THE ESSENTIAL GUIDE FOR THE NEW AGE OF RETIREMENT

WHY THE RULES HAVE CHANGED

L David Overson

This document discusses general concepts for retirement planning and is not intended to provide tax or legal advice. Individuals are urged to consult with their tax and legal professionals regarding these issues.

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INTRODUCTION

I'll never forget the day she came into my office. Even I was amazed by the story she told.

Mary was an attractive, fit woman in her early seventies with a kind, gentle demeanor that put me instantly at ease. It was our first meeting but it could have been our tenth. It didn't matter. We hit it off well. She had attended one of my financial workshops the prior week and felt the need to come in for financial advice.

As I began to ask questions about her situation, Mary revealed that her husband had died four months previous. She told me that they really didn't talk much about their finances. Bill liked to handle the money. She trusted him with it. He did his thing and she did her thing. It seemed to work well for them. But now he was gone and she didn't understand what her husband had done with their finances. She possessed little knowledge of investments and she was aware of it. What troubled her more was the fact that she was losing money every month. Lots of money. She was down about $400,000 in four months. The distress was clearly evident in her voice.

I began to peruse the brokerage statements Mary had placed in front of me. There were four, each from a different brokerage house. As I scanned the list of investments in each account, I was quite surprised at what I saw. Nearly every stock came from the technology field, names such as Oracle, Global Crossing, Palm, Solectron, Sun Microsystems and Compaq Computer. I could see that this was no average portfolio. A typical portfolio might contain a diversified mix of cash, bonds, large, high-quality stocks, some smaller, more aggressive stocks, and maybe even some international stocks. Not this one. I had never before seen such a high concentration of stocks in one sector of the market. Bill had plenty of money. He didn't need to take that kind of a risk.

It soon became apparent to me that Bill had rolled the dice with their investment accounts. This was a very aggressive portfolio. In all fairness to Bill, he had every right to be aggressive. It was his money. He had earned it. He could invest it any way he wanted. The problem was that Bill hadn't planned on two things that suddenly happened: his untimely death and the year 2000, the beginning of the end of the dot-com boom. That day, Bill wasn't sitting in front of me in the office – Mary was. And she was worried and seeking advice on how to correct the costly hemorrhaging of a net worth that was over $2.5 million the day Bill left the investment world for the spirit world.

This story has a happy ending, fortunately. Mary decided to transfer her accounts to my firm. I was then able to make needed adjustments in her portfolio that greatly reduced the risk and shored up the balance with a more reliable outcome. I was very happy with the final design. Mary was, too.

As the years have passed, I have met with Mary dozens of times for reviews and adjustments in her planning. She has since remarried. She's doing amazingly well in her late 80's. With each visit, the smile on her face has become, for me, a priceless validation of my efforts to make a positive difference in the financial lives of people.

Mistakes were clearly made in Mary and Bill's case, mistakes that could have been avoided by following sound principles of financial management. The following pages will address many of those principles. But there is a crucial fact that must be understood before we can proceed with any intelligent discussion of retirement planning or its principles. That fact is **change.**

WARNING! Traditional retirement as you know it or as you've come to understand it is about to be turned on its head. I will address in this book some of the reasons why I make such a brash statement and what you can do to prepare for the "new retirement" of the 21st century.

What has changed, you ask?

Gone are the days when you can earn a degree at an institution of higher learning, immediately find a job in your chosen career with full benefits, work your way up the company ladder over the next thirty-five years and then retire at age 65 with a pension, a gold watch, and a going away party stuffed with people you'll actually miss.

Gone are the days when you can contribute to a 401(k), IRA, or brokerage account with little knowledge or training in stock market behavior and average ten percent a year in return.

Gone are the days when you can save your money at fixed interest rates, outperform inflation, and earn enough interest to buy something more than a toaster and butter knife.

Gone are the days when government entitlement programs were healthy, funded adequately, and relied upon by all citizens as a blessing for hard work and effort instead of as a right.

