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7 RISKS TO YOUR RETIREMENT

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Most of us look forward to retirement, imagining that we'll get to relax and enjoy activities we haven't had time for such as traveling, reading, and exercising. However, as pre-retirees transition into full retirement, many don't realize they are crossing the threshold into an entirely new way of living, one in which they're increasingly vulnerable to risks that are unique to retirees.

After spending decades working toward a goal, too many retirement plans are set back by these 7 Easy-to-Avoid Risks.

Risk 1: Longer Lifespans

In the year 2000, 50,000 people lived to be age 100 or older. By 2050, that number is expected to reach 1 million.[1] With life expectancy rates higher than ever, it means that most people will need to plan for a longer retirement than they might expect. According to the Centers for Disease Control, for a couple in their mid-60s today, there is a 50% chance that at least one of them will live into their 90s. What this means is, to be safe, retirees today must plan and strategize for up to 30 years of retirement income.

Risk 2: Spending Principal

Spending principal in retirement has never been a smart strategy, but with the average life expectancy rising, it's more of a slippery slope than ever before. To understand the potential dangers of spending principal, let's consider a 30-year retirement like a 30-year mortgage, only in reverse.

When you first start making mortgage payments, you're not paying back much principal at all. Instead, you're paying mostly interest and just a small amount of principal. As the years go on and the balance gets paid down, you pay a little less interest and a little more principal. The process continues until, after 30 years, your mortgage is paid off.

Now, imagine the same process in reverse. Take a pool of savings worth $1 million, generating 5% interest, or $50,000 per year. If you take even a little bit more than the $50,000 each year, just a small amount of your original principal, your $1 million in savings could be depleted within 30 years in much the same way that a mortgage is paid off — or much sooner than 30 years depending on market conditions.

Risk 3: Underestimating Inflation

It's no secret that inflation has the potential to eat away at the purchasing power of your money. The Bureau of Labor and Statistics estimates that the average rate of inflation is around 3-4%. What many people don't realize is that the rate of inflation on the things you'll need during retirement, like healthcare, can easily reach 6-10%. That means that if you retire today in your 60s, and live 30 years or more into retirement, you'll need three-to-four times more at the end of your retirement than you did at the start.

Risk 4: Underestimating Healthcare Costs

A common mistake many retirees make when planning for retirement is to use the current prices for healthcare when they formulate their plan for handling these costs in the future. As noted, the rate of inflation on healthcare can easily reach 6-10%. This means that for those retiring in their 60s, although the current cost of full-time in-home healthcare might be about $200,000 per year, after accounting conservatively for 6% inflation, that cost could easily reach $600,000 per year by the time you reach your 80s.

Risk 5: Counting on Stock Market Growth to Help Engineer Income

Between the years 2000 and 2013, the stock market experienced two major, prolonged corrections of around 50% or more. In each case, it took the market about six years to recover to its previous peak. If you had all your money in growth stocks and mutual funds from 2000 to 2013, it means your portfolio was underwater virtually the entire time. And if you were retired and counting on stock market growth to generate income, you probably struggled. You may even have had to go back to work.

Relying on stock market growth to engineer income is potentially one of the biggest mistakes you can make in retirement. That's because growth can quickly turn to shrinkage when the market falls, and you can never be sure when shrinkage will turn to growth again. Meanwhile, should you get caught in a Bear Market that drags on for years, the situation is worse than just spending principal because, during those years, you are forced to liquidate a greater number of shares to generate the same income needed to pay the bills. This is known as reverse dollar-cost averaging and it's one of the biggest mistakes you can make because you can end up cannibalizing your entire principal and running out of income.

None of this means the stock market can't be part of your retirement income strategy. If you have the right risk tolerance, you can continue investing in the stock market but, in my experience, you can do it with somewhat less risk and more strategic growth potential through an investment approach geared toward dividend income rather than capital gains.

Risk 6: Relying too Much on Social Security

For the first time since 1982, Social Security recently had to dip into its trust fund to pay for the program. After 2034, the Social Security Administration projects that if nothing is done to reform the system, benefits will have to be reduced by 23%. Whether Social Security is reformed or not, the reality is that for most people Social Security doesn't provide nearly enough income to help meet their needs and goals in retirement. While it can be a significant part of your income strategy, it needs to be considered in the context of other income-generating sources, such as your 401(k) and IRA.

Risk 7: Unexpected Events

Life always tends to throw curveballs our way, but with a little pre-planning, you can be ready for them. Here are a few unexpected events that have been known to wreak havoc on the retirement plans of many people.

- Major health event: Whether it's an injury, heart attack, disease, or something else, a major health event can have a major impact on your finances at any stage of life — but especially during retirement. Statistically, the number one reason for financial hardship during retirement is the onset of a major health issue. Though you can never fully guard against health problems, you can take steps to help reduce your risk through preventive healthcare measures and good lifestyle choices, and you can take steps to help protect your finances through proper planning.

- Reduction in income from the loss of a spouse: This is one of many potential crises you can help prepare for through estate planning. Though many people mistakenly believe an estate plan is only concerned with what happens to your money after you die, the fact is estate planning also helps to protect and grow your assets while you're still alive. Estate planning is a crucial ingredient in your broader retirement income strategy.

- Caring for elderly parents, dependent children, or grandchildren: Modern family life has created a "Sandwich Generation" of retirees who are picking up the responsibility of caring for their elderly parents, while also caring for their own grown children and grandchildren. Instead of spending their "golden years" enjoying the activities they had planned, many retirees find themselves taking on the extra financial and emotional burdens of supporting their grown children financially and/or caring for their elderly parents or grandchildren. Though this is a tough situation for all involved — it's also one that can be managed with proper planning.

Take Action!

So, how can you best make sure you help avoid these 7 Easy-to-Avoid Risks and many others? Simple: Contact a qualified financial advisor who specializes in the universe of income-based investments designed to help protect your principal and generate more reliable income through interest and dividends. This is income you can spend, or if you don't need it, reinvest to grow your portfolio organically — "the old-fashioned way"!

Source:

1. https://www.inverse.com/article/10455-here-s-how-americans-re-living-past-age-100

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