CHAPTER 1

Facing Reality: What's It Going to Take to Be Able to Retire?

Seventy million American workers and their families are dependent on their individual ability to save enough during their work years to fund their own retirement. The average 60-year-old worker with 30 years of continuous service has only $146,000 of retirement savings,[1] enough to add only $400 per month of income on top of Social Security. This has occurred because the average worker changed jobs 9.6 times in the 1980s and 1990s, often forfeiting eligibility for retirement programs.[2] The problem is multigenerational, but the baby boomers (born between 1946 and 1964) will be the first to be confronted with this harsh reality. The oldest of the 80 million baby boomers will begin to reach age 65 in 2011, but more than half of them will not be financially able to retire.

Let's examine the root of these problems, the probable outcome of these cumulative misdeeds, and the winning strategies you can initiate now to avoid becoming a poor retiree.

The One-Way Tide of Change

Ever since the early 1980s, the financial ground rules for retirement have been changing. Employers have quietly been shifting the responsibility for retirement savings from the corporation to the individual worker. This self-serving shift created a short-term boost to corporate earnings and share price and filled budget gaps in government spending, but was not accompanied by a sufficient caution to workers that if they did not force themselves to save, their retirement income would be limited to Social Security and the proceeds from selling their homes. Employers and policy makers who have had the most to gain from shifting this funding responsibility to employees have done so silently and without intervention by regulators. The time for silence is over.

Today 80 percent of American workers must rely on self-directed contributory pension plans to fund their retirement.[3] In addition to the plans commonly known by the Internal Revenue Code sections that established them—401(k), 403(b), 457—there are individual retirement accounts (IRAs) and other contributory pension plans. Simply put, if you do not contribute to these plans out of current income, you do not develop any retirement savings. If you are over age 30 (and don't stand to inherit a substantial sum of money), you must make retirement saving a central issue or you may never be able to retire. It's that simple.

Balancing home expenses, children's education, and retirement savings necessitates a plan. In this chapter we look at the economic realities facing you while developing a strategy to help you reach your goals. Once you decide on a strategy, your job is to be consistent in how you save and how you invest.

Most of us hope for:

- Our own house.
- A comfortable lifestyle.
- Well-educated children.
- Good health care.
- Retirement years to pursue favorite or new activities.

Achieving all or most of this is a tall order requiring discipline and planning.

Some common myths often prevent people from achieving these goals. Each myth will be examined, and either dispelled or put in perspective:

- I can't save any money.
- I will never be able to afford my own house.
- I earn too much to qualify for college financial aid.
- Scholarships are for only the best students.
- I can't afford to send my child to an expensive private college.
- When I start, I will be able to save enough to retire.
- Strong future economic growth will bail out my mutual fund portfolio.
- I will postpone retirement until age 70 when I will be more financially able to retire.

Baby boomers came of age in an era of abundant housing, access to new model cars and merchandise for every need. Their freewheeling consumption transformed our nation and the rest of the developed world into a consumer-driven economy. The economic run-up to the bursting of the tech bubble in March 2000, combined with events since then, has changed this country to our, and most likely our children's, detriment. Seven key elements affecting our changing economic climate are:

1. Executives and the stock prices of their companies get punished if quarter-over-quarter earnings don't beat analysts' expectations.

   Result: Companies cut costs (jobs) and don't add them back until there is shareholder perception that the economy has turned positive.
2. Much of the tech boom was fueled by companies investing in automation that promised near-term positive impact. But the positive impact took years longer than anticipated to be successfully realized by these companies.

   Result: Many of the 2.7 million worker layoffs[4] in the past three years may well be permanent, resulting from technology allowing people to work more efficiently and moving jobs offshore as the so-called positive impact trickles down in companies. Of the nine million out of work, 20 percent are managers and specialty workers.[5]
3. As a nation we are on a track to annually spend 4 percent of gross domestic product (GDP)—the sum of all the goods and services we produce—while collecting only 3 percent in taxes and other revenue to cover our costs,[6] meanwhile just selling more bonds to other nations.

