

February 2011 Issue

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The Pleasant Burden of Living Longer

It's the proverbial good news, bad news story: Americans are living longer. The good news is not only that we're living longer, but that we're staying healthier longer, too, so we're able to enjoy those longer years. But the bad news is that unless we've planned well enough to avoid running out of money, we might have trouble financing those extra years.

First, here are the facts. According to the latest federal statistics, average longevity for U.S. men and women is at an all-time high: 75.3 years for men and 80.4 years for women. But, if you make it to age 55, you can expect to live until you're 79 if you're a man and 83 if you're a woman; and if you're 65, you can count on making it to 82 (male) or 84 (female). Odds are that this trend is going to increase. Some life scientists are forecasting that within another two generations, life expectancies in the industrialized nations of the world could reach 100.

Think of what this means. If you retire at age 55, you could already spend almost the same number of years in retirement as you did earning a living.

Meanwhile, there's pressure on the retirement-income end of the equation. Stock market values have declined in the past few years, interest rates are near historic lows putting the squeeze on fixed incomes, fewer and fewer employers offer pension plans, and demographics are working against the health of the Social Security system.

In 1950, when Social Security had been around for less than 20 years, there were 16 people working for every retiree (Source: Social Security Administration, 2010). Today, that number has dropped to 3.3 workers per retiree; and by 2025, it will reach - and

remain at - about two workers per retiree. That means there's a chance that benefits will have to be reduced, unless taxes increase.

The bottom line is that whether you are still working or already retired, you now need more than ever to have a sound financial plan to cover your retirement income needs. Here are the considerations:

If you haven't yet retired:

- Can you retire as young as you previously planned or hoped, or should you postpone it by working full-time? Should you consider easing into full retirement by several more years earning income part-time?
- How many years do you need to plan for? A conservative plan would cover you at least until you reach the age of 85.
- Are you saving enough every year? Remember that once you're older than 50, the federal government increases the limits on how much you can contribute to tax-deferred retirement plans.
- Which is better for you: a traditional tax-deferred retirement plan that requires you to pay taxes on your withdrawals, or a Roth IRA/401(k) that you fund with after-tax income but pay no taxes at all when you make withdrawals?
- What asset allocation strategy will achieve the growth rate you will need to reach your nest-egg goal?
- What provisions should you make for long-term health care?

If you're already retired:

- If you're able, should you find a source of part-time income?
- Do you need to pursue higher interest rates on your bond portfolio? If so, how much risk should you take to get them?
- Should you increase your portfolio exposure to stocks to potentially raise your long-term growth rate?
- Should you consider making adjustments to your lifestyle, particularly for discretionary spending on such items as vacations, club memberships, dining out, and entertainment?

We may or may not have passed the bottom of the current economic and stock market cycle, in which case market and fixed-income returns will or won't go up from here. Whatever the case, our increasing longevity means you need to change your assumptions about how big your nest egg has to be and how you manage it to meet your long-term goals.

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A Dream Is Not a Plan

Year after year, funding retirement consistently comes up in surveys as the most worrisome financial concern on people's minds. Yet, most people spend more time planning a vacation than they do planning for retirement. Here are some of the vacation questions everybody asks themselves:

- Where are we going and when?
- How will we get there?
- How long will we stay?
- How much is it going to cost us, and where will we get the money?

But if people planned their vacations like most plan for retirement, here's what it might sound like:

Okay, honey, it's time for our dream vacation. Pack the bags; bring some cash and the credit cards. We'll go to an airport and take the first plane we can catch. We'll stay in the best hotel we can find, eat at the best restaurants, and stay until the money runs out.

The difference between these two approaches is that one way involves setting a goal and managing money to reach it. The other is an impulse based on dreams, wishes, and hope.

To be more than a dream, an investment goal includes the following:

- **Time horizon:** When will you need it?
- **Amount:** How much money will you need?
- **Term:** For how long will you need it?
- **Resources:** How much do you already have put aside, and how much more can you put aside every year?
- **Rate of Return:** What rate of return will you need?

Now, let's see what's involved in answering these questions.

When Do You Want to Retire?

Start here with your dream. There's no point in starting with your sense of when it's practical for you to retire, because sooner or later you're going to want to know when the earliest date is that you can afford to retire. If you would really like to retire when you turn 55, run the numbers and see what happens.

How Much Annual Income Do You Want?

If you don't know what your lifestyle is going to cost you 20 or 30 years from now, relax. Simple rules of thumb indicate anywhere from 60% to over 100% of your current annual household budget; if you can't decide, start with 80%.

How Long Will You Need It?

Nobody knows how long they're going to live, but Americans are living longer than ever. If you reach the age of 65, the odds are good that you'll live at least to age 85, so use that age for your calculations. If you're older than 65, add 20 years to your time horizon.

How Much Savings Do You Have Already, and How Much Will You Have When You Retire?

Here, you need to start with how much you've already accumulated in retirement assets, and how much they will total by the time you retire, given how much you put away and the rate at which it's growing. You also need to estimate any other sources of annual income you may have, including Social Security, a pension, and rent or royalties, plus the value of the sale of any assets, like investment property or a business.

What Annual Rate of Return Do You Need?

Notice that the rate of return comes last in this sequence of questions, because it can't be answered by itself. It has to be derived from the answers to the preceding questions. The investment choices you make and the investment returns you earn will be heavily dependent on your answers to the preceding questions.

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Make Sure There's One, and Only One, You

By now, you've probably heard plenty of the horror stories: people's bank accounts emptied, loans taken out for which they've never applied, bills unpaid, and credit ratings ruined. The cause: identity theft.

