Are the Golden Years a Myth?

Planning for retirement can be complicated. It is a very personal thing that depends upon a variety of factors including one's general health, attitude toward work, level of activity, social engagement, support system, and sense of purpose.

DIVERSIFIED TRUST

By Bill Spitz, Principal

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"Retirement is wonderful if you have two essentials -much to live on and much to live for."

—Anonymous

Are the Golden Years a Myth?

One of the central components of the American Dream is a retirement filled with travel, the pursuit of hobbies, time spent with children and grandchildren, endless rounds of golf, or perhaps just carefree puttering around the house. While a portion of the population does indeed enjoy the fruits of their long labor, the Golden Years are unfortunately a myth for many due to insufficient savings, poor health, and inadequate mental preparation. The financial services industry has done a good job of providing retirement saving education and it offers a wide variety of diversified investment vehicles; in combination, these resources should allow disciplined savers to achieve their financial goals. And, psychologists, sociologists and medical professionals provide helpful hints for staying active and engaged during retirement. The problem is that most of us are not great at saving and investing, and even the financially diligent are typically unprepared for the mental, physical, and emotional challenges of retirement. The key to retirement success is developing both a financial and a life plan. Most people could use a little help in this endeavor which may call for a support team consisting of financial and investment planning and a life coach. In fact, there is a new field known as Financial Therapy which combines these two disciplines.

A SHORT HISTORY OF RETIREMENT

Retirement is a fairly recent idea; for most of history, people simply worked for their entire lives. Pensions were offered to retired soldiers as early as Roman times, typically to ensure they did not rise up against the empire. In the mid-1800's, policemen, firefighters, and many railroad employees in the U.S. began to receive retirement benefits, and American Express offered the first private pension plan in 1875. However, the more generalized notion of retirement is attributed to German Chancellor Otto von Bismarck who approached the Reichstag in 1881 with the proposition that citizens over 70 be provided a government retirement benefit in return for voluntarily leaving the workforce. Interestingly, his primary motivation was to clear out older workers to make room for unemployed younger men who he feared might otherwise stage a revolt.

In the early part of the 20th century, corporations such as Standard Oil, U.S. Steel, AT&T, Eastman Kodak, Goodyear, and General Electric instituted pension plans. Based on newly found financial security, many individuals flocked to retirement communities that began to appear in Florida in the 1920's, and the number of golf courses in the U.S. tripled between 1920 and 1930.

While government and railroad pension plans survived largely intact, many private plans were victims of the Great Depression leading to the passage of The Social Security Act of 1935. It created Federal retirement benefits for all employees beginning at age 65 but was not expected to pay out large sums given that life expectancy at the time was roughly 58. Over time, Social Security was expanded to include disability payments, benefits to children and spouses, and cost-of-living adjustments. Additionally, the government instituted health benefits through the Medicare program which was created in 1965. Most relevant to today's workers is the 1978 amendment to the IRS Code that created 401(k) and similar defined contribution retirement plans. Currently, 86% of government employees remain covered by traditional defined benefit plans whereas only 16% of workers in the private sector enjoy that benefit. Seventy percent of employees have access to 401(k) plans, but sadly only about 56% choose to participate. A recent Gallup survey found that the average reported age at retirement in now 61, up from 57 in 1991. Similarly, those still employed estimate on average that they will retire at age 66, up from 60 in the 1990's.

WHY MIGHT THE GOLDEN YEARS BE A MYTH?

Most Americans are actually better off than previous generations but many have inflated and unrealistic expectations because they have been seduced by the myth of the Golden Years.

The first reality is that a huge swath of the population is financially unprepared for retirement. Some of the following bullet points represent hard data whereas others are derived from surveys. For that reason, there is some variation in the numbers but they all point to the shaky finances of many approaching retirement.

