Chapter 1

Planning

The secret of getting ahead is getting started.

—Mark Twain

Planning is all about creating an image for the future and the path to get there. If you are planning on upgrading your home, you envision the revised structure, estimate its costs and revise the image to bring it into sync with the amount that you can afford. Then you enumerate the things you have to do to get to that position in the future.

So it is with retirement planning. You have to think about the future lifestyle that you want and the path to get there. You have to estimate what that will cost and bring the image of the future into sync with the sacrifices you have to make now.

planning

a strategy and actions to get to an objective. In finance, it requires a projection based on some assumptions about the economy, resources, saving and/or spending that provides an estimate of future financial status.

The image we have of our retirement needs is far different than it was for our grandparents. Grandfather may have lived on a farm, depended on his children when he got old, had little use for a telephone, never saw a computer, had a few 78 rpm phonograph records, worked until unable, and, for the short time until he died, liked sitting on the front porch talking to neighbors and relatives.

Now our retirement image is vastly different. We are influenced greatly by the lifestyles of friends and images portrayed by newspapers, magazines, movies, television, and so forth. We are living longer, retiring earlier, relying heavily on technology, and are well aware of the lifestyles of those around us. So let's examine some of these things.

The Joneses

Today, it is all about keeping up with the Joneses. The Joneses may be real people in your neighborhood, business, relations, friends, or even celebrities you have never met. They create the lifestyle goals you seek. Images from TV, advertisements, holiday cards from acquaintances, and visits to other homes or areas may sway you. You may also feel pressure from your children whose friends may set your children's goals. All of this is reflected in your choice of houses, automobiles, furnishings, electronics, club memberships, sports, vacation spots, entertainment, restaurants, colleges for children, and the like.

inflation
A measure of increasing costs for the same items. Inflation is usually measured by changes in the *consumer price index* (CPI), which is based on a "basket" of items that are supposed to represent the kind and proportion of things consumed by the average person. Specifically, inflation is the cost growth (this year's costs less last year's costs) divided by last year's costs.

By foregoing some parts of the Joneses' lifestyle now, you are likely to do better than the Joneses in the long run even if you have lower income now. This book is going to tell you what the future may well hold and the benefits you will be able to enjoy by lagging a little behind the Joneses, showing some restraint, and putting aside enough money for a decent retirement which, after all, could well be one-third of your life.

By the time some people will be reading this, they will already be retired. This book also is for retired people. Whether still working or already retired, the same principles apply. Everyone has to save, everyone has to invest, everyone is exposed to *inflation*, and everyone is subject to taxes. Retired people are not an exception, but they have a serious disadvantage compared to younger working people, namely, it is very hard for them to get back into the workplace after they discover that their financial problems force them to seek more income.

Don't forget, this is a *long-range* planning book. You will not likely see any of the effects that I forecast for a long time. This is to your advantage because the more everyone else spends, the better off you are as a consequence of greater investment opportunities and lower taxes. But someday, that will change, and you will be far ahead if you follow the advice in this book.

The Planning Path

The first step to do better than the aging Joneses is to develop a conservative financial plan that provides a reasonable lifestyle in your retirement, particularly your late retirement. We are looking for how much you will be able to spend in retirement, and, if you are not yet retired, how much you will have to save beforehand. It is an amazing thing to me that many people expect to live twenty to forty years in retirement and still have not made an attempt to reconcile how much they would have to save in order for their savings to support a reasonable retirement lifestyle without going broke in short order.

Eighty percent of success is showing up.—Woody Allen

The future environment, as influenced by massive overspending in the last few decades, requires forecasts of lower than historical returns, higher inflation, and higher tax rates. It also means setting aside some money as a contingency for unforeseen events, which could include things that could happen to your adult children or aged parents and at least partial provisions for long-term care.

You can make such plans yourself using the simplified approach in the appendixes of this book, use a competent computer program, or rely on the help of a professional planner. You may have to lean on the planner to use conservative inputs because less experienced planners often believe they can foresee the future—and they would have you believe the future is going to be glorious with their help. It is common to use historical data for things like inflation and returns, but it is very unlikely that the long-term future will be like the past. So don't let an apparently sophisticated planner have you believe that a comprehensive computer program with a *Monte Carlo analysis* will give you high confidence. Plan more conservatively than this.

Uncertainties in Forecasts

There are many uncertainties in long-range plans, but even an imperfect plan is likely to give a better basis for your economic decisions than no plan at all.

- Family emergencies
- Aging parents' care
- Adult children troubles
- Returns
- Inflation
- Taxes
- Social Security
- Pension viability
- Medical costs
- Years your money must last

Monte Carlo analysis

a statistical analysis involving a large number of trials of randomly drawn values. In financial analysis, the values are usually historical daily or monthly returns on investments. The result is the probability that investments would have been exhausted in a certain number of past years. Caution! It represents what happened in the past, not necessarily what will happen in the future.

There are many imponderables when doing planning including economics, health issues, and unforeseen events. Although you cannot be precise, every year that you redo your plan, you get closer to reality and build a financial base that hopefully gives you some resiliency to accommodate the unknowns.

