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Retirement, will yours be happily ever after?

"When Sleeping Beauty wakes up she is almost fifty years old. Time to start planning her retirement cottage."

The Archaeology of a Marriage (1978)

September 2014

In This Issue...

Fairy tales usually end happily ever after. So, whether Sleeping Beauty gets serious about retirement planning or not is a moot point. Unfortunately, you and I are not characters in a fairy tale and if we don't plan for retirement, the ending of our stories will be anything but happily ever after. So, let's talk about planning for retirement.

Any discussion of retirement should include at least three topics: understanding the phases of retirement, understanding that retirement is more than just money, and making sure there are adequate financial resources to cover the cost of retirement for the rest of our lives.

Most folks go through three phases. Phase One: No matter how carefully the retirement budget was crafted, new retirees quite often exceed their budget in the first few months of retirement. They buy the new fishing boat, they take the previously unplanned trip to Tangiers, they buy a dilapidated 1954 Ford pickup and restore it. Point is: most retirees go through *"I'm only going to live once"* period in early retirement. Bad news is this phase can be expensive. Good news is this phase typically lasts only a short period of time. Phase Two: The bills arrive from Phase One and panic sets in; years ago we actually had a client break down and sob in our office and say, in a tearful voice, "If we keep spending like this, we'll be doomed to eating nothing but peanut butter and jelly sandwiches for the rest of our lives". Needless to say, Phase Two doesn't last very long either and retirees then move on to the final phase, which, as you can guess, is Phase Three. In this final phase, most retirees settle into a routine and, in many cases, actually start saving again.

Believe it or not, everyone I have ever seen enter retirement had a list of things they were going to do after their careers were over. Often the list was long and detailed. But guess what? a couple years down the road and all the items on the list had been checked off. Most likely that will happen to you, too. It's not enough to plan for the money side of retirement; you must spend at least as much time planning for all those hours when you no longer punch the clock. Here's a sobering number to keep you focused on the time aspect of retirement. If you retire at age 65 and live an additional twenty years, you'll need to find something to occupy one hundred seventy-five thousand two hundred hours!

Okay, now let's talk about money. Forget all the formulas you've read over the years. If you want the same life style in retirement that you are enjoying today, you're going to need the same cash flow that you have now, period. So, **step one** in planning for retirement cash flow is to calculate what you are spending today and then reduce that dollar amount by any financial obligations that will be discharged prior to your planned retirement date. That dollar amount is now your net retirement cash flow need. Adjust that net number for expected income tax obligations and

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Retirement continued

now you have your gross retirement cash flow needs. **Step two** is easy. Calculate the total dollar amount of outside retirement cash flows you expect to receive (pensions, Social Security payments, etc). **Step three** is easy, too. Subtract step two from step one. That number is your gross retirement cash flow shortfall, the dollars you will need to generate from your personal savings. The **fourth and final step** is a little more complicated. You'll need to calculate the personal investment dollars needed to generate that shortfall when you retire. For most folks, step four will also need to include periodic savings you'll need between today and that planned retirement date.

And here are a couple more thoughts to add to your pre-retirement list of things to do. Get rid of personal debt, such as mortgage and/or consumer debt. Debt service will eat into your retirement life style like a hungry mosquito on a sultry August evening down by the pond! And lastly, think about accumulating additional assets in non-retirement accounts, accounts that have already incurred the impact of taxes. Consider the following example. Let's say you want a new car and the dealer's best price is $30,000. If you have money in the bank (so to speak), you'll write the check for $30,00 and drive away. However, if you must withdraw the money from a retirement account, that same car may cost you lots more. Let's assume you are in the 20% tax bracket (15% federal and 5% state). That same car, after taxes, is going to cost you $37,500.

Planning for retirement is, for some folks, both a scary and an almost overwhelming project, so they put it off. Don't! While the thought of peanut butter and jelly sandwiches may bring back fond memories of your childhood, I can assure you a steady diet of PB&J at 65 is not a comforting thought. Need help? Call us. We have helped lots of other folks and we can help you.

