Making the right decisions at these milestone ages

Guide to Aging: Making the right decisions at these milestone ages

Working Americans at or approaching retirement age today face many unprecedented challenges unique to their generation. That's why it's important to have a retirement plan that addresses these challenges and uncertainties head-on. One of the keys to doing that is being aware of the retirement planning milestones that occur from age 50 onward. Several of these milestones present you with options that could significantly impact whether you have sufficient income to achieve your retirement goals. Of course, sound retirement planning is more than just a matter of paying attention to these age milestones. But, being aware of their significance and making the right decisions in coordination with your financial advisor when each one comes along can certainly improve your odds of success!

So, let's go through each milestone one at a time and discuss its significance along with some of the things you may want to keep in mind when considering what, if any, actions you might want to take.

Age 50 – This is when you are first allowed to make "catch-up" contributions to 401(k)s and other tax-deferred employer-sponsored retirement plans, as well as IRAs. Amounts are subject to change each year, with the current maximum being $6,000. Up-to-date guidelines are always available at irs.gov. Congress added the catch-up contribution option to retirement plans due to concerns that Baby Boomers, specifically, haven't been saving enough for retirement—which most studies and surveys indicate is true. Deciding whether you should make catch-up contributions is a matter you should discuss with your financial advisor while considering numerous factors, including when you'd like to retire, your additional financial assets, both existing and anticipated (i.e. Social Security), and your retirement goals—which we'll discuss much more in just a bit.

Age 55 – If you separate from your job, you may be eligible at this age to take an income distribution from your 401(k) or another employer-sponsored plan without paying an additional 10 percent tax for early withdrawal. Although there are exceptions to this "age 55 rule," there are also ways to use it to your financial advantage depending on your needs and situation. Regardless of that situation, there are some general things you may want to consider regarding any major financial decision or strategic move you may take at this age. One of those, again, is whether the move aligns with your specific long-term financial/retirement goals. Perhaps the most important thing to consider, however, is whether your decision allows you to maintain a sufficient focus on "financial defense" in your overall strategy.

Starting at age 55, financial defense becomes increasingly important to ensure you are protecting the assets you'll need to generate retirement income. Another way to look at it is to realize that by age 55, you should start shifting from a "growth mindset" to an "income mindset." Focusing primarily on portfolio growth and asset accumulation in your 30s and 40s is reasonable, but by your mid-50s, it's important to recognize that portfolio growth no longer needs to be your top priority—nor should it be. That's because when you're investing first and foremost for growth, you're probably focusing on capital gains and relying mostly on tools and strategies tied to the stock market. The problem is that when you invest for growth, you can get shrinkage. When you strive for gains, you can get losses, and sometimes those losses can be devastating as we've witnessed with two major stock market crashes since 2000. While a big monetary loss at any age is unfortunate, it becomes worse as you get older because you increasingly lose the luxury of time to rebuild your nest egg.

Age 59½ – Withdrawals from your employer-sponsored plans are no longer subject to the 10 percent early withdrawal tax once you reach this age, but you will still owe taxes on distributions from traditional 401(k)s and traditional IRAs. Whether you need to or want to take advantage of this rule for any reason depends on many factors, including—as I've mentioned several times now—your retirement goals.

It's surprising how many people reach their 60s without ever having identified their specific goals for retirement. A good way to start this process is by deciding whether your goals are performance-based or purpose-based. If they are performance-based, it means your primary objective is to have a chance of getting the highest possible returns on every investment. Most people recognize the risk inherent in that approach (especially as they get older) and therefore identify their goals as purpose-based. Their primary objectives are to have reliable income throughout retirement, avoid any major financial losses, grow their portfolio at a reasonable rate, and to try to leave a financial legacy for their loved ones.

Each of those goals underscores why it makes so much sense to really start focusing on income-based investing by the time you reach age 60. Most people see this clearly when they examine their goals more closely and write down specifically the ways in which they'd like to spend their time. For most people, they're looking forward to activities like traveling, dining out more, enjoying favorite pastimes, and spending time with their children and grandchildren. If that sounds a bit like you, then an important question to ask is: how would you like to pay for those activities? Is it by drawing from a lump-sum asset, selling portions of your investments, or through your regular income stream? If the answer is income (and for most people, it is), the next question to ask yourself is: doesn't it make sense to maximize my investment returns *in the form* of income?

Ages 62 and 67 – We'll discuss these ages together because they both relate to Social Security. At 62, you are eligible to receive Social Security income at a reduced rate. For each year you postpone taking your benefits (until age 70), your monthly check will be larger. If you wait until at least age 67, that is considered your "full retirement age," meaning the age at which you may first be entitled to receive unreduced Social Security benefits. And, if you wait until age 70, you'll get the biggest possible monthly benefit for Social Security—potentially as much as 76% larger than if you had started receiving payments at age 62.