There is a saying that expresses the other side of uncertainty:

"When nothing is certain, everything is possible." Our objective in this book is to show you some things that are possible and help you rise above the crowd. If you seize on the possibilities, you will succeed.

Overcoming Planning Uncertainties

No one can predict the future. We don't know how long we are going to live, what surprise events will develop, nor what is going to happen in the economic world of returns, inflation, and taxes. Yet

all of these things need to be specified to develop a financial plan that determines how much you should be saving before retirement or how much you can spend after retiring. Fortunately, there are some things that we can do to provide some insulation from the uncertainties in planning.

> There are only two groups of forecasters—those who do not know and those who do not know that they do not know.
> —John Kenneth Galbraith

I would like to go back in my own history and give you an analogy that may help you understand some things that most financial planners do not. I started my working career in the Boeing Company in a stress group of a technical organization called *Structures*. My first project involved the design of a very advanced and highly classified new airplane. I was responsible for the preliminary design of the wing structure. In order to size the wing structural members and skin, we needed to know the loads and the strength of the materials. Our stress group computed the loads and we received "allowable" stresses for various materials from a group that specialized in the strength of materials.

The strength of materials was determined by testing many samples, mainly in "pull" tests where machines pulled at each end of carefully cut samples and measured how much stress the materials could take either before deforming unacceptably or failing completely. After many pull tests on the several test sheets, the materials group used the statistics from those tests to give us a design "allowable stress" that had a high probability of surviving an "ultimate load." We got ultimate loads by multiplying known loads by 1.5 to account for unknown loads and provide a "factor of safety."

The material "allowable stress" is analogous to a planner using the statistics of investment returns and inflation in preparing a plan. Planners call the results "success probabilities." You want a conservative success probability just as you want a high probability of getting to your destination in an airplane. Of course, no planner ever recommends the ultrahigh success requirements used in the design of an airplane. Retirees would be able to spend very little indeed.

Moreover, the financial planner cannot go as far as an airplane manufacturer because the planner cannot sample the future to determine the statistics of the future. Unlike a financial planner, a materials specialist sets up stringent material content and process specifications and confirmation

requirements. But it does not end there because after the materials are produced and delivered, the materials are tested again to see that they meet the specifications. For example, they might require that a sheet of aluminum to be used for a wing skin have three pull specimens cut from the sheet and tested to see if the statistics of that sheet actually match the same kind of strength statistics that were used in the design.

The materials specialist then makes a technical calculation of the "confidence" that that sheet will survive by comparing the results from these samples with the more extensive tests used to develop the allowable stresses. If the confidence level does not meet the designer's requirement, the sheet is rejected. A financial planner not only cannot sample the future, he does not have the opportunity to reject the future if it does not meet the assumptions used in the plan.

Unfortunately, planners have become so enamored with statistical programs such as Monte Carlo analyses that, unlike the materials specialist, they fail to remember that they are not able to sample the future. So they blithely say that they have a certain success probability that a retiree can live on such and such income for a certain number of years. What they really should say is that *if* the statistics of future returns, inflation and taxes turn out to be very similar to those of the past, and *if* the reserves prove to be adequate for surprise events, then the chances of succeeding (or success rate) is some specific number.

Now that you have this background, the planner's qualified success statement is not likely to be very comforting. Of equal import is the fact that no one knows what financial surprises may confront you. Perhaps an aging parent needs some uninsured care and does not have sufficient funds, or perhaps a daughter with several children gets divorced and desperately needs financial help. All of these things point to the need to make a conservative plan by using less-than-average returns, higher-than-average inflation, longer-than-average life expectancies, and so on, as well as putting aside some reserves, even though arbitrary, for surprise events. Like the factor of safety used to get ultimate loads in airplane design, a reserve provides some cushion for unknown events that happen in everyone's life.

So how do we get confidence in the planning process? We do it by using conservative and repetitive analysis and by gradually shifting to the kind of investments that have much less uncertain performance. When young we can take risks and recover from stock and real estate volatility. When older, we shift to a larger share of fixed income securities like certificates of deposits (CDs), bonds, and immediate annuities. If we do a new conservative

Overcoming Uncertainties

There are numerous ways we can protect ourselves from retirement planning uncertainties:

- Conservative plans
- Reserves for unknowns
- Shift to fixed income investments
- Immediate annuities late in life
- Repeat planning process every year
- Fewer uncertainties as we age

plan each year, as we age we experience the surprise events and use some of the reserves. We get some of the event uncertainties behind us. Using the previous examples, aging parents finally die and the children of the divorced daughter finally become self-supporting adults.

If the economy goes awry, we have some cushion to accommodate it. If the economy turns out better, we raise our sights somewhat but still use conservative projection values. The plan will never be perfect so, unlike the theory, we will not spend our last nickel on our last day on earth—instead we try to have enough money to support us if we live longer than average. If not, we leave something for our children or some worthy cause.

immediate annuities

a contract with an insurance company that, in exchange for a lump sum of money, will make lifetime payments on a regular basis. These may be either fixed, have cost-of-living adjustments, COLAs, or be based on other kind of an index. Pensions are really immediate annuities, most of which have fixed payments and some have COLAs.