   Result: Escalating debt and the loss of confidence in our economy by other nations may push interest rates up, affecting housing prices and the cost of corporate debt for continued expansion and adding more volatility to the stock markets.
4. In 1980, 58 percent of American workers' pensions were provided by company-funded pension plans. Today only 13 percent of American workers' retirement depends solely on these vanishing defined benefit company-funded pension plans.[7] Eighty percent of American workers today rely on their own contributions and some employer matching to provide for their retirement income.[8]

   Result: Seventy million American workers and their families are dependent for retirement on their individual ability to save, plus modest matching contributions from employers. Although they should be better informed, many of these workers have no idea how much money they must save in order to retire.
5. In the mid-1990s, Larry Kotlikoff, a professor of economics at Boston University, predicted that baby boomers would inherit $10 trillion from their parents in the greatest wealth transfer in the history of the world.[9]

Reality: The stock market plunge and the continued reduction of corporate and government spending on programs for today's middle-class seniors have brought new meaning to the bumper sticker: "I Am Spending My Children's Inheritance." Today only 15 percent of boomers surveyed by AARP expect to receive an inheritance.[10] The average baby boomer stands to inherit $90,000, with the median at $30,000—not a meaningful supplement to retirement savings.[11]

6. It is estimated that large employers will pay only 10 percent of retirees' medical costs by 2031,[12] as opposed to 68 percent coverage in 1988 and 38 percent medical cost coverage for retirees in 2003.[13] Over the same period the cost of Medicare Part B health insurance will escalate from 6 percent of Social Security payments to 10 percent—a 70 percent increase.[14]

Result: The Employee Benefit Research Institute (EBRI) estimates that a 65-year-old who retires today and lives to age 80 will pay well over $100,000 for health care. A retiree living to age 100 can expect over his or her retired lifetime to pay $700,000 for health care.[15]

7. Eighty million baby boomers, the oldest of whom are age 59 and will start retiring in six years, expect to start collecting Social Security and participating in Medicare.[16]

Reality: During the baby boom era, six workers paid into Social Security to fund the benefits for each worker who had retired. By 2011 there will be only 2.8 workers funding the benefits anticipated by each retiring worker.[17] The Bush administration is waging war against the AARP and its 32 million members over the future of Social Security.

Shocker: A study prepared in 2002 for Treasury Secretary Paul O'Neill, but never released by the government, predicts a $44 trillion budget shortfall in Medicare and Social Security (now $51 trillion because of the new Medicare drug benefit), based on current government revenue and spending.[18] Put in perspective, this is the equivalent of one entire year's world GDP, or, closer to home, the equivalent of all the money that would be collected from a fire sale of all stocks, bonds, and residential real estate in the nation.[19] As Larry Kotlikoff points out, this gap can be closed only by major tax increases and/or spending cuts. Martin Feldstein of Harvard University adds to this list "or change the way we finance the system."[20] The latter method means contributing more for benefits you already paid for, plus a dramatic reduction in future benefits.

Bigger Shocker: Today, the portion of our official cumulative national debt amassed through good and bad times since Benjamin Franklin's times in 1776 is about $14,000 for each man, woman, and child in the country. Add the future impact of Medicare and Social Security and it explodes to $159,000 if paid today—more than the

> $146,000 the average 60-year-old has saved for retirement. Wait 15 years to pay it and the amount swells to $76 trillion with interest (more about the positive effects of compound interest later).

Changing also is the composition of the average household. While married couples account for 50 percent of households, breadwinner dads and stay-at-home moms now account for only 1 in 10 households.[21] Sixty-two percent of two-income households have children between the ages of 1 and 6.[22] They believe they can start saving for retirement after they satisfy their near-term home and family needs. Unless they change their saving habits by age 35 and certainly by age 40 when they have their first home and two kids, they won't be able to put enough away in their 401(k) type accounts to retire at age 65. This is where the two-income household has a distinct advantage if it contributes to two retirement plans. Unfortunately, much of this extra money goes to support a lifestyle. Being able to just pay the bills leaves very little to save for anything, let alone retirement—a concept way out in your distant future.

