SOLID ROCK WEALTH MANAGEMENT

WealthGuide

# Retirement Planning Challenges: What You Need To Know

An Educational Resource From
Solid Rock Wealth Management

By Christopher Nolt, LUTCF

## Introduction

People face many financial challenges today. Low interest rates, volatile stock markets, increasing life expectancies, uncertainties of Social Security and fears of higher inflation and tax rates have made planning for retirement a daunting task. In addition, news reports on our economy, national debt and homeland security raise fears about our well-being and future financial security. Many today are scared, confused and unsure of how to invest to provide themselves an income that will last as long as they do and that will keep pace with the rising cost of living.

## Increasing Life Expectancies

One of the greatest challenges people face today in retirement is longevity. People are living longer due to advances in medical technology. Today, a married couple age 65 has a 50% chance that one spouse will live to age 90. Investing for a retirement that could last 20 to 40 years requires a lot of money and careful planning.

**MARRIED COUPLES, AGE 65**

| One spouse lives to age... | Probability |
|---|---|
| 70 | 99.5% |
| 75 | 97.2 |
| 80 | 90.6 |
| 85 | 75.9 |
| 90 | 50.3 |
| 95 | 22.1 |

Source: Applied Risk Management During Retirement, Milevsky and Abaimova, June 2005, Society of Actuaries RP-2000 table.

For married couples, age 65, there is a **50% chance** of at least one spouse **living to age 90**.

## Rising Healthcare Costs

The rising cost of healthcare is one of the greatest fears people have today. According to the U.S. Department of Health & Human Services, health care costs were less than 10% of our total Gross Domestic Product (GDP) as recently as the early 80's. Currently, health care represents about 17% of our GDP, and is projected to hit 20% in 2017.

As we age, the percentage of our annual spending on health care costs rises. As you can see in the chart below, the amount spent on health care in our 60's and 70's is twice to three times as high as in our 40's.

## Funding Future Healthcare

According to a 2010 study conducted at the Center for Retirement Research at Boston College (1), a couple retiring today at age 65 will need an estimated $197,000 in savings to pay for the present value of health insurance premiums, co-payments, and uninsured prescription drug costs. If you add nursing home costs, the figure increases to $260,000!

Assuming you don't have long-term care insurance, how many of you have at least $260,000 earmarked for uninsured healthcare costs in retirement?