Early in retirement, your forecast may change significantly from year to year. Plans change; that is the nature of planning. Don't believe that you can set out on a course where during the first year of retirement you spend a certain "safe" percentage of your income and then continue to simply increase that by the amount of inflation in every succeeding year until your death. Realistically, you have to change your outlook every year. If you don't, you overspend so much in bear markets that you cannot recover. Or, if you really get lucky in a bull market, you are at your planner's door asking why you cannot spend more. And you know what? Your advisor will give you a new plan which is what you should have developed each year yourself as a matter of course (see Figure 1.1).

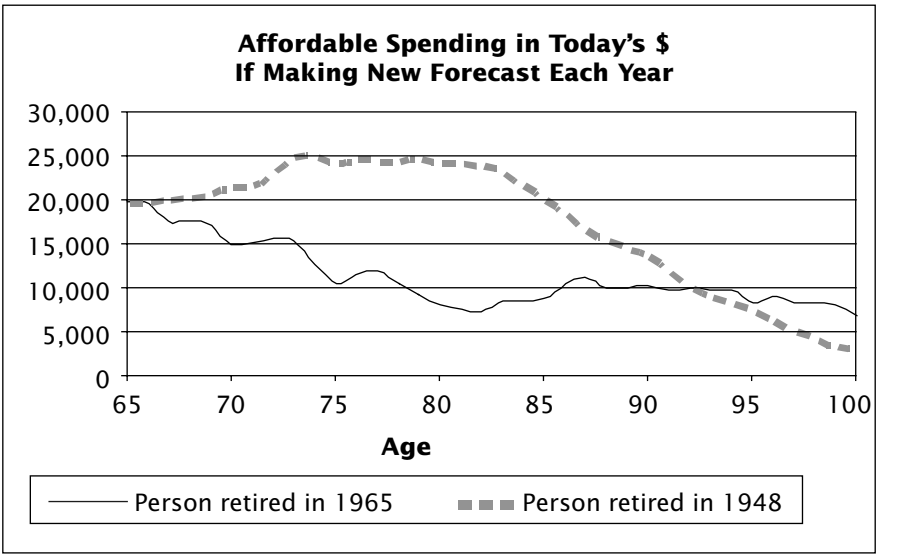

FIGURE 1.1 In real life, people do not spend a constant (inflation-adjusted) amount each year until death.
Source: Dynamics program from www.analyzenow.com.

One of my big gripes about the planning programs used by the vast majority of professionals is that these supposedly sophisticated programs do not make a new affordable spending calculation every year. Advisors would like you to come back every year for a new calculation anyway, so why don't they use models that include the mathematics to calculate affordable spending every year instead of just in the first year with an inflation adjustment for all of the following years? This is not hard to do. I demonstrated this by incorporating this feature in the professional program, *Dynamic Financial Planning Pro,* on www.analyzenow.com. This gives a more realistic perspective of human behavior. For example, virtually everyone who has any significant dependence on the stock market would modify their spending in the year after a market crash or increase spending following some years of extraordinary market growth. That is human nature. Your professional's model will not simulate this.

But, let's get back to confidence. We can improve our confidence too by the way we invest. Diversified investments reduce risk. The natural process of investing in more fixed income investments as we age

reduces the risk. We might put some part of our investments in immediate annuities that will make payments until whenever our death actually occurs without exhausting investments on some assumed death date. We can reduce the uncertainty of inflation with inflation-adjusted government bonds or competitively priced inflation-adjusted immediate annuities. Many can sensibly reduce the uncertainty of tax rates by investing in tax-exempt bonds. Those that can meet the income requirements can avoid future tax increases by investing in Roth *IRAs* or Roth *401(k)s* that, unlike regular IRAs and 401(k)s, have no tax deduction on deposits, do not tax withdrawals, permit withdrawals of deposits before 59½, and do not have minimum distribution requirements..

The ultimate answer to the need for planning in spite of uncertainty comes from examining the alternative, that is, no planning. No planning is a disaster. President Eisenhower likened planning to his experiences as a general. He said you cannot enter a battle without a plan. Yet that plan may change every day or hour as the enemy modifies its tactics to counter yours. Retirement planning is no different. It just has a different time scale. Things do not change as fast in your life as they do in war.

No financial planning leads to little savings. Little savings ultimately make retirees reliant on relatives, charity and/or welfare. Think of no planning as being equivalent to a life dependent on Social Security, Medicaid, and a very restrained lifestyle that probably does not fit the image you may have of what you would like to do when you finally can get away from work and have an opportunity to broaden your horizons and pursue your hobbies or new activities. A plan provides an opportunity, though not totally assured, of a much better future.

IRA

stands for Individual Retirement Account. This is the most common of deferred tax accounts. They are administered by financial institutions such as mutual funds and brokerages. There are a number of stringent requirements subject to strict regulations such as the earliest age to take out money (59½) and age to start mandatory withdrawals (70½). (Roth IRAs have major exceptions to these rules.) IRS Publication 590 thoroughly covers associated regulations and life expectancy tables used for withdrawals.

401(k)

stands for the applicable part of tax code that authorized employers to offer savings plans with deferred-tax benefits. Deposits are tax deductible, but withdrawals are fully taxable and are subject to constraints similar to regular IRAs.