Yes, a lot has changed. I will address in Chapter 1 a significant cause of many of the economic and financial changes we've experienced in this country over the last few years. And it's only the beginning of the changes that will occur. I am convinced that

America as we knew it and as we know it today will not be the same again, at least for decades to come. Because of these changes, many standard financial theories and concepts that worked in the past will not work well, if at all, in this new age of retirement. Every retiree and retiree wannabe will be affected by these changes. If you understand this changing environment, you can adapt. Otherwise, you will become an unwitting victim.

As for fundamental principles of retirement, the way you choose to approach retirement will impact your income, your taxes, your legacy and your emotional state of mind. It is a truism among financial professionals that when it comes to retirement ***a few hours of planning can be worth more than an entire lifetime of working and saving.***

How is that possible? Because **r*etirement changes all the rules you have followed up to this point.*** During your working years (the accumulation phase), you are able to take what I call "risk in the hope of greater gain." You don't need the money yet. It remains in your chosen investments. If you suffer losses, you have time to make them up.

Once you enter retirement (the distribution phase), you don't have a lot of time to make up losses if the risk doesn't pan out. In addition, you may need to withdraw an income to sustain your other income sources. You now can't afford to lose money since, as a result, your income payments may be reduced or a loved one may end up inheriting less of your hard earned assets. In other words, **the game has changed.**

The problem is that many retirees don't change anything about the way they invest or think about money. This is one of the many mistakes made in retirement planning: continuing to invest the same way after retirement that one invested before retirement. Why would someone do this? Because it's what they're comfortable with. It's what they know. It's always easier to follow what you know than to learn something new. Learning something new requires time and effort or money to buy better advice.

Retirement is more than kicking back and cashing in on your Social Security benefits. Not only are there thousands of different options for each individual that affect when and how to file for Social Security, there are thousands of options for how to invest individual retirement accounts (IRAs), 401(k)s and other investment portfolios. Investing is as unique as you are. Discovering the most efficient and effective way to invest your assets for a comfortable retirement requires a comprehensive understanding of the vast number of available options.

Think of it like this: You took time to choose your career, your educational path, your employment experience and your professional skill set. You chose a profession or a line of work that matched your skills and talents with your income needs. You probably spent some money getting educated or trained. Creating a retirement plan requires the same crafting and care that you put into your career. Your assets, your income needs, and your lifestyle are unique to you. They're different from anyone else. This is why **it is dangerous to seek financial advice from your friends and neighbors**. Did you ask them what career you should pursue, what church you should join, or which political party to embrace? If not, then why ask them how you should invest or plan the golden years of your life?

It's a sad fact that ***most people spend more time planning their vacations than they spend planning their retirement.*** The fact is most people do not have a good understanding of what they need to do for retirement. Not knowing what to do or how to plan for it makes it easy to default to procrastination. Putting off making decisions is a natural human reaction that usually hurts us or someone else. This choice can cause a myriad of problems that can greatly alter the course of your retirement.

This book is an attempt to share some of the vital principles that can help facilitate a more peaceful, rewarding experience in this new age of retirement. Whether you are anticipating retirement or already retired, this information can help you correct or avoid some of the common mistakes that can jeopardize your assets, your income, and your future way of life.

Let's begin with a discussion of why the rules have changed.

1

THE MOST IMPORTANT NUMBER IN FINANCE

If your outgo exceeds your income, then the upkeep will be your downfall.

– Bill Earle

76 million! The most important number in finance in the 21st century. Yet most people are unaware of the impact this number possesses in the arithmetic of their financial future.

76 million! An astounding number that represents a select group of people in this country. This group of people is so powerful, so influential, so demanding, so numerous that when they sneeze, the nation groans at what might happen. These people have become indispensable to the American economy and our way of life. In fact, they helped create life as we know it in America today. They have infiltrated every element of society, from the boardrooms of business to the hallowed halls of Congress. No

element of American life in the last 50 years has escaped their fingerprint. This group's expected impact on our society and the world caused Time Magazine to vote this group "Man of the Year" in 1966.