- 49% of those aged 55-66 have no retirement assets
- 26% of all active workers have no retirement savings
- Less than one half of all workers have saved at least $100,000
- 36% of those nearing retirement age could not afford even one year of elder care
- Vanguard reports that the median retirement account balance for those 65 and older is just $87,700
- The Center for Retirement Research at Boston College estimates that one half of households are at risk of a material income shortfall during retirement (more on that topic below)

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While 37% of survey respondents have not done any retirement planning, most people have a general sense of the risks they face. The average worker over 45 believes that savings of $1.1 million will be required to live comfortably yet 56% expect to have less than $500,000 saved by their retirement date. Only 22% of those approaching retirement believe they have sufficient funds, and 45% believe there is a good chance they will outlive their assets. In fact, their concern may be correct in that the Social Security Administration estimates that one in four people currently sixty-five will live beyond age 90. Finally, 44% of retirees state that their expenses are greater than anticipated. Yet, despite this awareness, one third of all workers are not contributing to their retirement plans, and 41% of those who are concerned about outliving their assets have not increased their savings at all.

In order to quantify the extent of what the media has labeled the "retirement crisis," I crunched some numbers using household income, the average Social Security benefit, the median retirement account balance as reported by Vanguard, and a variety of other required assumptions. This exercise is far from precise due to questions regarding the future of Social Security and Medicare, inflation, investment returns, and recent fluctuations in life expectancy. Given this caveat, I estimate the median couple might expect retirement income roughly equal to 70% of pre-retirement earnings. (Known as the replacement ratio) Financial planners historically recommended a replacement ratio of about 75% but many people now find that their retirement expenses equal or exceed their pre-retirement income. This is attributable to the high priority assigned to travel and other expensive retirement pursuits, inflation, the desire to provide financial assistance to family members, and the ever-present threat of health care costs. Many planners therefore now recommend targeting a replacement ratio of 100%. Once again, the numbers are somewhat squishy, but this analysis suggests that the median couple is likely to end up with an income deficit of 5% to 30%, and many below the median are in even worse shape. That hardly qualifies as the Golden Years!

Now, we consider the physical and emotional issues associated with retirement. The following bullet points summarize the conclusions of a number of research studies:

- Retirement increases the odds of serious depression by 25%-50%
- Retirement increases the odds of having at least one diagnosed chronic physical condition by 60%
- Retirement leads to a 5%-15% increase in mobility difficulties
- Retirees are 40% more likely to have a heart attack or stroke than those still working
- The Social Security Administration found that men retiring at age 62 have a 20% higher likelihood of death than the general population
- A study of Shell Oil employees found that those who retired at 55 and lived to 65 died 37% sooner than those who retired at 65
- Mental and physical issues during retirement appear to be more likely and acute in men than in women

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On the other hand, one study found that retirement did not change the risk of chronic disease and it actually materially reduced mental and physical fatigue as well as the prevalence of depressive symptoms. Several studies also found that early retirement improves mortality while others suggest very little or no correlation between retirement age and mortality.

Given all of this conflicting research, the most logical conclusion is that the impact of retirement is a very personal thing that depends upon a variety of factors including one's general health, attitude toward work, level of activity, social engagement, support system, and sense of purpose. All of these will be discussed in the section devoted to maintaining physical and mental health during retirement.

FINANCIAL PLANNING FOR RETIREMENT

Financial planning should be detailed, comprehensive, and highly personalized so this is not the place to dive into its intricacies. Instead, I provide a number of high-level recommendations and then suggest the use of the retirement calculators and diversified portfolios provided by financial service companies, or even better, employing a planning professional. These recommendations probably sound like a painful lecture from one's parents but they are in fact critical to achieving financial retirement goals.

- **Begin saving early.** Yes, this is motherhood and apple pie. But, starting a retirement savings program at age 25 rather than at 30 reduces the required saving rate as a percent of salary from about 15% to 12%. Looked at from a different perspective, the early saver will end up with about 20% more money assuming the same savings rate. One caveat-this analysis requires a number of assumptions so someone else could easily come up with materially different answers
- **Postpone retirement to age 70 or even later.** We will consider the psychological benefits of continued employment in the next section, but the financial impact is compelling as well. Assuming that a saving program begins at age 30, postponing retirement until age 70 reduces the annual contribution from about 15% to 11% of salary.
- **Start early and work longer.** The combination of the previous two points lowers the annual savings rate to about 9.5% of salary.