Planning Myths

pension
an annuity that makes lifetime payments to a retired employee and, as a lower-paying option, to a surviving spouse.

***consumer price index* (CPI)**
a federal measure of inflation. This index is based on the price of a "basket" of items that is supposed to represent the purchases of the average person. The index is ratio of the current prices to the price in some past reference year.

There are a number of things commonly accepted, even by professionals, that may be far from the truth. Let's take a look at some of these.

Social Security is the foundation for the vast majority of people's retirement planning. The general belief is that Social Security is adjusted for inflation every year. In fact, it is adjusted in accordance with the *consumer price index* or *CPI*. The weighting of the constituents of the CPI are unlikely to match those of retirees, particularly as they age and incur larger medical, dental, eye, hearing, and service expenses. Not only do retirees incur an ever richer mix of these elements, the elements themselves are increasing faster than the CPI. Further, the government itself reduces the actual Social Security checks if you (wisely) sign up for Part B to cover many medical costs. Those deductions are increasing faster than inflation, so the net Social Security payment is growing even more slowly than the CPI.

Another common myth is that your pension is insured. Long before Enron, WorldCom, Arthur Andersen, and other debacles, I was asked to participate in a television program to ask questions of a panel of four professional financial advisors. One of my key questions and their reply was

Planning Myths

There are many things we accept as true that may be simply myths:

- Social Security is inflation-adjusted.
- Your *pension* is insured.
- There are "Safe" withdrawal limits.
- It is easy to get high returns.
- Inflation will be 3 percent.
- Any planning method works, but Monte Carlo programs are best.

edited from the show before airing because all four professionals made it sound like the proposition was preposterous. I asked, "What kind of assurance do retirees have that they will get their pensions?"

The panelists all responded that this was not a problem. They said that not only were the funds in trusts but there was a *Pension Benefit Guaranty Corporation* (PBGC) that backed them up. I knew that was the wrong answer because I had found some research showing the projections that the companies were using for future returns in their trust projections. These projected returns were all near 10 percent at a time when they not only were not making 10 percent, but also they had a large percentage of fixed income investments with much lower returns. Further, I knew that the PGBC had a cap on the most the PBGC would pay each person and severe reductions if a person retired before age 65.

Pension Benefit Guaranty Corporation (PBGC)

a quasi-government corporation set up to insure employee pensions in case the employer fails to fund its pension trust. It collects insurance premiums from employers and makes pension payments if necessary in accordance with its own rules.

Well now anyone who can read a newspaper or has paid any attention to the news on television knows that numerous large companies have defaulted on their pension promises, and the PGBC is paying a lot less than retirees expected. Furthermore, the PBGC itself is essentially bankrupt, something the U.S. Congress will try to rectify at some point with an infusion. Firms have started to be a little more conservative in their trust projections, but many are getting out of pensions entirely and now leaving the responsibility for saving to the employees themselves. Unfortunately, only a small number of employees are now saving at a rate that would equal the benefits that they would get from a pension.

Still another myth is that there are "safe" withdrawal limits. What is meant by this is that if a retiree withdraws the "safe" amount in the first year, the retiree can increase that withdrawal amount each succeeding year by the amount of the previous year's inflation—and not exhaust the retirement investments until death. In my view, this is nonsense, and the only ways that this could be safe would be to either use zero for the safe amount, or have planned so conservatively that no unforeseen event would have otherwise depleted investments, or that the retiree would be assured to be in the 50 percent of the population that lives less than the life-expectancy used in the initial calculation.

Now it is common to say that the "safe" amount is 3 percent to 5 percent of a balanced portfolio. Figure 1.2 shows that these would not be safe for a long-lived person who retired in 1965 or somewhere within that period because of significant market failures and inflation far higher than 3 percent.

In 2000, a highly respected and well-written scholar advocated that retirees use an all-stock portfolio and draw 7.5 percent the first year and increase the amount every year by inflation. He based his conclusions on a million Monte Carlo statistical simulations per case. He concluded that there was only a 10.4 percent chance of failure for a male and 15.6 percent chance of failure for a female if they retired at age 65. (Note the accuracy down to 0.1 percent.)

I wrote a counter for the advocates of high withdrawal rates on AnalyzeNow.com, which turned out to be prophetic. Anyone who retired in 2000 and followed that author's advice for three or four years without realizing the folly would now be in dire straits indeed as the stock