Saving is difficult when at every turn another need is tugging on your wallet. You do this by learning what you will need financially to attain each goal and alternative ways to pay for it. By balancing reality with both your short-term goals and the desire to put something away for the long term, my aim is to keep you focused on your biggest, most often overlooked long-term need: retirement savings.

Imagine the Year 2025

Fast-forward to the year 2025 when the oldest of the nation's 80 million baby boomers begin to turn 80.

> For many middle-class baby boomers this is the year they never expected to see. After all, the actuarial tables all say one-half will be dead before age 80, so most continued to live as if they expected to be in that half. In more than 70 percent of married couples, however, at least one spouse will survive to age 85. No matter that 50 percent more women than men will be alive. Generally, men managed the family money and spent it with only a subliminal fear of the future.
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> Baby boomers have always been an optimistic generation full of denial about their long-term future. Too late to make a difference, most baby boomers either began to save too little for retirement or threw their hands in the air and continued to rely on the system to protect them. They didn't notice the muted cries to save, nor did they pay much attention to the sleight-of-hand actions in Washington shrinking the social safety net by privatizing programs long

thought to be entitlements. These collective misdeeds have coalesced to create a new breed of once middle-class seniors facing poverty without a safety net, but with 10 plus years left to live.

A succession of bad bets by both past administrations in Washington and many ordinary Americans will have made our country a vastly different place by the year 2025. China, India, Europe, and Japan have reacted harshly to the debt our government has taken on by forcing interest rates to an all-time high. These prolonged high interest rates have put a damper on business output and new housing while driving the stock market to uncustomary volatility. All of this world economic turmoil has caused a de facto devaluation of the dollar. The dollar has lost one-half of its value relative to the yuan (China), the rupee (India), and the euro since 2004.

As many people had predicted back in the 1980s, Social Security has failed. The program still exists, but the payout has shrunk to almost nothing relative to the current cost of living. Although in 2005 a married couple could receive $18,000 annually from Social Security, government policies to reduce cost-of-living increases have eroded Social Security's spending power. Legislation passed in 2010 has fully privatized Medicare. But without effective cost controls and with no limits on co-payments, seniors can no longer afford coverage, or have been dropped by insurance companies that are abandoning markets and discontinuing coverage. Meanwhile, medical science is keeping us alive longer, further focusing attention on health care management issues (living with Alzheimer's, arthritis, etc.).

As the illusion of a social safety net disappears, individuals must rely on their own savings.

Seniors with formerly parallel lifestyles now regard each other from opposite sides of a great divide separating the haves from the have-nots. The haves, the minority, either had retirement provided by a big employer or were disciplined savers and took advantage of corporate matching in their 401(k) type pension plans. The other group, the have-nots, to differing degrees, did not put enough money away, nor did they have enough to put away in the first place. Worse, they did not learn how to manage what they did have. They continued to buy mutual funds with high management fees that underperformed the markets and further eroded their savings. They have spent or lost much of their retirement savings.

A new generation of 15-year fixed-term reverse mortgages has come to the rescue, allowing seniors at age 65 to spend the equity in their homes; however, at age 80 the monthly payments to them are stopping before they are ready to move out. Seniors who sought to improve their lifestyle by jumping on this bandwagon early are about to lose this lifeline. Their loans are coming due, and the banks are going to take possession of their homes.

> Seniors in this predicament are threatened by a radical change in their living arrangements. With their savings mostly depleted, their possessions sold, and their house gone, these seniors will be forced to rent in a more communal living situation. Widows are especially threatened by unfortunate compromises to their comfort and privacy.
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> Unprepared for this new form of retirement, seniors are forced to compete for minimum-wage jobs. The same employers who switched to contributory-type pension plans as a way to shift the retirement funding liability to workers now exploit these seniors as part-time workers without providing benefits. As always, the savvy get richer and the legions of poor keep growing.

