RETIREES

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HOW TO MAKE MONEY LAST IN RETIREMENT

We're living longer. And even if we've saved for our retirement, will we have enough? When should we file for Social Security benefits? And how much should we be taking out of our retirement portfolios each year? A recent panel at the Morningstar Individual Investment Conference tackled these questions and more. Panelists included Morningstar's Christine Benz, financial planner Mark Balasa, of Balasa Dinverno Foltz, and retirement specialist Mark Miller. Here's an edited excerpt of the conversation:

Morningstar: Mark, when you have a client who comes to you and says, "I'm thinking about retiring; I'm not sure if I have enough," how does longevity enter into the discussion?

Mark Balasa: Let's say you're 65; your life expectancy is usually in your early 80s. Fidelity and J.P. Morgan have done some nice work showing that a married couple, if they are 65 at the moment, has a 90 percent chance of one of them making it to 80, a 70 percent chance of making it to 85, and a 50 percent chance of making it to 90.

So we try to help them better understand that, as a couple, someone is going to be here probably longer. We need to be really conservative when we are running projections — should it be around 85, 90 or 95? We help to encourage them to think about longevity in those terms.

Christine Benz: You also want to factor in your own health history, familial health history, your parents' longevity and your grandparents' longevity. If your family has a history of longevity, you also want to think about the role of cognitive decline because we also tend to see a strong correlation between longevity and a higher prevalence of cognitive decline. An NIH study found that roughly 25 percent of people in their 80s were experiencing some sort of cognitive decline or dementia, and that number jumps even higher if you are in your 90s.

The combination of that greater longevity and potentially the need for long-term care would argue for a larger pool of money that you would need to set aside for your own retirement.

Morningstar: A lot of people talk about working longer into their retirement years. Mark, you have written about employment prospects for older workers. How realistic is that expectation?

Mark Miller: It's a great aspiration, and it's a good idea to work a few additional years. Even working an extra three to five years is very salutary for your retirement plan in terms of additional years of contributing to retirement accounts, fewer years of drawing down from that money in large sums and then the opportunity to delay your Social Security claiming. Together, those things can have a very dramatic impact on your retirement plan.

There is also, however, an acknowledgment that there is a lot of age discrimination in the workforce. The numbers also tell us that roughly half of people retire earlier than they expected because of a health problem or because they are providing care for somebody else, job loss or job burnout. So, I think working longer is a great strategy, and it is a great thing to try to do. It is not a plan, though.

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Morningstar: For many, Social Security will be the only guaranteed lifetime income source. Can you provide some sort of basic rules of thumb or guidelines in terms of how to best treat that benefit?

Miller: At a high level, I think delayed claiming is something most people should think about — especially married couples — because, as has just been pointed out, one person in the couple is likely to exceed the longevity numbers, and that's where Social Security provides a huge benefit. Oftentimes, you have situations where people get into their late 80s or 90s, and they've exhausted their savings, and then Social Security is still there as a bedrock.

Morningstar: If you are trying to build a portfolio that's going to last for a 25- or 30-year retirement or longer, what are the basic components that you need to focus on?

Benz: I think a balanced portfolio really is a great starting point. You absolutely need equities for the longevity risk. You need that growth portion of your portfolio. When you think about the fact that starting bond yields have historically been a pretty good predictor of what you might expect from bonds over the next decade, well, at 2 percent on the Barclays U.S. Aggregate Bond Index right now, that's not a return engine for many retirees. They'll be lucky to keep up with inflation at that level. So, you absolutely do need stocks in the portfolio.

In talking to retirees recently and hearing from readers, though, my concern is that there is some complacency about equity-market risk — that, in fact, retirees are perhaps too comfortable with their equities. They have forgotten what it felt like during the bear market. So, if anything, I think many retirees seem to be erring on the side of having too much equity risk in their portfolios. You absolutely do need stabilizers, and that's why my hypothetical retirement bucket portfolios include cash, they include high-quality bonds — miserly yields and all. But the idea is that those are the ballast for the return-engine piece of your portfolio.

Morningstar: How should people think about health care spending in retirement?

Miller: I would start with Medicare because most of us are going to file for it at age 65. Medicare does a good job of smoothing out the more general, routine health-care costs and some not-so-routine costs as well. If you need to go into the hospital, it covers a great deal of that.

The basic decision is whether you want traditional Medicare or the managed-care version, which is called Medicare Advantage. It can save some money for some people, but I still regard traditional Medicare as the gold standard because it gives you the greatest flexibility in terms of seeing providers. It costs a bit more, and it requires more paperwork because you're putting together the different layers on your own. There are more moving parts. But for a lot of people it's the way to go because they don't want to worry about just seeing in-network doctors.

Morningstar: Mark, is long-term-care insurance something that you recommend for your clients?

Balasa: In many cases, our typical client can self-insure because they have sufficient assets. The typical monthly cost of long-term care in today's dollars is somewhere between $8,000 and $10,000. We then use a conservative average stay of around four to five years. We'll put that into their plan, inflate it and see whether the client can withstand that.

Some clients still like insurance because of the psychology around it. They've seen how their own families have been devastated by end-of-life costs, and so they might buy just a starter policy, even though they don't really need it.

Miller: There have been massive price increases with long-term care policies because the underwriters have had trouble figuring out how to properly price these things. Some people think we're through the worst of that, but the increases have been scary. For people who have seen increases of 40 percent, it usually makes sense to hang on and ride through it, because you've already invested in the policy.

Morningstar: Some people like the lifetime income stream that annuities offer. Others talk about the high cost and wonder if it's worth it. Are there specific kinds of annuities that you would recommend?

Benz: I would tend to start with a very plain-vanilla annuity type. The problem is, interest rates are really low. Annuity payouts from the single premium immediate annuities are arguably as low as they can go, too. I think it might be an interesting product for someone who wants to just add that baseline of assured income, but the timing issue is certainly there.

Balasa: You can make a scenario for annuities, but a lot of times, the cost is an issue, and also the quality of the insurance company backing the annuity. And then, of course, the big concern is people losing the assets at death. There are different payout options for survivors, but when you factor in that the money doesn't pass on to the family, that's for many families a showstopper.

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