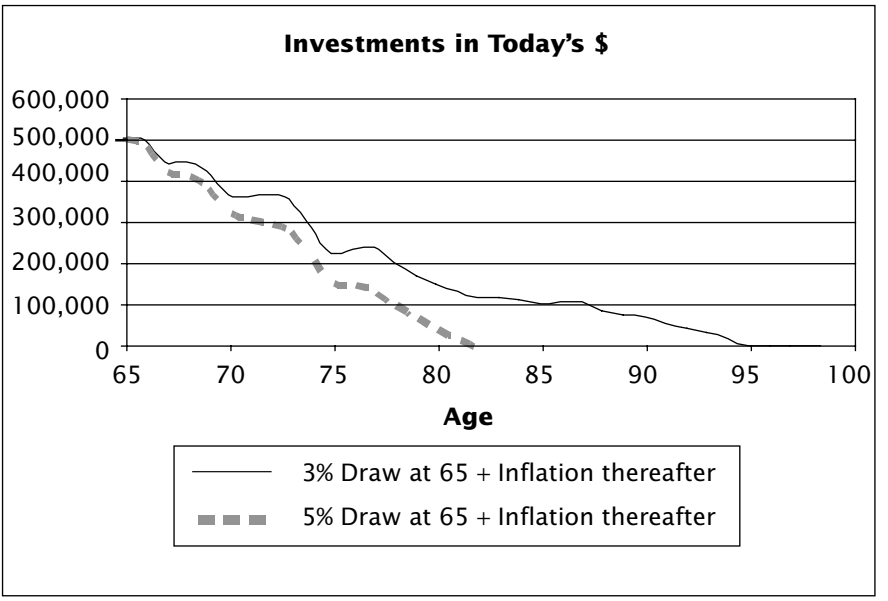

FIGURE 1.2 These safe withdrawal limits did not work for those who retired around 1965 and had 50 percent S&P 500 stocks plus 50 percent AAA-corporate bonds, 15 percent tax and about average (1.25 percent) investment costs.

Source: Dynamic program from www.analyzenow.com.

market plummeted. It would take some absolutely incredible market performance in future years to make his prophecy ring true.

Figure 1.3 shows what would have happened to an all stock portfolio for those who retired around 1965 and made large withdrawals in the first year followed by inflation adjustments thereafter.

Another planning myth is that a person can calculate an affordable spending amount at retirement and increase the amount thereafter by the amount of inflation. That is an inherent assumption even in the most expensive commercial planning methods using Monte Carlo analysis. Nevertheless, no retiree who uses a financial planner or has the capability of doing an affordability analysis would ever do such a thing. Normally, retirees should make a completely new calculation each year—not simply increase last year's budget by last year's inflation. If investments drop precipitously, even those who do not make a regular new calculation would do so after seeing their investments plummet. And conversely, those who find their investments growing far faster than predicted would certainly want to spend some of this largesse.

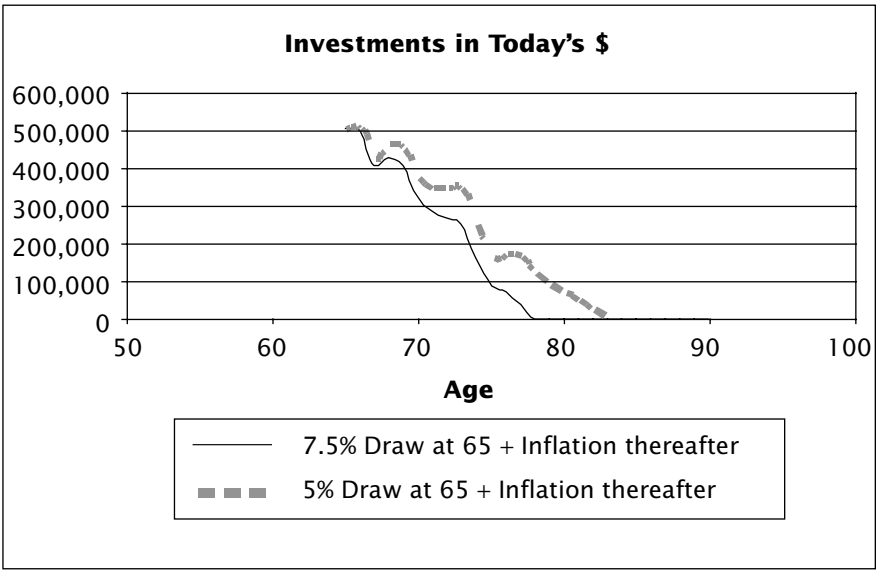

FIGURE 1.3 The highly touted safe withdrawal limits would have failed miserably for these 1965 retirees who had 100 percent of their investments in stocks (S&P 500), 15 percent tax and only 0.3 percent investment costs.
Source: Dynamic program from www.analyzenow.com.

Figure 1.4 shows the huge difference between the common assumption of constant inflation-adjusted spending and that based on making an entirely new calculation each year. It illustrates that no practical person would continue with such a spending program when seeing that investments would soon be depleted.

The planning myths do not end with the assumptions about Social Security, pensions or safe withdrawals from investments. They frequently extend to the basic assumptions. It is commonly accepted that stocks will return 10 percent to 12 percent over long periods of time. I personally don't feel that the future will be as good as the past, but independent of that, even if such growth would persist on a long-term basis, it may well have crucial dips early in your retirement when large withdrawals will take disproportionate amounts of the remaining investments. Those who retired in 1965, like my father, understood this well—as probably do those people who retired in 2000 and saw the investment world fall apart the next year.