- **Target annual savings of about 15% of salary.** Even though this number is higher than the required rates in the previous bullet points, the higher savings rate provides a cushion against unforeseen events and may result in a significantly improved lifestyle during retirement.
- **A good way to start a savings program is to contribute an annual raise or salary bump from a promotion.** This strategy is relatively painless because it does not require a decrease in discretionary spending.
- **Maximize the employer match in 401(K) plans.** Sadly, about 20% of employees do not contribute enough to get the full corporate match; that is akin to leaving dollar bills lying on the ground!
- **Invest in a diversified portfolio that is structured based on time horizon and risk tolerance.** Avoid the temptation to time markets and try to ignore the headlines. Similarly, avoid looking at retirement fund statements frequently. (More motherhood and apple pie!)
- **Develop and stick to a budget.** This discipline makes it easier to save along the way. As Warren Buffet has said "Don't save what is left after spending; spend what is left after saving." Developing a detailed retirement budget also contributes to more accurate planning and increases the odds of success. However, make sure that the retirement budget is realistic including unexpected medical expenses, elder care, and so on.
- Unless there are specific medical conditions that indicate otherwise, **base retirement planning on the assumption of a life span of at least ninety years** (Some planners assume a 100 year life)
- **Take advantage of all of the financial expertise that is available because this topic can be complicated.** Various retirement savings vehicles have different tax implications and there are pros and cons of all of the different methods of withdrawing funds during retirement.

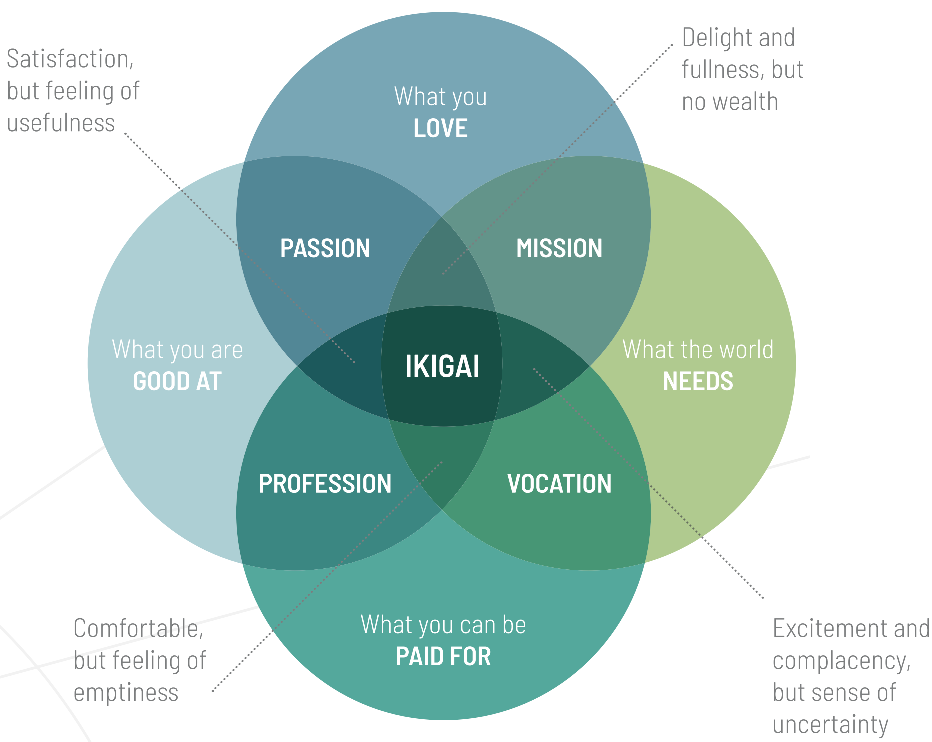
BLUE ZONES

There are five “Blue Zones” in the world in which people enjoy unusually long life spans including a significant number of centenarians. They are: Sardinia, Italy; Ikaria, Greece; Nicoya, Costa Rica; Loma Linda, California; and Okinawa, Japan. Researchers have studied these areas in search of commonalities and have discovered nine principles for longer, healthier lives:

1. **Move naturally** - people in the Blue Zones do not necessarily “work out” but are physically active in the course of their day-to-day lives
2. **Down shift** - reduce stress through quiet time, meditation, a nap, and so on
3. **Stop eating when 80% full**
4. **Eat a Mediterranean diet** (grains, fruit, vegetables, seafood, beans, nuts)
5. **Consume moderate amounts of alcohol** (particularly wine) on a regular basis
6. **Belong to a faith based community** - denomination does not seem to matter
7. **Maintain close knit family groups**
8. **Maintain strong social groups**

97%

of respondents who claimed to have ikigai in their lives were still alive *seven years after the initial survey as compared to 83% of those who did not.*



The ninth principle is the importance of having a reason to get up every day. In Okinawa, there is no word for retirement. Instead they use the word "ikigai" which means purpose. Purpose need not be connected to work but can be found in a broad range of human endeavors. A study by Tohoku University found that 95% of respondents who claimed to have ikigai in their lives were still alive seven years after the initial survey as compared to 83% of those who did not.

The nine Blue Zone principles are directly translatable into the keys to a successful retirement. Here are five retirement tips that reflect them:

- **Keep working (at something)** - important for a sense of purpose, social connections, self-esteem, and so on
- **Contribute** - a Carnegie Mellon Study found that volunteering regularly materially increases life expectancy. It also adds to a sense of purpose
- **Maintain social connections** - work, family, friends, community, volunteerism, etc.
- **Develop a daily schedule** - it need not be rigid or taxing
- **Engage in life** - long learning-Go back to school
- **Plan at least one physical activity every day** in addition to just "moving about"
- **Practice self-care** - Diet, exercise, gratitude, mindfulness, medical care

FINDING YOUR IKIGAI

While the online tools provided by financial services firms are sufficient for people with relatively straightforward needs, those with more complicated finances are probably best served by retaining a financial planner. One way or the other, constructing a financial plan for retirement is not that difficult; sticking to it is the hard part.

The emotional and mental aspects of preparing for retirement are much more complex because they are deeply personal. Thankfully, there exists a wide range of resources that can help. As mentioned earlier, there is a new field called Financial Therapy that combines the financial and mental aspects of money. A Financial Therapist may be a good way to get started. However, even with the help of a professional, good mental health will require a personal investment of time, energy, and introspection.

A minimalist approach might call for studying one or more highly recommended books such as:

- Purposeful Retirement: How to Bring Happiness and Meaning to Your Retirement - *Hyrum W. Smith*
- A Psychiatrist's Guide to Successful Retirement and Aging - *H. Michael Zal*
- Retirement by Design: A Guided Workbook for Creating a Happy and Purposeful Future - *Ida O. Abbott*

For those who want to take a much more active role in maintaining their mental health during retirement, here are a couple of interesting programs:

- Stanford Continuing Studies - Stanford offers a wide variety of on-line courses that are open to all adults.
- Inspired Leadership Initiative - An in-person program at Notre Dame for successful individuals who have finished their first career and want to discover and design the next phase of their lives.

Similarly, many other universities offer continuing education in a variety of formats.

The key point is that good mental health during retirement does not just happen, it requires an active and focused strategy.

THE GOLDEN YEARS

Yes, the retirement years can be Golden, but they require financial planning, disciplined saving and investing, and a life plan that includes purpose, social connections, and a positive attitude.

"There is a fountain of youth: its is your mind, your talents, the creativity you bring to your life and the lives of the people you love. When you learn to tap this source, you will have truly defeated age."

—Sophia Loren

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