expenses (such as movies and trips), whereas their income (Social Security and pension) came to only $1,500 a month.

That was useful information. They could relax about basic needs and focus on managing their Lifestyle spending. If their investments were sufficient to support withdrawals of $500 to $700 a month, they could maintain their current lifestyle. If not, they would have to limit their spending.

had to—or at least for a while, until the money was in your bank account to pay for these items.

How Not to Spend Your Future

Now let me give you the timing tool, which I call the "Lifestyle Balance Register."

To track your expenditures, get a check register from a bank. This is a booklet the bank gives you to monitor your check writing. (See Table 2-1 for an example.)

Give yourself a beginning balance—the dollar amount you can afford to spend on Lifestyle Expenses for the month. This is your Lifestyle Balance. Like the balance in a checking account, use it as a starting point each month. Spend the balance as you wish on Lifestyle items such as gifts or entertainment, or save it for bigger items such as vacations. As with a checking account, be careful not to overdraw this balance.

Carry the register with you at all times. Enter every amount you spend on lifestyle items, no matter how small. As you make purchases—whether you pay by check, cash, credit card, or debit card—subtract each expense from your updated Lifestyle Balance.

In the example below, I've purchased two items and deducted them from my Lifestyle Balance of $500. Keep in mind that this register covers only my Lifestyle Expenses. In this example, I did not need to use the register to record Essential Expenses, because those were already covered by my pension and Social Security.

Date	Check #	Payee	Amount	Lifestyle Balance
January			Beginning Balance:	$500
Jan 5	Cash	Movie Tickets	$24	$476
Jan 7	Cash	Magazines	$12	$464

Table 2-1: Check register showing a $500 beginning Lifestyle Balance

WARNING!

Some people may think they can overspend their Lifestyle Balance and then make up the deficit by spending that much less the next month. That's spending money you don't have, which is what people do when they live on credit. Spend every last penny of your monthly Lifestyle Balance any way you want, but don't spend a penny of next month's deposit until next month arrives. Stick to the present. Don't spend the future.

As a new month begins, give yourself another lifestyle deposit of $500, adding that to any money remaining in your Lifestyle Balance from the previous month, and start spending as you wish. The only rule is that you cannot overdraw this account.

Budgeting is hard on just about everyone, but timing expenditures is manageable. Whereas a budgeting system is about saying "No," this timing system is all about asking "When?" If you want to spend money that would overdraw the Lifestyle Balance, all you have to do is wait until the balance increases on the first of the next month with the deposit of your next $500.

Where Does the Money Go? I have yet to meet anyone whose idea of a good time is poring over bills, checks, and credit-card receipts. So let me share some tips on how to get the information you need with the least amount of effort.

For a rough estimate of your expenses, compare your take-home pay with what you have left at the end of the month. For example, if you take home $1,000 a month and you have $100 left at the end of the month, you are spending $900 a month.

That's a good start. If you have more time to devote to this exercise, you can learn even more. Gather up the last three months of bills, bank statements, and credit-card and debit-card receipts, and make a list of cash expenditures. Set aside a weekend afternoon and, if you are married, get your spouse involved. Go through the records for the most recent month first. Review your checks and any other withdrawals from your bank account, which will also show debit-card activity. Then review your credit-card bills. Scrutinize each expenditure.

A Closer Look:

The Lifestyle Balance Register

Here's an example of how timing expenditures works. Harry and Joan receive pension and Social Security income of $5,000 a month (which covers their Essential Expenses) and withdraw $2,000 a month from their savings for Lifestyle Expenses. They normally spend $7,000 a month but are distressed because they often exceed that amount. On reviewing their spending, we uncovered the problem: spontaneous credit-card purchases of lifestyle "wants," such as gifts for their grandchildren. We decided to give the Lifestyle Balance Register a try. Harry and Joan started the month with a "Lifestyle Deposit" of $1,000 each. They agreed to record each expenditure (whether by plastic, check, or cash) and to deduct that amount from their Lifestyle Balance on a running basis. If they wanted to make a purchase when the balance had fallen too low, they were forced to wait until the next deposit.

Did the regimen work? You be the judge. By tracking their expenditures and timing their lifestyle spending, Harry and Joan stopped worrying about money. They knew that they could buy what they wanted so long as they made purchases only as their Lifestyle Balance permitted.