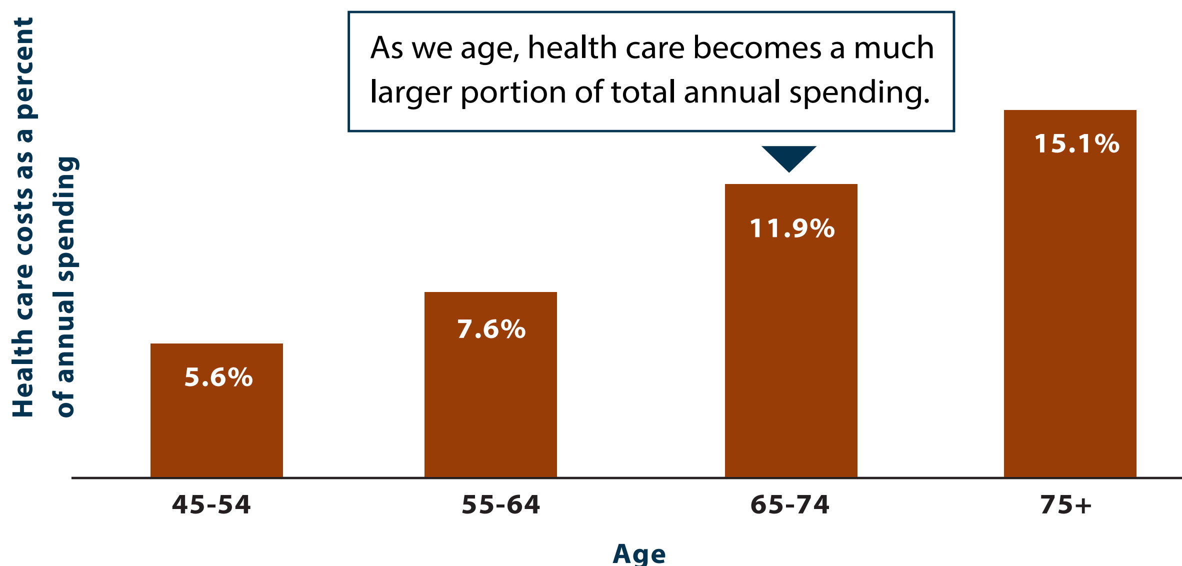
## The Uncertainty of Social Security

Social Security is the federal government's largest single program. When social security started in 1935, there were many more people paying into the social security system than those receiving benefits. Today, that is just the opposite. By the year 2036, there will be almost twice as many older Americans as today - from 41.9 million today to 78.1 million. There are currently 2.9 workers for each Social Security beneficiary. By 2036, there will be 2.1 workers for each beneficiary.

According to the U.S. Congressional Budget Office (CBO), in calendar year 2010, for the first time since the enactment of the Social Security Amendments of 1983, annual outlays for the program exceeded annual tax revenues (that is, outlays exceeded total revenues excluding interest credited to the trust funds). In 2011, outlays exceeded tax revenues by 4 percent. In fiscal year 2012, outlays for Social Security totaled a little under $800 billion, equal to about 5 percent of gross domestic product and one-fifth of federal spending.

The CBO projects that the gap between tax revenues and program spending will average about 10 percent of tax revenues over the next decade. As more members of the baby-boom generation enter retirement, outlays will increase relative to the size of the economy, whereas tax revenues will remain at an almost constant share of the economy. As a result, the gap will grow larger in the 2020s and will exceed 20 percent of revenues by 2030.

CBO projects that under current law, the DI trust fund will be exhausted in fiscal year 2016 and the OASI trust fund will be exhausted in 2038. (2)




Source: U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, 2010

## Taxes

Increased government spending on health care and other areas, combined with the size of our national debt, means it is likely that we will face increased tax rates in the future. Higher taxes take a bigger bite out of your income and your investment earnings. This means you will have to save more to maintain your standard of living. Careful tax planning is important to reduce taxes and maximize retirement income.

## Inflation

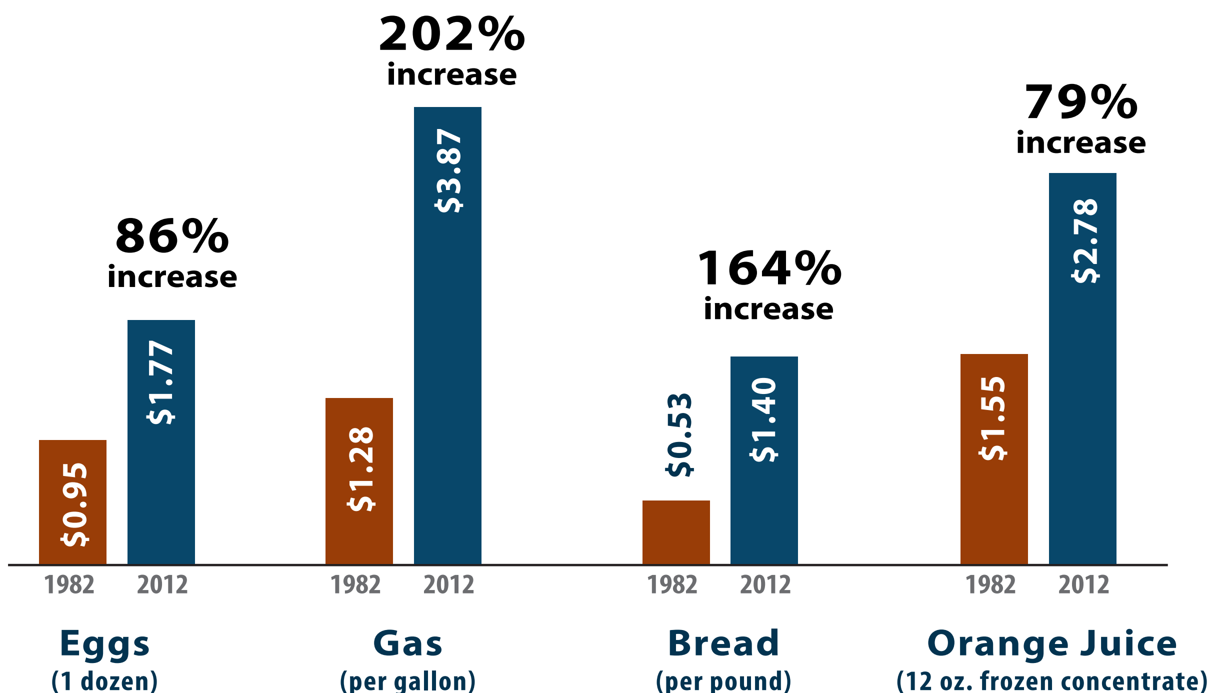
Inflation is a critical factor in retirement planning. As inflation rises, every dollar you own buys a smaller percentage of a good or service. When inflation goes up, there is a decline in the purchasing power of money.

