WHITE PAPER

Principles of Retirement Planning

Strategies for Overcoming Six Risks to Retirement Security

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It takes a lifetime of work to afford retirement. After years of dedicated labor and diligent saving, retirees deserve to enjoy retirement without concern over their financial stability. When transitioning to retirement, there's a shift from earning to spending. This lifestyle change makes it vital to develop and establish a plan to protect retirement income for necessities and maximize it for wants.

While many focus on a savings amount goal, retirement success is also achievable by shifting focus to prioritizing retirement income. The first step to developing a strategy that reinforces financial stability in retirement is to understand six universal retirement risks and the extent to which those risks could impact your unique retirement income situation.

Risk #1: **Longevity**

Increasing longevity is great for spending more time with loved ones, checking off bucket lists, and more, but longevity could be a risk to your retirement success. The rapid growth of Americans' life expectancies makes the risk of outliving one's retirement savings more relevant since people need more money to fund longer lives. Unfortunately, recent behavioral finance research reveals that regardless of how long people expect they will live, the great majority of 65-year-olds have either already outlived their assets or will soon do so, and 67% of 55-year-olds currently expect to outlive their savings.[2,3]

For couples both reaching age 65, there's an estimated 50% chance of one spouse living to 93.[1]

According to AARP, a retiree needs approximately 80% of their pre-retirement (working) income to maintain their lifestyle in retirement.[4] Hypothetically, if you and your spouse's pre-retirement annual income is $150,000, you can anticipate needing $120,000 each year to afford your current lifestyle in retirement. If you anticipate a 20-year-long retirement, this equates to needing $2.4 million in retirement income for your life.

Potential Longevity Risk Mitigation Strategy

These findings demonstrate the need to consider the costs of a longer life. For retirees concerned about longevity risk, a potential solution lies in financial vehicles providing a guaranteed, lifetime, protected income stream. With a steady stream of guaranteed income, retirees can avoid sacrificing their lifestyle to stretch a fixed savings amount across an extended time horizon. These vehicles can help retirees gain income security and confidence in meeting their retirement income needs.

Risk #2: **Liquidity**

In addition to longevity risk, liquidity risk or limited access to assets for meeting life's unexpected financial needs can threaten retirement stability. The lifestyle transition to a fixed income in retirement makes it critical to account for financial emergencies. Accessibility of liquid assets can be crucial in meeting short-term financial obligations.[5]

Americans generally fall incredibly short in terms of saving for retirement, especially for potential financial emergencies. Over one-third (35%) of 55-year-olds, 19% of 65-year-olds, and 15% of 75-year-olds reported they would have trouble putting together $400 within one month to cover unforeseen expenses.[6]

Home Repairs

82% of homeowners have at least one issue in their home that needs to be addressed.[7] The average household spent $2,458 on maintenance and $1,667 on emergency repairs in 2023.[8]

Healthcare Expenses

A typical 65-year-old individual faces an estimated $165,000 in after-tax income to pay for healthcare expenses in 2024.[9]

Long-Term Care

On average, an American turning 65 today will incur $120,900 in future LTC costs and nearly 40% of the cost will need to be paid out-of-pocket.[10]

Potential Liquidity Risk Mitigation Strategy

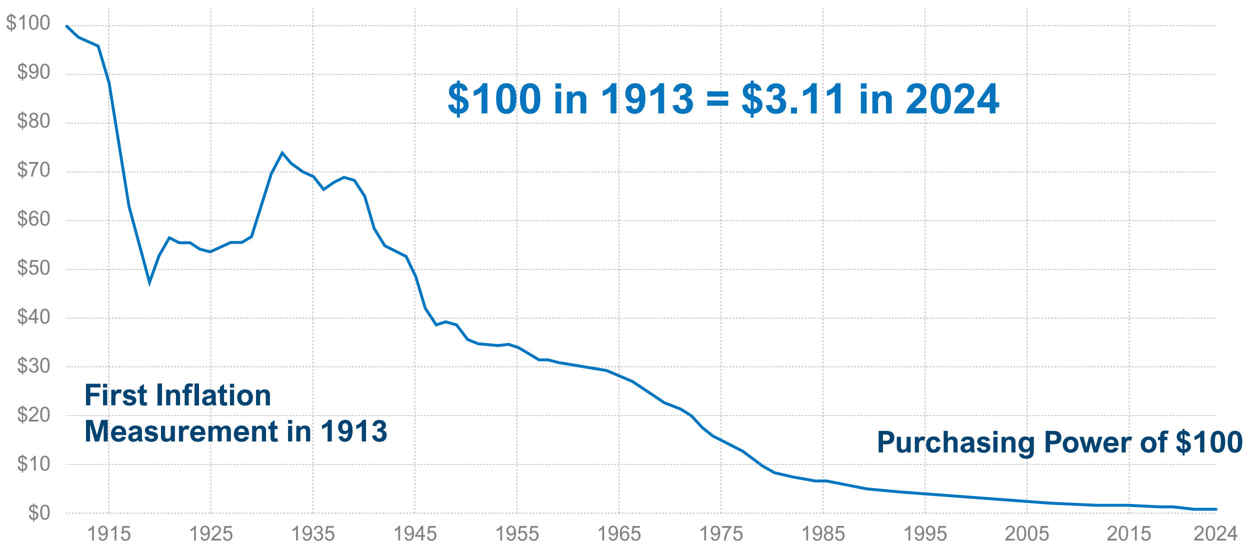
To safeguard retirement savings from liquidity risk, many advise retirees to set aside one to two years' worth of living expenses to account for potential financial emergencies.[11] Some financial vehicles could accomplish this through a bank savings account, short-term or ultrashort bond funds, tax-free short-term funds, or short-term certificates of deposit.