Fiction? Yes, but unless procrastinators over the age of 30 can be shaken into abandoning denial about the need for retirement savings, the future will be grim. Taken to heart, savings strategies in this book will make their retirement years better for many Americans. Forward-thinking, and I believe inevitable, new concepts in this book will lead to a new social contract between corporate employers and their would-be retirees: in exchange for their much-needed skills that are in short supply, corporations will agree to provide both health care benefits and continue matching pension contributions. This reversal of the tide by progressive corporate managers will be encouraged by the government, which is incapable of solving the problem by itself. However, I cannot guarantee there will not be years of pain before this compromise is reached.

Why Saving Is Difficult

There was a time when you could expect to be rewarded for years of loyal job performance with a relatively comfortable retirement. Sadly, that has become a myth, whether you are a union worker or a professional. If you don't use every trick you can to put money aside for a house, the kids' education, and your retirement, it won't be there.

Chances are, your costs are growing faster than your income. Employers try to keep wage increases equal to inflation. Inflation and thus wage increases tend to be about 2.5 to 4.0 percent, but increases in payroll taxes and health insurance co-payments probably take half or more of that before you even see it. So, except for the occasional bonus, you are ahead 1 percent to 2 percent annually in a world where college costs go up annually by 7 percent to 14 percent[23] and inflation often increases housing prices by 4 percent. No wonder you think you can't save for the future.

Most policy makers and economists assume that retirement is such an important issue that everyone will automatically plan and save for it. Therefore, government and employers need not intervene. In 2000, Matthew Rabin, a University of California at Berkeley professor of a new discipline known as "psychological economics," used the latest mathematical formulas and a healthy dose of common sense to theorize that instant gratification is far more powerful than saving now for future rewards (such as a comfortable retirement). Rabin argues that most individuals will postpone anything that involves immediate costs and/or delayed gratification. And the higher the costs in terms of time and effort and the greater the price of failure, the more they will procrastinate. That's why so many people put off retirement planning for so long.[24]

"The real killer," Rabin says, "is our overoptimism about our discipline in the future." Rabin, a self-proclaimed procrastinator, makes the compelling point that "people who admit they're slugs are better off than those who don't."

Planning for retirement is a multistep process with constant challenges in overcoming procrastination and denial. Procrastination occurs because we can always find something more pressing to spend money on than saving and investing for retirement, at least until retirement stares us in the face. Denial exists because we try to convince ourselves that what we have saved somehow will be enough if we just change our lifestyle when retirement does come.

Matthew Rabin's later work is more encouraging. He observes that saving is like any other thrill: once you start, it becomes habit-forming. He argues that even if you start small, the discipline of accumulating savings will become addictive.[25] If you will give savings a chance, even modestly at first, this book and its tools will help you identify and attain your goals. None of the book's savings examples taken alone will buy you a house or let you retire, but the cumulative effect will be significant. For example:

The Miracle of Compound Interest

Supposedly, Albert Einstein once said that the most powerful force in the universe was compound interest.[26]

Instead of buying a new car, buy a two-year-old "nearly new" "preowned" car that has just come off a dealer lease. You have seen the TV commercials. What the dealers are not advertising is that this two- or three-year-old car is one-third to one-half the price of a new one. It has a dealer/factory-approved warranty and can be financed at an interest rate just slightly higher than if it were new. This single trick alone over two years can save you $6,000 per year toward your 401(k) contribution. With 50 percent employer matching, that equals $9,000 in each of two years toward retirement if you put it in your 401(k) and don't spend it. Bear in mind the miracle of compound interest: the earlier you save, the more dramatically it grows toward retirement. Table 1.1 shows how at an 8

TABLE 1.1 Results of Compounding $18,000, Assuming 8 Percent Annual Return

Age When Invested	Retirement at 65	Retirement at 70
Invested at 30	$283,000	$422,000
Invested at 40	$127,000	$190,000
Invested at 50	$ 57,000	$ 86,000

percent annual investment rate of return that $18,000 compounds tax-free until retirement at age 65 or age 70, when you start to gradually take it out.

Observation: Thanks to the miracle of compound interest, the earlier you start saving, the more annual interest is added to principal. This compounding more than doubles the balance available for a 30-year-old ($283,000) as opposed to someone who starts saving at age 40 ($127,000), both retiring at the same time.