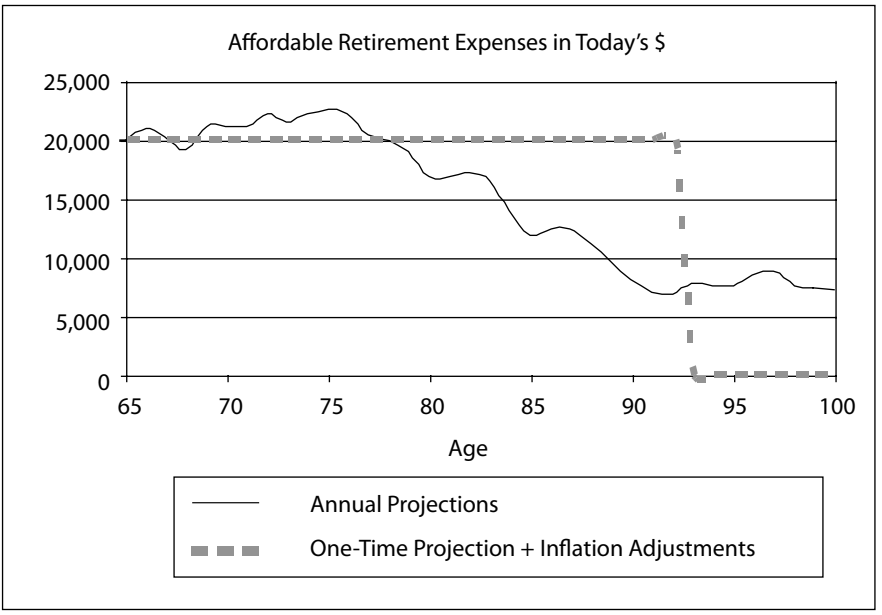

FIGURE 1.4 The contrast between the assumptions used in almost all planning programs and that which happens in real life is startling as illustrated by this typical case beginning in 1955 for $500,000 investments starting with a 45 percent stock allocation and a 1 percent reduction every year thereafter.

Source: Dynamic program from www.analyzenow.com.

Consider also that the very common assumption that inflation grows at 3 percent is based on a period in history that includes the *Great Depression*. The statistics starting shortly thereafter and extending to current times show that inflation has averaged over 4 percent, and there were periods of extraordinary inflation that were devastating to virtually all retirees.

Great Depression
the most tragic economic situation in the United States that followed the stock market collapse in October of 1929. Numerous companies failed, prices plummeted, unemployment was widespread, and many people went hungry.

Virtually all retirement planning programs assume that inflation will be constant throughout your retired life, even those that use Monte Carlo simulations to represent statistical variations of returns. Those that use "real" returns, that is, statistics for returns adjusted for the inflation in the same period as the return, would provide a more realistic simulation of what would have happened in the past, but still offer no promise that the future will be like the past. I think that the most honest representation of the past is to review what would have happened to retirees if they retired in each successive year in the past. That is what I do in the *Dynamic Financial Planning Pro* application available at www.analyzenow.com. Then you don't have one period's return mixed with another period's inflation and the return from, say, 1933's depression loss back to back with a return from 1999's booming market (see Figure 1.5).

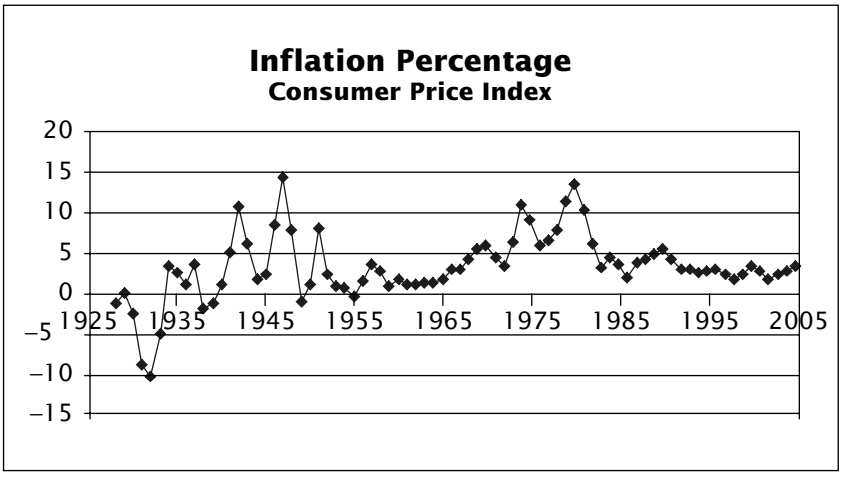

FIGURE 1.5 Inflation has been far from a constant 3 percent.
Source: Dynamic program from www.analyzenow.com.

Not all planning methods would give honest results even if both future returns and inflation were perfectly constant. (This is the most common assumption for simplified computer programs and magazine type retirement tables.) Many of the simplified programs use a gap-type analysis in which they ask you to subtract your forecasts for Social Security and pension from the amount that you would like to have for retirement income. Then they proceed to calculate how much savings you would need to fill the gap between what you want and the amount Social Security and the pension will provide.

cost-of-living adjustment (COLA)
wages or benefits may be adjusted according to an index, usually the consumer price index (CPI) or some other index that measures inflation.