If you're like most people, whether you start taking your benefits at 62, 67, or 70, Social Security alone won't provide nearly enough income to achieve your retirement goals. Thus, you need the right asset allocation to maximize your benefits, and you need to coordinate them with your other sources of retirement income. But how? There is no single answer that applies to everyone, of course, but there are some things everyone should keep in mind.

If you have most of your money in bank accounts or CDs today, that strategy obviously isn't going to make for a very good supplemental income source, with short-term interest rates at historic lows. Even if rates can eventually get back to two percent, if you have as much as $1 million in the bank, you'll still only get $20,000 a year to use as income if you don't touch the principal—which is the last thing you should want to do! Spending down on principal in retirement has never been a good strategy, but today, it is a "slipperier slope" than ever, especially in the early years of retirement. That's because average life expectancy rates today are higher than they've ever been, and most people need to plan for 30 years of retirement. To see the potential danger of spending principal, consider a 30-year retirement like a 30-year mortgage in reverse.

When you first start making mortgage payments, you're not paying back much principal at all. Instead, you're paying primary interest and just a small amount of principal. But, as the years go on and the balance gets paid down, you pay a little less interest and a little more principal. The process continues until, after 30 years, your mortgage is thankfully paid off. Now, imagine the process in reverse. Take a pool of savings worth $1 million, generating five percent interest—in other words, $50,000 a year. If you take even a little bit more than that $50,000 each year, just a small amount of the principal, that sum will be depleted within 30 years in much the same way that a mortgage is paid off.

So, if banks, CDs, and money markets earning less than two percent are not great options to supplement your Social Security right now, what about the stock market? Well, the potential for another major market crash like those we saw from 2000-2003 and 2007-2009 creates the need for "financial defense" after age 50, but that's

only half the problem. With the average dividend yield in a diversified stock portfolio today at around just 2.5 percent, that's still only $25,000 in annual income even if you have a full $1 million invested, which most people don't. Once again, you might end up having to spend down principal to meet your income needs—especially if something like a major health issue were to come along—and, as noted, that's a very slippery slope.

In short, retirement income for any purpose should adhere to the advice your parents probably gave you years ago: spend only your interest and dividends, not your principal. Fortunately, there are many strategies and options specifically designed to generate income through interest and dividends that can be coordinated with your Social Security benefits to help ensure your income will align with your retirement goals. Best of all, these options carry far less risk of a major loss than stock market-based strategies, which means they satisfy your increasing need for "financial defense" after age 50.

Age 65 – At this age, most Americans are eligible for Medicare, the federal government's retirement health insurance program, as well as for a private "Medigap" insurance policy to help with co-payments and deductibles not covered by Medicare. Unforeseen healthcare costs are a major factor that can undermine any retirement plan, so it's important to work with your advisor to discuss and coordinate decisions specifically relevant to healthcare. This also illustrates why it's so important to have an advisor who works with you on an individual and ongoing basis; while your goals may not change, circumstances often do.

Age 70½ – The government stipulates that Required Minimum Distributions (RMDs) from traditional retirement plans such as 401(k)s or IRAs *must* begin at this age. The tax penalty for not taking sufficient RMDs each year after age 70½ is a whopping 50 percent. Thus, it's important to do your RMD calculations correctly, and it's equally important to satisfy your RMDs without compromising your overall financial strategy and potentially putting your retirement goals at risk.

For example, using a strategy in which you satisfy your RMDs from capital gains or capital appreciation in your stock market-based investments rather than from interest and dividends is really no different than taking them from principal. Again, that's because sometimes, when you invest for appreciation, you end up with depreciation instead, and when you bank on growth, you end up getting shrinkage. Admittedly, this was less of a danger years ago. In the 1980s and 1990s, during the best long-term secular bull market our country has ever seen, investors conceivably could have satisfied their RMDs completely from capital gains rather than dividends without harming principal. Since the year 2000, however, the opposite has been true. That's because, as mentioned, in this time, the market has seen two major drops of 50 percent or more, and many analysts today increasingly believe that a third such drop is very possible.

Whatever age milestone you may be at or approaching, keep in mind that retirement planning in today's complex and uncertain financial environment shouldn't be a "do-it-yourself" activity for most people. The far better alternative is to find and work with an experienced, qualified independent financial advisor. Find someone who makes client education a high priority, who has a specific and consistent vision, and who specializes in helping clients address the unprecedented challenges unique to today's generation of retirees and near-retirees.

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