Unfortunately, the amounts in Table 1.1 are future dollars without shrinkage for inflation. Inflation destroys the purchasing power of your wealth. If we assume 3 percent annual inflation and keep the math simple, then your average annual rate of return drops to 5 percent. The initial two-year $18,000 investment with returns compounded monthly at an annual 5 percent rate is shown at various points in Table 1.2. This would mean that the 30-year-old who wants to retire at age 65 would have $101,000 in today's equivalent dollars from that single investment. Likewise, the 40-year-old retiring at 65 would have only $61,000.

And that is just one year's contribution. If our 30-year-old does this every four years when the old car loan is paid off and the cycle is repeated, by age 65 he will have put away $464,000[27] in today's dollars, with an annual 4 percent draw of $18,500 starting at age 65. Considering

TABLE 1.2 Results of Compounding $18,000, Assuming 5 Percent Inflation-Adjusted Annual Return

Age When Invested	Retirement at 65	Retirement at 70
Invested at 30	$101,000	$129,000
Invested at 40	$ 61,000	$ 78,000
Invested at 50	$ 37,000	$ 47,000

Observation: When the investment yield drops from 8 percent to 5 percent, your investment return drops 60 percent. Further, at a 5 percent rate of return, each 10 years you wait to start saving costs you another 60 percent on what your balances could have been—again, the miracle of compound interest at work. Chapter 7 looks at the reality of sustaining an 8 percent, preinflation investment rate of return, especially in postretirement years.

a 30- or 40-year-old who retires at age 65 can expect to live 20 to 35 years in retirement, we can quickly observe how retirement savings must become an annual routine to be started as early as possible.

Observation: This trick of buying a pre-owned car will reward you $18,500 per year in retirement, which is the same as or more than you can expect to get per year from Social Security. Add the two together and you are up to $36,000 per year, cost of living adjusted, in retirement. Not great, but it is a meaningful start.

Key Tip: Now for the real incentive! When you combine the practice of buying a *nearly* new instead of brand-new car every four years with the miracle of compound interest and the low-cost index investment philosophy in Chapter 7, the diligent 30-year-old can grow the $464,000 from this single savings strategy into $1,250,000 in today's dollars at age 65. As you will learn later, this single trick can provide you $100,000 of retirement income per year, in today's dollars (purchasing power) cost of living adjusted.

Congress passed the Employee Retirement Income Security Act (ERISA) in 1974 to further protect participants' rights in pension plans. Traditionally, most large employers offered plans in which the contributions were made by the employer and the participant's benefits were defined by some combination of years of service, final retirement age, and final pay. The focus on pension benefits forced smaller employers to offer pension plans to compete for skilled workers. These smaller employers turned to a new contributory type of plan where the ultimate retirement benefit was determined by the amount the employee put away toward retirement, plus some tax-free employer matching contribution. Congress made the contributions by the employee tax-deductible, and the earnings compound tax-free until amounts are withdrawn at retirement. By the 1980s, large corporations, eager to contain costs, seized upon this new form of pension plan. In 1980, 58 percent of American workers had defined benefit pension plans as part of their pay packages. Today that percentage has shrunk to 13 percent of workers.[28]

As many baby boomers began shifting away from careers in large corporations, they for the most part forfeited their benefits under the older defined benefit plans, and now they themselves had to create any retirement savings. The transition of this mobile workforce from the old to the new paralleled that of the economy. Between 1980 and 2000, the average worker changed jobs 9.6 times.[29] At each job change, the typical corporation made the new worker wait from one to three years before becoming eligible to participate in the company's 401(k) plan, often never becoming eligible to participate because of their short stay with each employer. Today, although 80 percent of workers are eligible to participate in company-sponsored 401(k) plans, only 51 percent of white-collar workers and 38 percent of workers in blue-collar occupations participate in their employers' 401(k) plans.[30]

No wonder 75 percent of American households are underfunded for retirement! Let's look at the most common self-directed plans: the 401(k) for private employers, the 403(b) plan for teachers, and the 457 plan for government employeees. We will use the 401(k) for an example.