Sounds simple. Only one problem though. Social Security and the amount you would like to get are inflation-adjusted. But the pension is not for most people. The equation works for those with a *cost-of-living-adjusted* (COLA) pension but not the fixed pensions that are common for non government employees. COLA pensions and expenses are apples while fixed pensions are oranges—and you cannot just add or subtract apples and oranges as everyone knows. It does not take many years for the value of the oranges to fall far behind the apples.

reverse-dollar cost averaging
the opposite of dollar cost averaging. This generally adverse effect on returns is the result of regular withdrawals that cause selling more shares when prices may be down and fewer shares when prices are high. Few projection methods alert users to this common problem in retirement.

The other thing that very few simple programs take into account is that retirees suffer from *reverse-dollar cost averaging*. Savers generally benefit from regular deposits in volatile markets so that they effectively are buying more shares when markets are low and less shares when markets are high. That is just the thing needed to make a greater return. The poor retiree is forced to do just the opposite and so loses return.

The last myth that I would like to discuss is that propagated in "get rich quick" seminars. One of the most infamous series of these was offered by a very well-known person in Seattle. He got thousands of people to attend his expensive seminars, buy his materials, and use his advisory services, never mind that his own firm could not successfully manage its own investments. He even trademarked one of his trading momentum schemes so

that I cannot use the term here, but an incredible number of people fell for it. Now he is facing numerous lawsuits and criminal charges, and his clients are far poorer.

So the lesson from all of this is that if it sounds too good to be true, it likely is not true. Sound concepts for saving and investing elude the vast majority of people. Even the government does not do it well for the Social Security system. You and your employer are each docked 6.2 percent for a total of 12.4 percent. If you are not saving at least that much in addition yourself, then it is not likely that you will supplement Social Security with a comparable sum in retirement unless you are more savvy than the average individual or even our elected officials.

Put Details in Perspective

Most people that do their own planning give little thought to the kind of program that they use and the details they enter for personalized values. Yet both the methods as well as the entries may well give radically different results.

Let's consider planning methods first. There are two extreme financial planning methods: (1) those that are oversimplified and (2) those that are detailed beyond common sense. In between, you can find a few that may serve you well, but you still will have to think carefully about the inputs.

today's dollars

a measure of future values that adjusts for inflation. In financial terminology, today's dollar is the present value of a future value that has been discounted at the rate of inflation. It generally takes more future dollars to buy something than it does in today's because inflation reduces the value of each future dollar.

The oversimplified planning methods include those that do not ask any questions about the kind of pension (COLA or fixed) and whether the quote is a future value (escalated dollars) or present value (*today's dollars*). Most often they suggest returns that are considerably above those most people can achieve, especially in retirement when subject to reverse-dollar cost averaging. Further, they assume that all of your present investments are used for normal retirement expenses—something that is generally far from the truth.

The programs that are detailed beyond common sense are those that pretend to be able to foretell the future from the return statistics for your detailed list of investments and may even do a

Garbage in, Garbage Out!

You will be surprised by the different results you can get from different programs with the same inputs or the same program with different inputs. Make sure you question both.

- Is your program too simple or impossibly detailed?
- Are you confident about your inputs?
- Are there external events that might upset your plans?
- Put things in perspective by considering plans with alternative inputs as well.

detailed tax analysis for every future year—assuming the current provisions of our tax laws will stay the same when they change almost every year. Further, the vast majority of these programs fail to account for investment costs and assume that, despite all of the other detail, inflation had no affect on the statistics of past returns.

Of course, there is no perfect program, no matter how detailed, and even if it were perfect mathematically, it still cannot predict the future. All any program can do is to give you an estimate based on the assumptions that the economics of the future will be statistically similar to the past and that there will not be any surprise financial events later in your life. So, be sure to give your planner a quizzical look when the planner tells you that your plan has an 81.5 percent success rate! (No kidding, I've seen technical reports from financial scholars that show success rates down to the tenth of a percent.)

Therefore, I believe that the best thing to do is to use a program that is not at either end of the spectrum unless you ask the right questions and view the result with some overarching perspective. The methods in this book, though fairly simple, will not give perfect projections either, but I believe that the accompanying text will make you think about the input and thereby improve your perspective of the final result.

There are hardly any inputs to any program that do not require some thought. Consider the amount of investments that you enter. It cannot be the total of what you have already accumulated, because, both before and after retiring, you will bump into events in your life that were unplanned. In addition, if your plan did not make provisions for known replacement expenses, high inflation budget components, and terminal

life expenses, then you have to assume that part of your investments will either go for such items or that your normal retirement living affordable spending projections will be overstated.

Another input that is often oversimplified is the value for a pension. The most important thing you should consider is whether you will get any significant pension at all. That is because an early change of employers will reduce whatever you vested to a very small amount both because of the formulas used to calculate pensions as well as the inflationary losses that occur between leaving the job and actually getting the pension. If it is a COLA pension, is it capped? If so, you may want to enter a slightly lower value to account for the years that inflation may exceed the cap. If it is a fixed pension, does the program specify whether it wants today's values or future values and is the quote itself in future or present dollar values.

There are probably no inputs that do not require careful consideration; but two real imponderables are life expectancy and investment growth rates. Insurance sales people are inclined to get you to consider early death. Security sales people are inclined to overstate growth prospects. From the standpoint of calculating how much you should save before retirement or how much you can spend after retiring, it is usually better to assume longer lives and lower returns.