The Book Worm

The Brothers by Stephen Kinzer: The New Your Times Book Review, November 8, 2013 had this to say about the book. *"Anyone wanting to know why the United States is hated across much of the world need look no farther than this book. The Brothers is a riveting chronicle of government-sanctioned murder, casual elimination of "inconvenient" regimes, relentless prioritization of American corporate interests and cynical arrogance on the part of two men who were once among the most powerful in the world."*

Mrs. Lincoln's Dress Maker by Jennifer Chiaverini. A fascinating historical novel focusing on two very different women: Mary Todd Lincoln and Elizabeth Hobbs Keckley. The former, a spendthrift First Lady who continued her spending habits long after she departed the White House; the latter a self-educated former slave who earned her freedom by her extraordinary skills as a dress maker.

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Stock Markets

Words! Words! Words, I'm so sick of words! I get words all day through; first from him now from you! Is that all you blighters can do?[1] Since 1792, Wall Street has had a love affair with words and phrases. Over the last two centuries, Wall Street has created a vocabulary so vast and complicated as to confuse even the most sophisticated investor. Looking through my library I came across two books: Barron's Dictionary of Finance and Investment Terms and David Scott's *Wall Street Words*. The former explains in some detail 3000 words and phrases useful to the investor; the latter expands the coverage to over 3600 words. I suspect a new edition of either would significantly increase those numbers to some mind boggling level. While thumbing through these books, I had a thought. If I find Wall Street's vocabulary confusing, perhaps you do too. So, for the next few issues, I thought it might be helpful to address a few of the more common words and phrases used by both Wall Street. For this issue, we're going to look at just two: value investing and growth investing.

A value investor analyzes the financials of a prospective investment by carefully reviewing information found in the targeted company's balance sheet, statement of income and statement of cash flows. By considering data from each, the value investor is able to calculate, from an accounting point of view, how much (in dollars) the company is worth today (the operative word being *today*). If the current market value of the targeted investment is less than that calculated dollar amount, the value investor has discovered an undervalued assets and, most likely, will proceed with the investment. By comparison, a **growth investor**, after doing the same exercise, may proceed with the investment even if today's market value exceeds the calculated accounting value. Why? Because the growth investor believes the company's future value (the operative word here is *future*) will exceed today's market value by enough margin to provide a meaningful total return over the assets planned holding period. Value investors focus on what is, growth investors focus on what will be.

1. Audrey Hepburn in the musical My Fair Lady. 1964

Bond Markets

Wall Street's love affair with words is not restricted to just the stock market. It has also crafted a plethora of words and phrases used in the bond market. We discussed one phrase (yield to maturity) in the December 2013 issue. In that same issue we discussed Rule #1 of bond investing: when interest rates go up, the market value of bonds go down (and vice versa). Now, with rising interest rates on the horizon (see below) it's probably a good time to introduce you to another phrase used in the bond market: *bond duration or a mutual fund's average duration.* The former refers to one bond, the latter to a bond portfolio. Duration is a mathematical concept developed by economist Frederick Macaulay (1882-1970). Dr Macaulay's study was an attempt to measure a bond (or a bond fund's) estimated price sensitivity to a given change in interest rates. For example, if a bond's duration is 3.8 years, the market value of that bond will rise or fall 3.8% if interest rates on similar maturity newly issued bonds fall or rise 1%.

Take a look at the following bonds, both public utilities.[2]

Georgia Power 4.25% due 12/1/2019, duration 4.6 years
Southern California Edison 4.65% due 10/01/2043, duration 16.6 years

Let's look at Georgia Pacific first; it matures in five years. If rates on newly issued similar quality and maturity bonds rise 1%, the market value of this bond is expected to decline 4.6% or $46 per $1000 face amount. Now, do the same exercise with the Southern California Edison bond; it matures in 29 years. The market value of this bond is expected to decline 16.6% or $160 per $1000 face amount, given the same scenario. Kind of scary, isn't it? Does this mean you should avoid bonds? Of course not. However, unless you are willing to hold bonds until maturity, it's probably not a great time to extend maturities into the distant future just for the sake of a few percentage points in yield.

And what would a prudent bond investor want to plan for? According to the Wall Street Journal 9/18/2014 pg A2, the Federal Reserve's median estimate for federal funds rates for the end of 2016 is between 2.75% - 3.00%. It's just about zero today.

2. Bond Central 09/19/2014

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You wouldn't worry so much about what others think of you if you realized how little they do — Eleanor Roosevelt