If you started making maximum annual $14,000 401(k) contributions at age 30 and continued them annually until retirement at age 65, these contributions plus compounding would total $1,700,000 in today's dollars, using 25 percent employer matching and discounting for inflation. Let's assume at retirement you draw down 4 percent of the balance each year for 35 years, but add 3 percent each year to your draw for inflation to maintain your spending power. In today's dollars, your annual draw starting at age 65 would be $68,000 and you would run out of money at age 99 when your inflation-adjusted annual draw is $145,000, the equivalent of the $68,000 the year you retired. If you delayed retirement until age 70, your first draw, again inflation-adjusted, would be $91,000 and you would run out of money at age 103. Thanks to modern medicine, 30-year-olds today have a strong chance of living to be 90 and even 100. (See Chapter 6 on pension plans for more detail.)

If your employer is typical today, it matches 50 percent on your first 7 percent of wages.[31] If you contributed only at this $9,000 level ($6,000 your money and $3,000 employer's) this would yield $35,000 for your first year in retirement if you started at age 30 in the example. For a two-income household in which both parties contribute to these employer-sponsored tax-deferred-type pension plans, these amounts would be double if both continued to work.

As a point of reference, assume in the first column in Table 1.3 that you put away only $6,000 each year with a 50 percent employer matching contribution starting at ages 30 and 40. In the second column, you increased your contribution to $14,000 per year. This is the maximum

TABLE 1.3 Funds at Retirement, Assuming 5 Percent Inflation-Adjusted Annual Return

Starting Age	$6,000 with 50% Match	$14,000 with 25% Match
Age 30	$875,000	$1,700,000
Yields	$ 35,000 per year	$ 68,000 per year
Age 40	$459,000	$ 890,000
Yields	$ 18,000 per year	$ 35,600 per year

allowable for a tax deduction in 2005 ($15,000 in 2006). Even though you get only $3,000 in matching money (a 25 percent match up to typical employer matching limits) the difference is dramatic: the miracle of compound interest.

Now the shocker (see Table 1.4): You are age 50, and waited to start saving until after you have educated the kids and they're self-sufficient. The fewer years of saving and compounding make a material difference. We'll assume you put away $6,000 per year with 50 percent employer match in the first column. In the second column we push the annual contribution to $14,000 with a 25 percent in matching money from your employer. Look at the difference if you retire at age 65 and age 70.

Establish Your Nest Egg Goal

Given where you are today financially and where you want to be at retirement, establish a pretax annual retirement income goal in today's dollars. This goal is really two numbers: first, how little money you would be *willing* to live on if you restructured your cost of living, and second, how much you would *like* to have to live on. Your first challenge is to get somewhere in this range. In today's dollars and at the 8 percent average annual return from mutual funds, for each $40,000 of retirement income you want you will need to have $1,000,000 in your investment account at age 65 steadily earning 5 percent after inflation. To accomplish this income level in the earlier example, our 50-year-old would have had to

TABLE 1.4 Funds at Retirement, Assuming 5 Percent Inflation-Adjusted Annual Return (Starting Age 50)

Retirement Age	$6,000 with 50% Match	$14,000 with 25% Match
Retirement at 65	$206,000	$400,000
Yields	$ 8,200 per year	$ 16,000 per year
Retirement at 70	$316,000	$615,000
Yields	$ 12,600 per year	$ 24,600 per year

start out with $250,000 at age 50 and contribute the maximum deferral, including additional catch-up contributions allowed by law ($14,000 plus $4,000 for 2005 and $15,000 plus $5,000 for 2006) to get to the initial $40,000 starting annual benefit level from the 401(k). For each additional $40,000 of annual retirement income, you would need to have had an additional $450,000 in your account at age 50. Short of a big inheritance or your ship coming in, this is where you would stand in this example.

If our 50-year-old had started saving at age 40, when his first child entered high school, done sufficient planning, and developed a good college funding strategy, the retirement savings would look much different, as shown in Table 1.5 (miracle of compound interest plus using even more of the government's money).

These examples demonstrate the importance of saving early for retirement.