If your annual living expenses were $50,000 per year in 1980, you would need $141,247 in 2013 to maintain the same standard of living.

Consider the annual increase in the items below you consume on a daily basis and how your income needs to keep pace with their rising costs.

## Investing in Retirement Years

Conventional thinking says that you must be conservative with investments as you approach retirement, as well as during your retirement years. If you have enough money and if inflation is not a significant factor, it might be possible to invest in only conservative investments. However, most people need a portfolio with the growth potential of stocks and real estate in order to have the best chances of providing an income that keeps up with inflation. On the other hand, too much exposure to more aggressive investments exposes you to the risk of a market downturn, which, in turn, could put your retirement security at risk.




Source: U.S. Bureau of Labor Statistics, Consumer Price Index — Average Price Data, March 1982 and March 2012

## CD vs. Stock and Bond Indexes

If one is able to tolerate volatility in their investments, they are more likely to enjoy greater wealth over time than if they invested in typical bank certificates of deposit (CDs). The basic concept here is that generally, as risk increases, so does the potential for higher returns.

The chart below compares two investment scenarios. In each scenario, $1 million was deposited on October 1st, 2002 and annual distributions of $30,000 were made for ten years. Scenario One represents investment in certificates of deposit. Scenario Two represents investment in a basic portfolio allocated 60% to the S&P 500 Stock Index and 40% to the Barclays Aggregate Bond Index.

From October 2002 through October 2012, the CD's provided a cumulative return of 24.51%. The stock and bond indexes returned a cumulative of 109.63%. The ending value of the CD after 10 years was $876,012.30. The ending value of the indexes after 10 years was $1,605,339.23.

As you can see below, from 2002 - 2012, the indexes experienced extreme volatility. In 2008, the worst year in the stock market since the Great Depression, the combined indexes lost 20.80%. However, even with this large loss, the stock and bond indexes still provided an average annualized return of 7.68% over the ten-year period and ended with $729,326.93 more money after 10 years than the certificates of deposit.