Now let's put the concepts and tools we've been discussing into practice, by taking a closer look at your own expenses.

Have your spouse do the same for his or her expenditures. Record each one in a ledger like the one shown in Table 2-2. Repeat the process for the two previous months.

You won't capture all your expenses this way (you'll be missing one-time expenses, such as a major purchase made earlier in the year), but you should arrive at a fairly sound estimate. For greater accuracy, review the last twelve months of your financial records, keeping an eye peeled for

Expense	Amount	Paid By	Date	Type
Home Insurance	$115	Check	June	Essential
Mortgage	500	Check	June	Essential
Electricity	120	Check	June	Essential
Phone	130	Check	June	Essential
Groceries	400	Credit Card	June	Essential
Entertainment	500	Credit Card	June	Lifestyle
Restaurants	150	Credit Card	June	Lifestyle
Newspapers	20	Cash	June	Lifestyle
Commuting	60	Cash	June	Essential
Gas	190	Cash	June	Essential
Car Repairs	200	Check	June	Essential
Magazines	20	Credit Card	June	Lifestyle
Medical	40	Check	June	Essential
Total Expenses	$2,445			

Table 2-2: Sample record of expenses

semiannual or annual expenditures such as real-estate taxes, life-insurance payments, car repairs, and the like.

The result will be an estimate of your monthly expenses. The next step is to categorize those expenses, as we discussed earlier, with the goal of identifying decision points. In Table 2-2, you can see that $690 was spent on Lifestyle Expenses and the rest ($1,755) was spent on Essential Expenses.

The purpose of this exercise is to enable you to plan. Whereas many of the elements that determine retirement security are beyond your control, how much you spend is very much within it.

How Much Can You Safely Spend?

Now that you understand how much you currently spend, you must figure out whether you can continue spending at that rate for the rest of your life. And any time we address the future, we have to consider ways of projecting what will happen.

So first let's talk about what we know—always the best place to start.

Inflation

Based on personal experience, we know that costs will rise over time. For example, I bought my first car—a yellow Karmann Ghia—for about $2,000 in 1967. With inflation having averaged 4.7 percent annually over the forty-some years since then, that car (were it still being made) would cost about $14,500 in 2017 dollars.

We can't avoid inflation, so we need to factor it into the puzzle. To calculate future costs, use 3 percent—the average annual inflation rate since 1926 (as published by Ibbotson Associates, a subsidiary of the investment-research firm Morningstar). To be more conservative, use a higher number such as 4 percent. To be more conservative still, use 6 percent—the inflation rate for the twenty years ending in 1992.

Let me show you how that works. You can project that if your Essential Expenses are $1,000 today, in twelve years they will be roughly $1,500 (assuming a 3 percent inflation rate) or $2,000 (assuming a 6 percent inflation rate). The rate you choose to plan with depends on how risk-averse you are, but in order to be certain of covering your Essential Expenses as you grow older, you must plan for a retirement income that will cover this rising cost of living. Because medical costs may rise faster than other expenses, it might be safer to use a higher inflation rate.

Longevity

Demographic studies tell us that boomers (people born in the years 1946 to 1964) will live much longer than any previous generation. According to the National Center for Health Statistics, the median life expectancy for a man who reaches the age of 65 is 18 years (age 83). (The "median"

simply means that an equal number of people will either outlive or fail to reach this age.) For a woman who attains that milestone (age 65), the median life expectancy is 20.5 years (age 85.5).

Hint: For a couple age 65, there is a 50 percent chance that one of them will live to age 93—and a 25 percent chance that one will live to age 97.

When projecting for your own personal situation, it's best to be optimistic. Unless medical concerns dictate otherwise, budget for a long life—thirty to forty years—in retirement.

Why Your Expenses Matter

As we discussed earlier, you can simplify retirement planning into a basic cash-flow equation between your income and your expenses. We've examined your spending habits before anything else for two reasons:

First, by understanding your expenses in retirement, you can better determine how much income you really need to generate right now. With that information in hand, you can then determine whether you have realistic expectations of continuing your current lifestyle—or whether some adjustments will need to be made.

Second, to a large degree, your expenses are within your control. Reduce your spending and you won't need to generate as much income; add to your expenses in retirement and you'll need to generate more.

Now let's turn to the other part of the cash-flow equation: sources of retirement income.