Reinventing RETIREMENT

Your Retirement Planning Newsletter

Third Quarter 2017

What Can Squirrels Teach Us About Saving?

They're smart and adaptable, and they plan

Darwin said that organisms don't need to be the smartest to survive, they need to be the most adaptable. Gray squirrels are a double threat: they are both smart and adaptable, equally at home in the woods, a backyard, or the city.

It turns out they also have a phenomenal ability to change their behavior to survive, including finding, storing, and retrieving nuts.[1] This puts them close to humans' ability to meet a long-dated future goal, such as saving money.

Sizing up nuts... and investments

Much as we assess which investments have the potential to provide long-term growth or preserve capital, squirrels use their sharp peripheral vision to size up nuts to see which ones are good to eat. Nuts that sprout use up valuable nutrients. A savvy squirrel will use its sharp teeth to cut off a nut's sprouting mechanism, thereby preserving its food value for winter.

When evaluating an investment for the future, such as a mutual fund, you want to be sure that the strategy it follows has the potential to deliver the results you expect over many years, often decades. In a way, you're sizing up your own nuts!

Looking at the fund's past performance is an often-useful way to evaluate returns, but it shouldn't be the sole factor. (Remember, past performance does not predict future returns.) In addition, look at the consistency of the fund's returns over time. How did it do against its benchmark in a down market? A fund that consistently underperforms in a down market is like a sprouting nut. Consider avoiding it, or replacing it with another option.

Don't hide them all in one spot

According to researchers, fox squirrels move thousands of nuts among five or more locations to discourage pilfering by rival squirrels.[2]

By avoiding losses, squirrels reduce risk. You do the same thing when diversifying a portfolio. Rather than putting all your "fund nuts" in one basket, you may be able to lessen the risk of experiencing a large loss by spreading your investments across multiple funds. There's less likelihood of all investments going down in value at the same time.[3]

Investors diversify by including stocks, bonds, and cash in their portfolios. Stocks, which represent shares of ownership in a company, usually perform differently from bonds or cash. Over long periods, stocks generally have provided the greatest returns, but with the most risk. Corporate bonds, which are essentially loans to a company, offer somewhat less return potential, but with less risk than stocks. Cash or "cash equivalents" typically are the least risky asset class, but also offer the least return.

Having the right balance of asset classes may help you save more for the future in a smart way — just like our crafty friends, the squirrels.

1 Natalie Angier, "Nut? What Nut? The Squirrel Outwits to Survive," New York Times, July 5, 2010. http://www.nytimes.com/2010/07/06/science/06angi.html

2 "Fox squirrels show long-term investment savvy when hoarding nuts," Berkeley News, October 3, 2012. http://news.berkeley.edu/2012/10/03/squirrelnuts/

3 Diversification does not guarantee a profit or protect from losses.

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Would You Rather have $1 Million or $5,000 a Month to Retire?

Choosing between these values is all about your perspective

Some people view having $1 million in the bank as more valuable than having an income of $5,000 per month. However, both values are roughly equivalent. This example illustrates what behavioral researchers call the illusion of wealth and the illusion of poverty.[4]

It seems that most of us have been conditioned to be attracted to large numbers, and in fact, having a $1 million war chest at our fingertips may be very appealing. But consider how the illusion of wealth may skew your judgment. Many financial planners use a rule of thumb not to withdraw more than 4% a year from your retirement account. Historic research has shown the risk of that withdrawal rate depleting the account as very remote. But a 4% annual withdrawal rate taken from a $1 million nest egg is just $40,000 — not chump change, but not likely to fund a lavish lifestyle, either.

On the other hand, the option to take $5,000 a month from an investment account may appear to suffer from the illusion of poverty, at least when comparing it to the $1 million lump sum. But here, again, perspective matters. It turns out that a $5,000 per month income is roughly equivalent to a $1 million nest egg that's annuitized (that is, converting it to a contract that provides a stream of fixed monthly payments for a defined period).[5]

When we examine our assumptions about money, it helps to consider the filters we use to make comparisons. Sometimes, illusions of wealth and poverty play a subliminal role.

4 Would You Rather Have $1 Million or $5,000 Monthly in Retirement?" Wall Street Journal, March 27, 2017. https://www.wsj.com/articles/would-you-rather-have-1-million-or-5-000-monthly-in-retirement-1490582208

5 Annuities are long-term, tax-deferred vehicles designed for retirement. There are costs and limitations associated with this product and guarantees are based on the claims paying ability of the underlying insurance company.

Long-term Investment Success: Time

Sticking to a sensible strategy potentially beats market timing

When the markets drop, sometimes investors panic, selling at or near a market bottom. Then they wait too long to get back in once the market recovers. More often than not, these investors make "market timing" decisions based more on emotion than logic.

Much as we'd like to, no one can predict the future, including the direction of the stock market. It makes little sense to base your investment plans and decisions on unknowns, over which you have no control.

Market timing usually fails as an investment strategy because it involves two decisions: knowing when to get out, and knowing when to get back in. Getting both decisions right is very tough, even for professional investors. Selling at the wrong time locks in actual losses, while staying invested only incurs losses on paper — they don't really affect you until you sell.