Double Your Retirement Income

I am going to jump ahead because the improved retirement income results possible from applying a better investment strategy are too important to not contrast at this time. You will learn in Chapter 7 the compelling reasons to change your investment approach and start buying and holding no-load, low-fee index-tracking investment products. This hands-off approach will increase the typical average annual investment yield from 8 percent to 12 percent (from 5 percent to approximately 9 percent after inflation). Had this added annual investment yield been applied in the earlier 401(k) type example, the amounts in Table 1.6 would be the pretax outcome. As you will see later, applying this winning investment strategy will allow you to substantially increase your retirement nest egg and *double your retirement income*. If you apply the indexing investment strategy to the last 28 years (1978–2005) of balanced index data, you can not only double your first retirement year income draw from $40,000 to $80,000 per one million dollars of retirement portfolio, but continue to draw down double the 4 percent inflation-adjusted

TABLE 1.5 Funds at Retirement, Assuming 5 Percent Inflation-Adjusted Annual Return and Good Planning (Starting Age 40)

Retirement Age	$6,000 with 50% Match	$14,000 with 25% Match
Retirement at 65	$460,000	$ 890,000
Yields	$ 18,400 per year	$ 35,600 per year
Retirement at 70	$641,000	$1,240,000
Yields	$ 29,000 per year	$ 49,600 per year

TABLE 1.6 Funds at Retirement, Assuming 9 Percent Inflation-Adjusted Annual Return (Starting Age 40)

Retirement Age	$6,000 with 50% Match	$14,000 with 25% Match
Retirement at 65	$ 882,400	$1,715,000
Yields	$ 77,000 per year	$ 137,000 per year
Retirement at 70	$1,441,000	$2,800,000
Yields	$ 115,000 per year	$ 224,000 per year

portfolio income amount while having substantial growth in your retirement portfolio. This is not voodoo; again, it's the combination of increasing your annual returns using the indexing strategy, combined with 28 years of compounding returns. The same cyclical investment returns that have occurred over the past 28 years can be expected over the long-term future.

Table 1.6 shows what happens when the same 40-year-old starts putting money away in a 401(k) type plan, but this time following the improved investment strategy.

You have been introduced you to the "nearly new" car idea. Chapter 5 shows you how the government's money can finance your children's education. (Did you know that most of the $105 billion in annual gift aid, money grants, scholarships, and loans to students and their parents comes from the federal government?[32]) No improved investment strategy in the world is going to help if you do not add to your retirement savings. Our challenge together is to see how all these pieces can fit together and have them work for you.

Although the 401(k) annual contribution limits will go up over time, the discussion is kept in today's dollars to help orient you. Whether by contributing at the higher 401(k) annual limits or by supplementing your retirement savings, you are probably going to have to do something more to put enough away. At today's benefit levels, Social Security will add up to another $18,000 per year, but that benefit cannot be counted upon.

The historic rule of thumb is that you will need 80 percent of your pay in your final working years in retirement. That 80 percent number is low! Today's consuming baby boomers will lead a different and more active retirement than their parents. Plan on spending at least 100 percent of final salary in your first five years in retirement on travel and all the things you wanted to do when you were working.

Why five years? Retirees today are healthy and throw themselves into activities and travel. By the end of five years many have reduced their wish list of things to do. This pattern adds to your costs in those early years, so plan for it.

What Is Expected of You and What You Will Get in Return

The process of evaluating where you are, identifying your goals, and deciding on action steps that can help you meet those goals is a process with a path. Once you commit to a set of action steps that are right for you, the process continues as you reevaluate your status a couple of times yearly. Just one in six investors with self-directed pension plans made changes of any kind to their investments in the past year.[33] Almost half did not adjust their investment mix over the last four years. They bought go-go mutual funds in 1999 and stared at the headlights as their nest egg disappeared. It is time to get an investment education and take an active part in your retirement destiny. The key is getting started and making a commitment to stick with it.

Three things are being asked of you in this process:

1. Honesty, no matter how painful.
2. If you have a spouse or partner, their equally honest involvement in the process.
3. Timely completion of the budgeting, self-assessment, goal setting, and action step processes.