I'm talking about the Boomers – babies born between 1946 and 1964. That eighteen year period following World War II produced the largest number of births in the nation's history. War has a tendency to bring us back to things that really matter. The nation – in fact the entire world – was hungry for healing and a return to normalcy after a bloody and costly contest. As life began to return to normal, the resulting spike in the birth rate added a wonderful new chapter to American history.

Boomers comprise 27 percent of the total US population, quite astounding when you realize there are only eighteen years between the oldest and the youngest in the group. The Boomers are clearly a force to be reckoned with, a massive placement of human capital in the economy. When they rock, the rest of America rolls. When they roll, America rocks. Yes, I'm one of them but I don't mean to pat my own back by patronizing the Boomers. I'm well aware of the fly in the soup. For now, let's focus on how the sheer size of the Boomer generation makes them the most important element in finance today.

SPENDING AND THE ECONOMY

To begin, Boomers control over 80 percent of all financial assets in this country. It's no wonder. They created much of it through their innovation and desire to have more than their Depression-era parents enjoyed. They were a more privileged generation, conceived and raised by parents whom Tom Brokaw labeled "The Greatest Generation." Conditions were ripe at the time for these children to emerge in an improved economic environment that fostered their natural creative talents. Wonderful technologies and advancements occurred as this generation moved through society at large. The internet and its related accessories, cellular phones, lasers, medical resonance imaging (MRI), GPS, digital music, DNA fingerprinting, genetic sequencing, and yes, even Prozac, have all been invented or advanced during the Boomers' working years. As a result of these innovations, a record number of millionaires have been created during the last 40 years, a testament to the power of American freedom and capitalism.

The Boomers also comprise roughly one half of all spending in this country. They buy 77 percent of all prescription drugs and 61 percent of all over-the-counter-drugs. They account for 80 percent of all leisure/travel expenses. Why is all this important?

Spending is roughly 70 percent of the economy. An economy ebbs and flows according to the spending habits of its participants. For instance, when you buy a box of Lucky Charms (because they're magically delicious), you keep the store in business by moving product and earning a profit. The store then needs to replace the sold box of cereal with a new one therefore they order another box from General Mills, the company that makes them. General Mills keeps on making Lucky Charms as long as people buy them. Employees of General Mills get paid to make the cereal and send it to the store. They now have wages to spend. If more people buy the cereal, the company will have to hire more employees to meet the demand. More people are then put to work. Those people now earn a wage that will be used to buy, among other things, Lucky Charms for the breakfast table. More Lucky Charms sold means more profit for the officers of the company. They, in turn, buy breakfast at Starbucks because they don't have time for a Lucky breakfast. Starbucks then needs more lattes. This explains why Starbucks' stock has done so well. The process repeats itself. More people working means more dollars available in the economy to buy more Lucky Charms... and lattes. Everybody wins. The rising tide of increased spending lifts all boats. It's the circle of economic life.

Now let's trail the spending habits of the average citizen to learn how individual spending affects the economy.

As young people first enter the workforce, they begin to earn and spend. They contribute needed labor. The resulting paychecks get spent to buy goods and services. They move away from home and begin to build their own nest. They have babies. Now there is a need for more apartments, homes, furniture and diapers.

As these young people age and establish their careers, they usually earn more. The increased earnings result in increased spending on larger homes, better furnishings, newer cars and all the attendant trappings. By the time they reach their late-forties to early-fifties, they reach their peak spending years. The kids are now older, maybe even out of the house, and people start to reduce their spending. If there are any dollars left over at the end of the month, they direct them toward investments for retirement instead of a new home or a boat or Lucky Charms, thus reducing the amount available for spending on goods and services. When businesses sell fewer goods and services, they lay off employees, their profits decline and there is less spending in the economy. The spending tide goes out, lowering all boats.