While we typically believe that identity theft is strictly a high-tech enterprise, the truth is that in addition to computer hacking and Internet scams, there are a number of low-tech ways of stealing someone's identity. Here are 10 different ways to guard against identity theft:

- Never give anyone you don't know or trust your Social Security number, in person, through the mail, over the telephone, or via the Internet.
- Buy a shredder and shred every document or item that has vital identity or financial information before tossing it into the garbage - especially your expired credit and debit cards.
- Don't fall for e-mail inquiries that ask for your passwords or any other high-stakes personal information. Typical attempts include requests from "banks" to verify information, notifications that you've won a sweepstake prize, or requests from a stranger who needs help moving a gigantic sum of money. These are typically phishing schemes. Phishing involves convincing consumers to divulge personal financial information on fraudulent web sites. For example, a consumer might receive an e-mail message from a phisher asking the recipient to click on a link in the e-mail to confirm account information. The web site the consumer is directed to is a fake or copy of the real web site. When the consumer enters the financial information, the phisher acquires all information needed to access the consumer's bank account or commit other forms of identity theft.
- Cut down on the number of credit and debit cards you carry in your wallet. Purse and wallet thefts are one of the most common forms of low-tech identity thievery.
- Report the loss of your wallet within 24 hours to assure that you'll be protected against any unauthorized charges on your credit cards. Keep a list or photocopy of all of your credit cards in a safe place inside your home, so you can quickly notify every issuer if they're lost or stolen.
- Never leave a restaurant with a signed credit or debit card bill sitting on the table. Make sure you hand it to your server or the cashier.
- Never permit your credit card number to be written on one of your personal checks.
- Always take your credit card receipts with you. Never throw them away in a public trash bin.
- Order a copy of your credit reports once a year. By federal law, credit bureaus are required to provide you with one copy a year free of charge.
- Place a "freeze" on your credit reports, which means you prevent them from providing any information without your expressed permission. This prevents thieves from taking out loans, opening new credit cards, or charging accounts in your name without your knowledge.

Security experts will tell you it's impossible to protect everyone from identity theft. But by taking these 10 precautions, you can significantly reduce the chances that the next victim will be you.

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Financial Decisions Regarding Your Children

Caught up in the day-to-day routine of raising your children, it's easy to forget to take care of other financial decisions involving them, including:

- **Naming a guardian for your minor children.** If you and your spouse both die without naming a guardian in your will, the courts will appoint one and will supervise your children's property. You may want to consider naming two guardians - one to take physical care of your children and one to manage their assets. As your children grow, review your guardian choice every couple of years.
- **Purchasing sufficient insurance.** You should obtain enough life insurance to provide for your children until they are adults. Determine how much is needed for living expenses, hobbies, medical expenses, and college. Consider other items as well. For instance, will your guardian's home comfortably accommodate your children, or should you leave funds for an addition to the house? Include a financial cushion so there is plenty of money for unanticipated expenses. Also ensure you have adequate disability income insurance, so your family's lifestyle won't be disrupted if you have an injury or illness.
- **Saving for college.** Determine how much you need to save for your children's college educations. You may have difficulty saving the amount needed to fully fund a college education. However, there are other sources to help fund those costs, such as borrowing and financial aid. Thus, your goal may be to accumulate 30%, 50%, or some other percentage of the total cost of college. Take a look at education savings accounts and section 529 plans, both of which have significant tax advantages.
- **Teaching money basics to your children.** In a society that has difficulty managing money, teaching your children good money skills is a lesson that will benefit them for a lifetime. As you teach these lessons to your children, keep in mind that how you treat money is probably the most significant influence on your children's views about financial matters. If you make large purchases only after careful research and price comparisons, your children will learn to be careful before making a purchase. If you use credit cards cautiously and explain how to select a card, what items to charge, and how to pay off the balance every month, your children will learn not to abuse credit cards.
- **Saving for your retirement.** Don't feel guilty thinking about your own retirement when your children still need your help. One of the best gifts you can give your

children is the knowledge that you will be financially independent during retirement.

- **Gifting assets to your children.** If you plan to leave assets to your children after your death, you may want to start making annual gifts, up to \$13,000 in 2011 (\$26,000 if the gift is split with your spouse), to any number of individuals without paying federal gift taxes. You can then teach your children how to handle those gifts and share in their joy from the gifts.

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Choosing Beneficiaries for Your 401(k) Plan

When you sign up for your 401(k) plan, you will typically be asked to fill out a beneficiary designation form, listing who should receive your 401(k) plan assets when you die. Make these selections carefully, since they typically override any provisions in your will.

If you are married, federal law dictates that your spouse is automatically your 401(k) plan's beneficiary. Even if you list another person as the primary beneficiary, your spouse will receive the proceeds unless he/she signs a written waiver. Thus, even if you are separated but not divorced from your spouse, he/she will be entitled to your 401(k) proceeds after your death.

Similarly, if you remarry and want to keep your children from a previous marriage as the beneficiaries, you must have your current spouse sign a waiver. You should not rely on a prenuptial agreement or other document.

When your beneficiaries are minor children, keep in mind that most 401(k) plans will not transfer money directly to minor children. Thus, you may want to set up a trust, so the trustee can take immediate control of the funds. Otherwise, a court-appointed trustee or guardian may need to be named before your children will have access to the funds.

If you are single and don't name a beneficiary, the proceeds will go to your estate and be distributed with the rest of your assets.

Periodically review your beneficiaries to determine if changes are needed. A divorce, remarriage, spouse's death, or child's birth are all events that may require changes to beneficiaries.