Risk #3: **Inflation**

Reduced purchasing power due to the increasing cost of living, known as inflation, directly impacts all consumers' revenue, savings, and spending, and retirees are no exception. To visualize the implications of this, the chart below illustrates how the purchasing power of $100 in 1913 is now a mere $3.11 in 2024.

43% of 65-year-olds postponed retirement due to inflation and higher living costs.[12]

Declining Purchasing Power of the U.S. Dollar[13]



Between the increase in living costs and the rise in life expectancies, retirees run the risk of depleting their savings. According to Fidelity's State of Retirement Planning survey, 71% of Americans are very concerned about inflation's impact on their retirement preparedness, and 31% aren't sure how to keep up with inflation.[14]

Potential Inflation Risk Mitigation Strategy

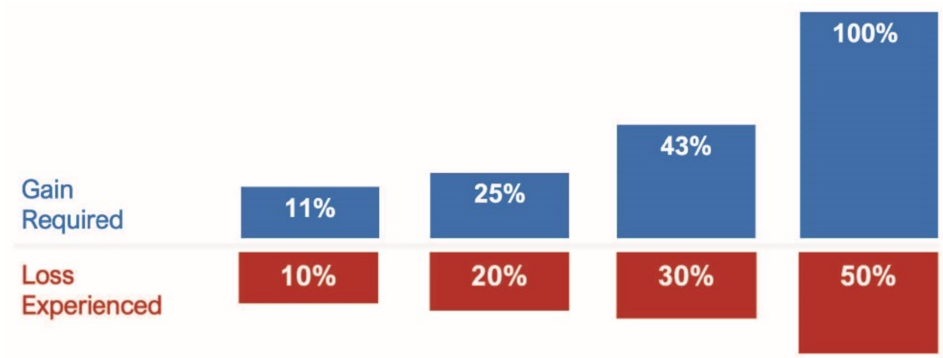
To increase future purchasing power, retirees have two primary options: extend their working years and delay retirement or reduce their lifestyle in retirement. Regardless of how near or far your retirement is in the future, the silent risk of inflation can be detrimental. It's vital to consider lucrative strategies that provide retirement income growth, adjust for inflationary movements, and protect with inflation-hedging vehicles.

Risk #4: **Market**

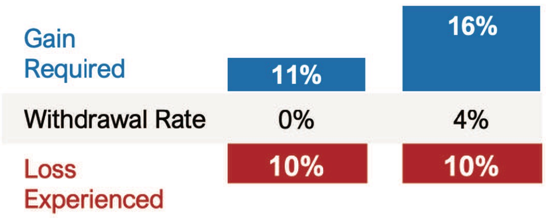
Although market volatility is constant throughout an investor's lifetime, it can significantly impact those in or approaching retirement. If retirees experience a market downturn, they have less time to recover from the financial asset's value reduction, causing investment losses in retirement to be more impactful than gains. To find the gain percentage needed to restore loss, we can use the formula on the right to arrive at the following values on the chart. Notice that as the loss grows, so does the rate and necessary gain percentage to restore it.

Calculating Gain Required for Loss Recovery

$$\left[\frac{1}{(1 - \%\ \text{Loss})}\right] - 1$$



Sequence of Returns Risk



Furthermore, the assumed loss can compound if a retiree withdraws income from this portfolio. If there's a withdrawal while the market is down, portfolio recovery requires a more significant value increase than a decrease in the loss. This financial phenomenon is also known as the sequence of returns risk. The chart on the left visualizes how withdrawals from the portfolio can influence the percentage of gains required to return the portfolio to its previous value.

With 66% of retirees and 75% of workers prioritizing income stability in retirement over maintaining wealth, retirees must learn strategies to protect their current retirement income from market volatility.[15]

Potential Market Risk Mitigation Strategies

Mitigating exposure to market risk is attainable through various strategies. As demonstrated in the longevity example, fixed-income investment products' reduced exposure to volatility can provide growth while protecting them from downsides to generate income. The availability of a cash reserve helps in the face of liquidity risk and market risk because it empowers investors to prevent investment liquidation during market downturns. Additionally, investors can stay proactive with their portfolios by adjusting investments to reflect risk tolerance and maintaining diversification.