### Scenario One: Certificates of Deposit

| Time Horizon | Beginning Value | Withdrawals | Ending Market Value | Cumulative Return |
|---|---|---|---|---|
| 10/01/02 - 12/31/02 | $1,000,000.00 | $30,000.00 | $973,619.11 | 0.37 % |
| 01/01/03 - 12/31/03 | $973,619.11 | $30,000.00 | $954,772.47 | 1.15 % |
| 01/01/04 - 12/31/04 | $954,772.47 | $30,000.00 | $939,627.35 | 1.57 % |
| 01/01/05 - 12/31/05 | $939,627.35 | $30,000.00 | $942,806.86 | 3.56 % |
| 01/01/06 - 12/31/06 | $942,806.86 | $30,000.00 | $961,875.35 | 5.25 % |
| 01/01/07 - 12/31/07 | $961,875.35 | $30,000.00 | $983,411.20 | 5.40 % |
| 01/01/08 - 12/31/08 | $983,411.20 | $30,000.00 | $982,756.40 | 3.01 % |
| 01/01/09 - 12/31/09 | $982,756.40 | $30,000.00 | $958,216.22 | 0.56 % |
| 01/01/10 - 12/31/10 | $958,216.22 | $30,000.00 | $931,186.21 | 0.31 % |
| 01/01/11 - 12/31/11 | $931,186.21 | $30,000.00 | $903,982.65 | 0.30 % |
| 01/01/12 - 09/30/12 | $903,982.65 | $30,000.00 | $876,012.30 | 0.22 % |

### Scenario Two: 60% S&P 500 Stock Index, 40% Barclays Aggregate Bond Index

| Time Horizon | Beginning Value | Withdrawals | Ending Market Value | Cumulative Return |
|---|---|---|---|---|
| 10/01/02 - 12/31/02 | $1,000,000.00 | $30,000.00 | $1,027,451.85 | 5.92 % |
| 01/01/03 - 12/31/03 | $1,027,451.85 | $30,000.00 | $1,187,654.89 | 18.64 % |
| 01/01/04 - 12/31/04 | $1,187,654.89 | $30,000.00 | $1,255,644.34 | 8.30 % |
| 01/01/05 - 12/31/05 | $1,255,644.34 | $30,000.00 | $1,276,081.19 | 4.04 % |
| 01/01/06 - 12/31/06 | $1,276,081.19 | $30,000.00 | $1,387,654.08 | 11.16 % |
| 01/01/07 - 12/31/07 | $1,387,654.08 | $30,000.00 | $1,447,683.11 | 6.52 % |
| 01/01/08 - 12/31/08 | $1,447,683.11 | $30,000.00 | $1,118,286.03 | -20.80 % |
| 01/01/09 - 12/31/09 | $1,118,286.03 | $30,000.00 | $1,299,432.29 | 19.00 % |
| 01/01/10 - 12/31/10 | $1,299,432.29 | $30,000.00 | $1,424,946.60 | 12.03 % |
| 01/01/11 - 12/31/11 | $1,424,946.60 | $30,000.00 | $1,466,647.98 | 5.06 % |
| 01/01/12 - 09/30/12 | $1,466,647.98 | $30,000.00 | $1,605,339.23 | 11.50 % |

The Barclays Capital Aggregate Bond Index is a broad base index and is used to represent investment grade bonds being traded in the United States. The S&P500 is a stock market index based on 500 of the top common stocks traded in the United States. Performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost and current perfor mance may be lower or higher than the performance quoted. Asset class performance returns do not reflect any management fees, transaction cost or expenses. Asset Classes and Indexes are unmanaged and one cannot invest directly in an Asset Class or Index. Inception Date refers to the date of First Public Offering. 5 Years, 10 Years and Since Inception (FPO) Returns are annualized. *Date of First Public Offering. The 90-day CD index measures total return equivalents of yield averages. The CD rate is a rotating sample (collected by the New York Federal Reserve Bank) of five banks and dealers surveyed daily.

## Planning for Retirement

Balancing the need for growth with the need for safety is a delicate act. If you invest too conservatively, you risk running out of money. If you invest too aggressively, you also risk running out of money.

Here are some key questions you must answer when planning for your retirement:

1. What age do I want to retire?
2. How much money will I need to have saved at my desired retirement age to provide my desired annual income for my life expectancy?
3. How much can I take out of my investments each year?
4. What is my risk tolerance?
5. How will inflation impact my future lifestyle?
6. What impact will taxes have on my retirement income?
7. How should I invest my money?
8. How should I distribute income from my investments for retirement?

