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The Major Retirement Planning Mistakes

Why are they made again and again?

Provided by Frank DeMaio*

Much has been written about the classic financial mistakes that plague start-ups, family businesses, corporations and charities. Aside from these blunders, there are also some classic financial missteps that plague retirees.

Calling them "mistakes" may be a bit harsh, as not all of them represent errors in judgment. Yet whether they result from ignorance or fate, we need to be aware of them as we plan for and enter retirement.

Leaving work too early. The full retirement age for many baby boomers is 66. As Social Security benefits rise about 8% for every year you delay receiving them, waiting a few years to apply for benefits can position you for greater retirement income.[1]

Some of us are forced to make this "mistake". Roughly 40% of us retire earlier than we want to; about half of us apply for Social Security before full retirement age. Still, any way that you can postpone applying for benefits will leave you with more SSI.[1]

Underestimating medical expenses. Fidelity Investments says that the typical couple retiring at 65 today will need $240,000 to pay for their future health care costs (assuming one spouse lives to 82 and the other to 85). The Employee Benefit Research Institute says $231,000 might suffice for 75% of retirements, $287,000 for 90% of retirements. Prudent retirees explore ways to cover these costs – they do exist.[2]

Taking the potential for longevity too lightly. Are you 65? If you are a man, you have a 40% chance of living to age 85; if you are a woman, a 53% chance. Those numbers are from the Social Security Administration. Planning for a 20- or 30-year retirement isn't absurd; it may be wise. The Society of Actuaries recently published a report in which about half of the 1,600 respondents (aged 45-60) underestimated their projected life expectancy. We still have a

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lingering cultural assumption that our retirements might duplicate the relatively brief ones of our parents.[3]

Withdrawing too much each year. You may have heard of the "4% rule", a popular guideline stating that you should withdraw only about 4% of your retirement savings annually. The "4% rule" isn't a rule, but many cautious retirees do try to abide by it.

So why do some retirees withdraw 7% or 8% a year? In the first phase of retirement, people tend to live it up; more free time naturally promotes new ventures and adventures, and an inclination to live a bit more lavishly.

Ignoring tax efficiency & fees. It can be a good idea to have both taxable and tax-advantaged accounts in retirement. Assuming that your retirement will be long, you may want to assign each investment to its "preferred domain" – that is, the taxable or tax-advantaged account that may be most appropriate for that investment in pursuit of the entire portfolio's optimal after-tax return.

Many younger investors chase the return. Some retirees, however, find a shortfall when they try to live on portfolio income. In response, they move money into stocks offering significant dividends or high-yield bonds – which may be bad moves in the long run. Taking retirement income off both the principal and interest of a portfolio may give you a way to reduce ordinary income and income taxes.

Account fees must also be watched. The Department of Labor notes that a 401(k) plan with a 1.5% annual account fee would leave a plan participant with 28% less money than a 401(k) with a 0.5% annual fee.[4]

Avoiding market risk. The return on many fixed-rate investments might seem pitiful in comparison to other options these days. Equity investment does invite risk, but the reward may be worth it.

Retiring with big debts. It is pretty hard to preserve (or accumulate) wealth when you are handing chunks of it to assorted creditors.

Putting college costs before retirement costs. There is no "financial aid" program for retirement. There are no "retirement loans". Your children have their whole financial lives ahead of them. Try to refrain from touching your home equity or your IRA to pay for their education expenses.

Retiring with no plan or investment strategy. Many people do this – too many. An unplanned retirement may bring terrible financial surprises; retiring without an investment strategy leaves some people prone to market timing and day trading.[4]

These are some of the classic retirement planning mistakes. Why not plan to avoid them? Take a little time to review and refine your retirement strategy in the company of the financial professional you know and trust.

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Citations.

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