My job as coach is easier than yours: I will provide you with the education and tools to start you on this path. I will help you be a smarter shopper when looking for financial advice. While I will offer you time-tested solutions that will work in most instances, I am no substitute for your good judgment.

If you are honest and stick with the process, you can expect to accomplish the following:

- Quantify your present situation with a valid (snapshot) budget.
- Quantify your retirement needs in today's dollars.
- Compile a thoughtful set of near-term and long-term goals.
- Balance short-term expectations with the realization that some goals will take longer and may involve sacrifice.
- Get a jump on planning to use other people's money to fund your children's education.
- If you admit you are too busy and do not want to take an active part in investing your retirement assets, I propose a hands-off, low-cost investment strategy that will allow you to outperform 80 percent of actively managed mutual funds.[34] Buying and holding a balance of low-cost index-tracking mutual funds or stocks will help you to weather a market downturn and maintain your target rate of return in the long term. More importantly, this investment strategy will potentially increase your average return from 8 percent to 12 percent. This can double both the size of your retirement portfolio and your income in retirement.

- Create a written plan for how to fund your future obligations and how to invest your retirement and other savings.
- If you are self-employed, consider types of pension options that allow you to put away lots more money tax free.
- Take your new knowledge and challenge yourself twice a year to reevaluate your performance and goals.
- Explore alternative strategies to hedge the need to supplement your investment income during your part-work, part-leisure later years. Many people may even change jobs to prepare for a rewarding career in a new job that experts say will be in demand during the next 25 years.
- Keep your checklists and references available for updating via my web site, www.RetireYes.com.

I hope you think this is a good trade and worth your effort.

Don't Overlook Plan B

Admitting to yourself where you are financially and being realistic is the subject of Chapter 9, but let's look at the salient facts. By age 50 you should be able to project whether or not you will have enough money to retire. The typical employee in a 401(k) type contributory pension plan will not have put away enough money to completely retire at age 65 and probably not at age 70 (unless they want to sell their home and live off the proceeds). The practical rules of retirement are going to be rewritten to include part-time work and part-time retirement.

You are your own best earning asset. With my help, you will assess your skills and figure out what you can improve upon or add to those skills to make you more marketable as a full-time or part-time worker later in life. Think about what you could do as a part-time skilled worker in your own business in a combined retirement/work-sharing future. Studies predict that employers will need to retain many older workers to fill required jobs.[35] Positioning yourself and figuring this out may be the key to enjoying life on your own terms. In the meantime, don't stop saving in every way you can today. If you sit on your hands and do nothing, your so-called second career may be flipping hamburgers.

Working on This Together

It is important that couples work through this book together. Until there is common agreement that they need to make a change, couples are often locked in a power struggle. Behind power and control is the fear of losing control. This often translates into hiding true feelings.

How you were taught to think about money as a child has a lot to do with your perceptions about money and thus your spending as an adult. As a child, if you got your allowance even when you wiggled out of your assigned chores, and worse, if you got extra money every time you asked for it, then you learned (were taught) to expect to get what you want. You also are a mirror of either your mother's or father's spending habits. These long-seated habits are why you and your partner need to talk about money issues to understand and overcome these blocks.[36]

If you have credit card debt, start by agreeing on a timetable to pay it off. This often brings other issues to the surface that will need to be talked through. In working through this credit card payoff strategy it is important to set the goals far enough out to be attainable. Paying off credit card debt out of current income is a challenge that requires sacrifice. You both will have to sacrifice during nine months to a year or longer to accomplish this goal. Remember that what happened in the past is past. Look toward the future.

Numerous studies and books have shown that men and women have fundamentally different views on risk tolerance, dependent children, and estate planning. A key tension between parents occurs when one wants to spend money on vacations and cars, and the other wants to save for college. Women tend to be more conservative and focus on issues that affect the family (for example, educating the kids and family security).

It is important to get each party to step into the other person's shoes, looking at money and its related concerns from the other's standpoint. College funding is often a tool to accomplish this because everyone is concerned about how to fund their children's college education. Clarifying the boundaries of what you think you can afford is important. Key is opening up a dialogue and reaching even tentative agreement.