Risk #5: **Mortality**

Upon the passing of a spouse or partner, the survivor's finances destabilize. The surviving spouse and any dependents face the challenge of income replacement or expense reduction by re-entering the workforce or adjusting their retirement lifestyle if mortality risk is not planned for or considered. For instance, regarding Social Security benefits, the income of a married household decreases when the number of checks reduces to one.

16% of new surviving spouses have income below the federal poverty level.[16]

While the impact of a mortality event can affect different situations to varying degrees, researchers have found that newly widowed spouses deplete roughly 10% of their savings within two years to pay living expenses.[17]

Potential Mortality Risk Mitigation Strategies

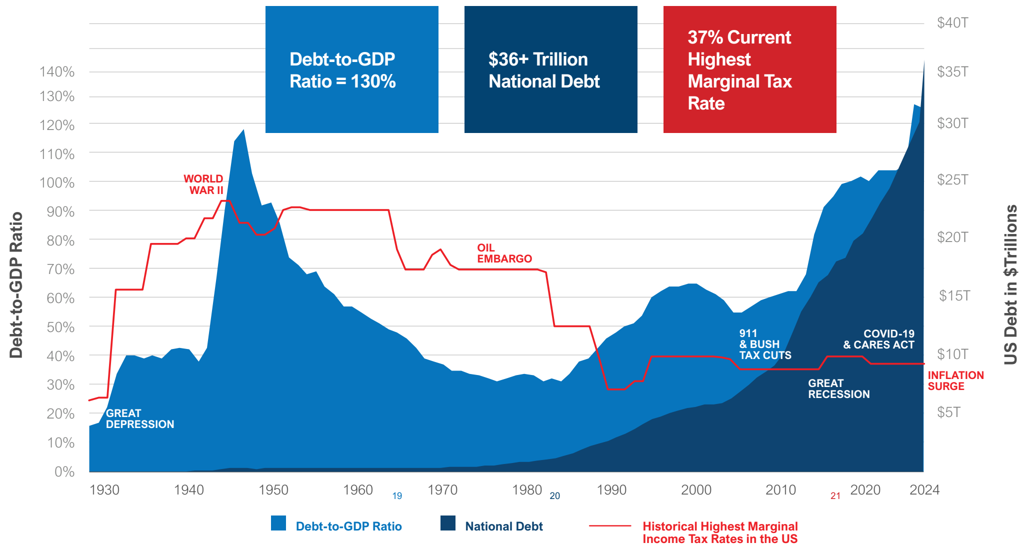
To mitigate this threat to financial stability in retirement, the death benefit from a term, whole, universal, index universal, or variable life insurance policy upon a partner's passing can provide support at a critical time. It's also essential to consider various income planning strategies to help the surviving spouse and any dependents maintain their current standard of living for the remainder of their lives.

Risk #6: **Taxes**

Tax risk is a decreased income and assets and/or the impairment of legacy assets from increasing taxes. Higher taxes can reduce the longevity of retirement assets and the value of the assets for beneficiaries. With over 70% of retirement-bound Americans expressing concern over future tax increases and the potential impact on their retirement accounts, tax risk is at the top of retirees' minds nationwide.[18]

As the historical chart illustrates below in blue, the correlation between debt and Gross Domestic Product (GDP) can be used as a leading indicator of tax increases. The most striking evidence in the chart below is the increase in the highest marginal tax rate, as indicated by the red line, during World War II; the government's spending increased dramatically to fund the war, and top marginal tax rates climbed as high as 94%.

Debt-to-GDP as a Leading Indicator of Tax Increases

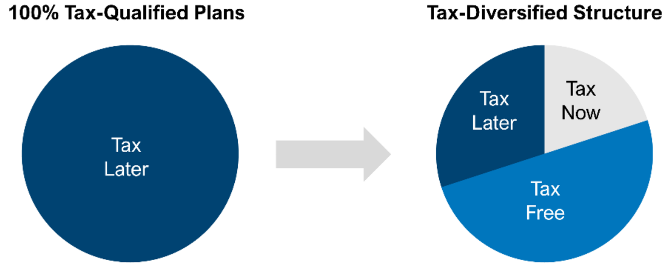


As the national debt swells to unprecedented levels, potential solutions boil down to reducing government spending or increasing the income they acquire from the public through taxation. With little to no indication that government spending will decrease based on historical budget deficits over the past 20 years, many retirees are concerned that their retirement income will turn into the government's income.[22]

Potential Tax Risk Mitigation Strategy

One way to mitigate taxes in retirement is through tax diversification, which involves the strategic allocation of assets among multiple investment and insurance vehicles with varying tax regulations. This strategy reduces market risk by aiming to minimize future tax liabilities while in retirement.

Tax Diversification



Navigating Retirement Risks with Confidence

If you've worked and saved your entire life to afford retirement, you deserve to enjoy it when it comes. By being as diligent with your retirement income planning as you were with your savings, you can work towards protecting your retirement from these six risks so that you have the income for things that you need and want in retirement. Be sure to consult a qualified financial professional to help you determine the appropriate strategies based on your personal financial situation.

To learn more about these six risks your retirement may face and discuss potential strategies for avoiding them, please contact:

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