It is very important to do more than one analysis to get the details in perspective. Almost all plans (except *Dynamic Financial Planning Pro* at www.analyzenow.com) are very sensitive to the year assumed for death. So calculate the result if you would live somewhat longer. Or, conversely, change your retirement spending rate and see how that affects the time when you exhaust your investments. You might try different returns and see how that changes your impressions and investment course. Try a different inflation rate, too. And, if your program permits, consider what will happen if the stock market tanks the year after you retire, or if already retired, tanks next year.

Planning Apathy

I know many people who have not done any retirement planning—even among some of my associates and closest friends. There are a number of reasons they cite, but I call them excuses. They blame procrastination, but after a while, a better description is apathy.

> Man must sit in chair with mouth open for very long time before roast duck fly in. —An old Chinese proverb

So here are some of the excuses.

Time

The most common reason some people give is that they do not have the time to plan. Isn't this interesting? Those who have not yet retired do not have an hour or two to plan for what could easily be 30 years of retirement. They have no idea how much they should be saving. Those who have retired generally are flying by the seat of their pants and get into trouble pretty quickly as they begin overspending too early because they do not understand that a plan relates their resources to the amount they can afford.

Timing

Another common reason is that the market is too high now, so it is not a good time to start saving and investing. Many studies have shown that deposits made only at the top of market peaks over a number of years do quite well, thank you. It is not the best, but it is not a reason not to start putting some money away. Better yet, if they would start saving some out of every paycheck, sometimes they will be making deposits when the market is low and make gains that far outstrip their investments made at the high points.

Don't Know How

This is often cited by many people. They don't know enough or are too frightened to show their ignorance and call one of the lower-cost mutual fund companies like Vanguard, Fidelity Investments, T. Rowe Price, or TIAA-CREF and ask for some general investment education information. Instead, when they pass age 50, they start attending financial seminars, some advertising get rich schemes. At this point they have saved too little and are taking a chance on the advice they get unless they have thoroughly researched the speaker's background.

Savings Plan Questions

Another reason for apathy is that people do not understand their *employer's savings plan* choices. Well, even if they picked a fund at random,

put a little in every fund offered, or chose some of the funds their friends liked, the chances are that over a period of years they would accumulate enough to help retirement. After getting some involvement, they would start to get interested in some of the investment topics such as those in this book and get smarter about allocations and diversification.

employer's savings plan this may be a 401(k), 403(b) or a number of other plans that are "qualified" by the IRS as tax-deferred accounts for employees to save for retirement. These have age requirements similar to IRAs but differ in allowable contributions.

Numbers Not Available

Another reason is that people do not know how much their investments are worth. This may sound bizarre, but there is an element of truth to this in some cases such as real estate partnerships. But you know what? Even if they guessed at inputs for a plan, they would be better off than not having a plan—and they would understand where to put their next savings deposit to come to a more rational allocation.

Had a Bad Experience

These people called a broker for some recommendations. They watched their balances fall instead of growing gloriously as forecasted by the broker. I had a similar experience; but a professional planner pulled me up short when he said individual stocks were for gambling, not investing. Index and mutual funds were for investing.

I Don't Have the Money to Save

There are not many people that are really in this boat. I've heard this story from people who interrupted the conversation with a cell phone with a camera from a child with the same. At home they had a computer on broadband and had cable for their flat-panel television. They had cars for their teenagers and let them buy numerous CDs and DVDs. More often, it is all a matter of priorities, is it not?

I'm Going to Have to Work in Retirement Anyway

That is certainly going to be a self-fulfilling promise if there ever was one. Sure, many are going to have to work because they have too little savings,

but how long will their bodies hold out, their minds stay sharp, and their skills stay current? This may have worked in the agrarian economy of the last century, but will there be the equivalent of a farm with their children and grandchildren helping in the field, doing the chores, and caring for the bedridden parents?

Kids to Support

This is a tough one, but it is surprising how once you start a payroll savings plan, you really don't miss the money—and it is a tax deduction. The kids have to learn that they cannot have everything they want or that the neighbor's kids have. You have to learn that, as ugly as this sounds, your retirement takes precedence over anything other than the basic needs for the children.

I Have Children in College

This is often common with middle-aged people who have not learned that their children can earn a significant part of their college expenses, that they can get scholarships if they apply themselves, and that they can get loans and sometime grants. Further, your own employer's savings plan balance or IRA may not be a factor in determining the need for scholarship support.

My Kids Will Help Me

Your children may give you some help, but it is unlikely it will be such that you will be comfortable—either physically or emotionally. There will always be financial worries and conflicts. Also, you should ask if this will be fair to your children, who should be putting that money aside for their own retirement as well as not worry about how much to give you.

The Government Will Support Me

You better think this one out carefully. First think about what your life will be like if you have to live on Social Security and Medicaid versus the additional freedom you would have if you had some savings. Then think about what has to be inevitable: Those are cuts in benefits and services in

order to bring some balance with tax revenues, especially as the number of workers compared to the elderly keeps going down and the promised benefits keep going up.

> Success is not the result of spontaneous combustion. You must first set yourself on fire. —Fred Shero, Canadian hockey player and coach