PLANNING FOR A MORE EXPENSIVE RETIREMENT

JAMES L DRUFFNER
CPA/PFS, CFP, CMA
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One of the most difficult challenges in today's financial planning profession is handling client expectations. Most people believe that financial planning is simply the process of finding an advisor who can get them high returns with minimal risk.

There are two problems with that belief. The first is that achieving financial security is primarily the result of making good decisions throughout one's life. In fact, when people ask what I do, I pull out my elevator speech: "I help people make good decisions."

The second problem is that clients (especially those who watch TV commercials) believe that there are high returns with low risk out there somewhere. There aren't. Or at least not anymore.

In the March 2017 edition of the Journal of Financial Planning, there is an excellent article by David Blanchett, Michael Finke, and Wade Pfau entitled "Planning For A More Expensive Retirement."

Let's start with their warning to financial planners:

> "The risk of presenting unrealistic scenarios is that clients may believe that they can achieve long term financial goals without the sacrifices required by the low-return environment."

In laymen's terms, the era of high returns is over and people need to adjust accordingly. Some statistics:

- Stocks in 2016 were nearly three times as expensive as they were in 1980 for each dollar of profit.
- Stock prices have risen more rapidly than firm earnings. The rise in stock prices without a rise in stock earnings has created an expectation of future returns that is inconsistent with actual returns.
- Stocks would need to fall significantly in value (by more than half) in order to maintain the historical equity premium.
- The average amount an investor paid for $1,000 of corporate earnings since 1881 was $16,671. Today an investor must pay $27,812.

- The price of a dollar of safe income for a client retiring in 2016 is nearly 50% higher than it was for a client retiring in the year 2000.
- At age 35, optimal savings rates rise to 24.1% in a low return simulation compared to 14.3% using historical returns. If the household waits until 40, the optimal savings rate rises to 27.5%.
- The low yield on safe assets, coupled with increases in longevity, has doubled the cost of buying guaranteed income in retirement since 1980.
- A couple who begins saving 18.7% of income at age 35 can maintain their lifestyle in retirement if they delay retirement to age 70.

But wait! It gets worse.

There's that longevity issue that also comes into play. At age 65, one member of a couple has a really good chance of living another 35-40 years.

Again, quoting the authors:

> "The combined impact of lower asset returns with long retirements suggests that retirement in 2016 was the most expensive it had been since calculations began in 1980 and would require increased savings, reduced consumption in retirement, a delayed retirement, or some combination of these to achieve a successful retirement."

Why is all this important? Because the expectation of high returns on investments leads people to make bad decisions. No one can predict the future, but one can make informed guesses. And given the information we have to work with now, clearly the expectation of LOW returns on investments will serve people better in making good decisions about their financial future, especially with regard to retirement planning.