Instead, you should establish a solid, long-term investment plan and stick to it. Contributing to your retirement plan each month imposes a certain discipline that has the potential to make you more money over time.[6] This is because your regular investment buys fewer shares of a fund when prices are high, but more shares when prices are low. The result? Potentially, more money to spend in retirement.

6 There is no guarantee that dollar-cost averaging will generate a profit or protect against investment losses. Investors need to carefully consider whether they can continue to invest in an extended down market.

Don't Know Where You're Heading? Any Road Will Take You There.

Having a personal plan is the critical first step to organizing your finances

Financial planning may seem daunting, if all you've ever done is pay bills and manage a checkbook. But personal planning — really, the first step to organizing your financial affairs — depends more on common sense than math skills. Here's a quick and simple guide to getting your financial house in order.

1. Get your records together.

Head to your local office supply store and pick up an inexpensive accordion folder that will organize the following documents:

- Bank, insurance, mutual fund, and brokerage statements, including individual retirement account (IRA) statements;
- Retirement plan statements from your employer's 401(k) or other qualified plan;
- Records from any other sources of income you receive, such as certificates of deposit (CDs) or savings bonds; and
- List of debts, including your most recent monthly mortgage statement, credit card statements, home equity line statement, car loans, education loans, etc.

2. Focus on your debt picture.

How much do you owe? How do you intend to pay it off? What interest rate are you paying on each type of debt? You need to have a clear picture of when you realistically expect to retire these obligations. It usually makes sense for you to pay down your highest-interest-debt first, although some financial planners recommend taking care of accounts with the smallest balances — this can give you a positive psychic boost. If you are paying just the minimum monthly finance charge on your credit cards, it becomes nearly impossible to get out from under the debt cloud. If this is your situation, think about ways to cut spending, and use those savings to pay off your cards as quickly as possible.

3. Know how your retirement is invested.

Are you taking too much or too little risk given your lifetime goals? A useful rule of thumb is to subtract your age from 100; you might use this number as the percentage you want to invest in stock funds. (Of course, if you are uncomfortable taking on stock market risk, or have a near-term use for your savings, this approach may not be appropriate for your situation.)

In addition, most retirement savers don't need exposure to complicated investments. Stick to funds you understand, and rebalance them about once a year to your target allocation. (That means selling your winning funds and investing the proceeds into your underperforming funds, so that you maintain the amount of risk you're comfortable taking in your portfolio.)

If you lack the time, interest, or basic knowledge to manage your investments, consider hiring a financial advisor, or allocating your contributions to a target-date or target-risk fund if one is offered in your retirement plan. These funds take the work out of managing your portfolio, as the fund managers make investment and asset allocation decisions for you.

4. Build a working budget.

To get a handle on your spending, build a budget. Start by listing the expenses you don't have a choice about spending. Rent/mortgage, food, child support, health insurance, utilities, clothes, transportation, and taxes all fall in this non-discretionary spending category. Then, add in discretionary items, such as travel, entertainment, hobbies, charitable donations, etc. Don't forget to include your retirement plan contributions, since they will be a major source of income when you stop working.

Financial planning can be a very complicated exercise that considers many sources and uses of your money, assumptions about investment returns, interest rates, and future goals. (A free online tool that can help you do this is ESPlanner, discussed in the Tools & Techniques section on p. 4.) Personal planning, however, is a common-sense approach that helps you quickly gain perspective on what you own, what you owe, and the simple steps you can take to become more financially independent.

Retirement in Motion

Tips and resources that everyone can use

Amp Up Your Savings

In 2017, anyone at least 50 years old can contribute up to $24,000 to a 401(k).[7] Even if that amount seems beyond your reach, you should make it a goal to save more this year than last, and increase your savings by at least one percentage point a year. If your company's retirement plan offers an employer-matching contribution, take advantage of the maximum amount allowed, if you can. Expect a raise next year? Consider setting aside half of it for retirement.

Q&A

When does Medicare eligibility begin?

You qualify for Medicare if you or your spouse worked for at least 10 years in Medicare-covered jobs, are 65 years or older, and a US citizen or US permanent resident. You may also be eligible for coverage if you have a disability or have end-stage renal disease. To get an estimate of when you're eligible and your premium amount, visit https://www.medicare.gov/eligibilitypremiumcalc/.

Quarterly Reminder

Fall is a great time to revisit your personal and financial goals. For example, have you set aside an emergency fund, covering at least six months of living expenses? Started to exercise an hour a day? Paid down high-interest debts? Started a college fund for the kids or your favorite nieces and nephews? Sometimes it's helpful to break big goals into smaller bite-sized pieces. Writing them down is an excellent way to help you visualize success.

Tools & Techniques

How much should you spend, save, and insure each year to achieve a stable standard of living? That depends on a host of factors, including job changes, having children, retiring early and much more. ESPlanner is a free online planning tool that helps you make lifestyle decisions. Download at https://basic.esplanner.com/.

Corner on the Market

Basic financial terms to know

Stretch IRA – Just as it sounds, a stretch IRA is a minimum withdrawal strategy designed to "stretch" the period over which earnings can be tax-deferred. This is a popular tax mitigation technique with inherited or "Beneficiary" IRAs. Essentially, the IRS allows you to take minimum annual withdrawals from such IRAs based on your life expectancy. Of course, withdrawals are taxed as ordinary income at your federal income tax bracket.

7 401khelpcenter.com, "401k and Retirement Plan Limits for 2017."

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