## Amount of Money Needed

Whether you are retired or saving for retirement, it is important to determine the amount of money you will need for the rest of your life. If you are not retired, you will need to determine the age you want to retire and how much you need to have saved by your desired retirement age. If you are retired, you need to calculate how much money you can withdraw each year without running out of money before you die.

It is important to analyze your spending so you can base your calculations on accurate figures. Many people don't have a good grasp of how much they are spending each year and are unrealistic about how much money they need at retirement and how much they can safely take out of their investments each year.

## Risk Tolerance

Determining your tolerance for risk is critical because if you experience a decline in your investments that you can't tolerate, you might abandon your investment at the worst possible time. Knowing the percentage loss you can tolerate in a single year without losing faith in the investment can help you choose a suitable investment allocation and avoid making the costly mistake of getting out of the investment during a down market. Along with understanding your tolerance for risk is the need to understand markets and the cycles they go through.

## Investment Choice

Choosing the right investment portfolio is critical. Small differences in the annual return and annual standard deviation of your investment portfolio can have a huge impact on the amount of money you can live on during retirement. To learn more about how to construct an investment portfolio for your retirement, request the Wealth Guide titled: Building An Effectively Diversified Investment Portfolio.

## Retirement Income Distribution Strategy

Assembling the right portfolio is one thing. Choosing a strategy for taking income from that portfolio is another. There are different strategies for taking income from investments for retirement income. To learn about some of these strategies, request the Wealth Guide titled: Retirement Income Strategies.

## Inflation Adjusted Income and Investment Returns

The chart on the next page illustrates how long $50,000 annual inflation adjusted distributions can be taken from a $1 million IRA account with 4%, 6% and 8% annual investment returns. The annual inflation rate and effective tax rate used in this example is 3.50% and 15%.

Based on this example, you can see that the accounts earning 4%, 6% and 8% were exhausted in years 19, 24 and 33 respectively. Notice how the initial distribution of $50,000 was equivalent to $161,043 in year 34.

| | Annual Investment Return | | |
|---|---|---|---|
| **Annual Distribution** | **4%** | **6%** | **8%** |
| ($50,000) | $1,000,000 | $1,000,000 | $1,000,000 |
| ($51,750) | $981,176 | $1,001,176 | $1,021,176 |
| ($53,561) | $959,541 | $1,000,365 | $1,041,988 |
| ($55,436) | $934,910 | $997,373 | $1,062,334 |
| ($57,376) | $907,087 | $991,997 | $1,082,102 |
| ($59,384) | $875,869 | $984,016 | $1,101,169 |
| ($61,463) | $841,040 | $973,193 | $1,119,399 |
| ($63,614) | $802,373 | $959,275 | $1,136,641 |
| ($65,840) | $759,628 | $941,992 | $1,152,733 |
| ($68,145) | $712,553 | $921,052 | $1,167,492 |
| ($70,530) | $660,885 | $896,144 | $1,180,721 |
| ($72,998) | $604,344 | $866,937 | $1,192,202 |
| ($75,553) | $542,637 | $833,072 | $1,201,698 |
| ($78,198) | $475,456 | $794,170 | $1,208,947 |
| ($80,935) | $402,477 | $749,823 | $1,213,665 |
| ($83,767) | $323,359 | $699,595 | $1,215,541 |
| ($86,699) | $237,744 | $643,021 | $1,214,235 |
| ($89,734) | $145,254 | $579,603 | $1,209,374 |
| ($92,874) | $45,495 | $508,810 | $1,200,555 |
| ($96,125) | $0 | $430,074 | $1,187,335 |
| ($99,489) | | $342,791 | $1,169,234 |
| ($102,972) | | $246,312 | $1,145,726 |
| ($106,576) | | $139,947 | $1,116,241 |
| ($110,306) | | $22,961 | $1,080,158 |
| ($114,166) | | $0 | $1,036,799 |
| ($118,162) | | | $985,429 |
| ($122,298) | | | $925,249 |
| ($126,578) | | | $855,389 |
| ($131,009) | | | $774,905 |
| ($135,594) | | | $682,769 |
| ($140,340) | | | $577,868 |
| ($145,252) | | | $458,992 |
| ($150,335) | | | $324,828 |
| ($155,597) | | | $173,949 |
| ($161,043) | | | $4,809 |
| | | | $0 |