Imagine what would happen if an immense generation of people began reducing their spending all within roughly an eighteen-year period of time? The first of the Boomers began retiring in 2011. This trend has already begun. The economy, the stock market, real estate and interest rates all will be affected by this immense change in the flow of money through the economy. Less spending translates into less profit for the companies that produce goods and services. Less profit means lower stock prices. Lower stock prices affect the value of retirement accounts. Lower retirement accounts create grumpy Boomers. No one likes a grumpy Boomer.

THE DILEMMA

To complicate matters further, the Boomers made a few big mistakes as they chased the American dream. First, they forgot to have babies. Generation X, the children of the Boomers, number approximately 82 million. This averages out to 1.07 children per Boomer. We'll return to this issue in a moment.

Second, the Boomers continued the tradition of government-sponsored entitlements funded on a pay-as-you-go basis. The game has worked for decades but now the game is up. The government's own projections show the so-called "trust funds" that pay these benefits will start showing a deficit by as early as 2019.

Most people agree that the current system needs a reform. Congress has been debating the issue for years. The Boomers didn't cause the problem but they haven't solved it yet either. Attempts have been made to reform the entitlement process but in the end little has changed and the challenges still face us.

So what is at the heart of the issue?

If a company you work for wants to provide you with a future pension or other retirement benefit, they are required by law to fund that benefit in advance by making contributions to the plan. That's only logical. This assures that money will be there when the promised benefit comes due.

Government, however, is exempt from this law. Government doesn't have to pre-fund future benefits. The government pays current benefits out of the taxes collected from those who are still working. In years when more taxes are collected than are needed to pay benefits, the government spends them instead of investing the funds so they'll be there for future lean years. When those promised entitlements come due to the Boomers, their children will be stuck with paying the promised benefits. Simply put, robbing Peter to pay Paul has left Pat with the bill.

This brings me back to the baby issue. I mentioned previously that the Boomer generation produced 1.07 children per Boomer.

This is going to be a problem. A big problem. Here's the million dollar question: How will each child be able to pay enough taxes to pay for their own public services AND pay for Dad or Mom's retirement entitlements AND fund their own future retirement benefits AND pay the interest on a national debt created by the desire of those same parents and grandparents to maintain a certain standard of living at any cost? The answer is obvious - they can't. It is a problem of astounding magnitude.

A PARADIGM SHIFT

This is the reason 76 million is the most important number in finance today. Like a cruise ship exiting a lock on the Panama Canal, just about everything will be affected by the movement of the Boomer generation into the next lock – the retirement years. Real estate, stocks, bonds and interest rates, the backbone of nearly every retirement plan, will react to this huge spending reduction wave, and those assets won't react the same way they have acted in the past. Stock market strategies that worked in the 1990s and 2000s will not work as well in the 2010s and 2020s, if at all. New strategies will be developed to capture a changing investment landscape. Investors who accept and prepare for this paradigm shift should weather it well with acceptable results.

In this complex and changing investment environment I believe there has never been a better time to utilize the advice of qualified financial professionals, especially those who specialize in retirement planning. Most investors simply do not have the time, the education nor the experience to navigate the retirement and investment waters that lie ahead of us. Too many, I'm afraid, will end up experiencing sub-par to poor results that will affect their peace of mind and way of life for years to come.

This wave of aging Boomers exiting the workforce and then consuming their investments throughout retirement will have the single greatest impact on retirement planning in the next 20 or more years. Everything will be affected by this wave. It is a predictable trend that has created a new age of retirement. If understood, this trend can help you plan better than you would otherwise. This book is designed to help you in that planning process.

CHAPTER 1 RECAP //

- Boomers are 76 million strong and comprise 27% of the total US population.
- Spending is 70% of the economy.
- As aging Boomers change their spending habits into their retirement years, the economy will be affected in a major way.
- Understanding this demographic shift can help you plan better than you would otherwise.