## Summary

Today's retirees face many challenges. Increasing life expectancies, volatile stock markets, soaring healthcare costs, the uncertainty of Social Security, rising taxes, inflation and more. Figuring out how to make our money last for a retirement that could last 20 to 40 years while the price of almost everything we buy increases and taxes continue to rise can be a real dilemma.

Unless one has a very large sum of money and can live comfortably on the income off of safe investments alone, it is usually necessary to have other investments that provide the growth necessary to provide an income that lasts many years and which outpaces inflation.

Every type of investment carries a certain type of risk and while nobody likes to see his or her investments decline in value, nobody likes the thought of running out of money or facing an ever-decreasing standard of living.

Planning for a retirement that could last 20 years or more requires thoughtful consideration of many factors.

For additional Wealth Guides on investing and planning for retirement, visit: www.solidrockwealth.com or call Chris Nolt at 406-582-1264.

### Sources:


1. What is the Distribution of Lifetime Health Care Costs From Age 65? By Anthony Webb and Natalia A. Zhivan. March 2010.
2. The 2012 Long-Term Projections for Social Security. www.cbo.gov

Chris Nolt is the owner of Solid Rock Wealth Management, Inc. and Solid Rock Realty Advisors, LLC, with offices in Bozeman, Montana and Fountain Hills, Arizona.  Solid Rock Wealth Management and Solid Rock Realty Advisors are dedicated to helping people effectively grow and preserve their wealth.  We use a comprehensive planning approach with a team of financial professionals, which addresses retirement planning, investment planning, estate planning, tax planning, charitable giving and risk management.  Our wealth preservation strategies are designed to help our clients reduce taxes, increase retirement income and maximize the amount of wealth they pass on to their heirs and favorite charitable organizations.

### Solid Rock Wealth Management

Solid Rock Wealth Management is an independent, fee-only registered investment adviser.  We offer globally diversified portfolios of no-load, low-cost institutional asset class mutual funds and exchange traded funds.  Are portfolios are diversified among as many as 15 asset classes and market sectors and are comprised of holdings in roughly 12,000 companies in 45 different countries.  Our model portfolios range from conservative (100% fixed income) to aggressive (100% equities) and are designed to achieve optimal returns for your level of risk tolerance.

### Solid Rock Realty Advisors

Solid Rock Realty Advisors assists investors who are seeking secure income producing real estate investments. We specialize in office buildings leased to the U.S. Federal Government and primarily work with investors who are purchasing properties through a 1031 tax-deferred exchange.  These fee-simple real estate properties offer long-term leases guaranteed by the full faith and credit of the U.S. government with competitive cap rates and professional property management.

### Chris Nolt, LUTCF

Chris grew up in Lewistown, Montana.  He received a Bachelors degree in business from Montana State University in 1987 and entered the financial services industry in 1989.   For over 25 years, Chris has been helping people reduce taxes, invest wisely and preserve their wealth. Chris has earned the designations of Certified Retirement Financial Advisor and Life Underwriter Training Council Fellow.

**For more information or to request other Wealth Guides, call 406-582-1264 or send an email to: chris@solidrockwealth.com**

**www.solidrockwealth.com**

**www.solidrockproperty.com**

This material was created to provide accurate and reliable information on the subjects covered. It is not, however, intended to provide specific legal, tax or other professional advice. Tax information provided can be sourced at www.irs.gov and your state's revenue department website. Because individuals' situations and objectives vary, this information is not intended to indicate suitability for any particular individual. The services of an appropriate tax or legal professional should be sought regarding your individual situation.

The names Wealth Guide and Plan, Grow, Preserve are registered trademarks with the Montana Secretary of State.