CHAPTER 1

The New Rules of Retirement

Keep my principal secure.
Pay me income.
Protect me from inflation.

These are the goals of more and more Americans age 40 and above. As Americans enter or approach their post-career years, their focus shifts from earning higher income and investment returns to preserving their hard-earned nest eggs. They want to receive steady cash flow from their nest eggs and control their expenses. They want to ensure they'll have enough income and assets to meet their lifetime goals.

Steady, secure income means financial independence. That's why interest in developing a continuing, stable stream of cash is booming.

Unfortunately, your job is becoming harder than ever. Your job is to establish and maintain financial security and independence in those post-career years. Not too many years ago, it was fairly easy to establish and maintain financial independence in retirement. Retirees had assistance and support from former employers and the government. Most of them had pensions. It also was fairly easy to convert a preretirement portfolio into a reliable stream of cash flow that helped replace your working years' income. Things are different now.

Much has changed and continues to change in the economy, the markets, government policies, and employer practices. The Federal Reserve has kept interest rates dirt low since 2008, and it is likely to be years before rates return to historic average levels. The government is cutting programs and increasing fees and taxes. Employers are slashing benefits. Wall Street and the markets aren't helping much. The rules and choices are becoming more complex. All the factors of retirement finance are changed or changing.

Tough, complicated decisions need to be made about IRAs, 401(k)s, medical insurance, investments, taxes, estate planning, and more. Many of the decisions are irreversible. Make a bad decision or two, and the rest of your retirement plan might not matter.

In 1989, only 30 percent of Americans ages 30 and older were on track to be financially unprepared for retirement, according to the Center for Retirement Research. In 2015, 52 percent of Americans over 30 were considered unlikely to be able to maintain their living standards in retirement. About two-thirds of those aged 45 to 60 said in 2015 they will retire later than they had planned, according to the Conference Board. In 2011, that number was only 42 percent. Government data show that after many decades of declining, the average retirement age has been increasing.

Even those who think they're prepared for retirement often aren't. Almost half of all Americans die with financial assets of less than $10,000, according to recent research by James Poterba, an MIT economist. Many Americans enter retirement with what seemed to be substantial and adequate financial assets, but because of mistakes and unforeseen events they spend faster than they anticipated or should have. They end up with few assets.

It doesn't have to be that way for you.

You can be financially secure during your post-career years, free of the worries that will plague many others in the coming years.

But you can't rely on what worked in the past. Following tired "rules of thumb" and traditional cookie-cutter approaches is the road to income insecurity. Don't travel that road. The markets and economy, tax law, estate planning, health insurance, Medicare, Social Security, long-term care, annuities, and all the other financial aspects of your post-career life are being transformed. You need to use strategies and tools that are different from those that worked for previous generations of retirees.

Six Threats to Lifetime Income Security

Most importantly, you need to know how to deal with today's six key threats to lifetime income security. Most of the threats aren't new, but they've been increasing, and so is the danger to your financial security.

Retirement Threat #1: The Foundations Are Crumbling

For decades, Social Security and Medicare provided the secure financial foundation of retirement. They still do. Today, however, those programs are in financial trouble, and they will have to change at some point.

You know about Social Security's problems. If changes aren't made by 2036, a 23 percent cut in benefits will be required to maintain the system, according to its chief actuary. The specifics of its financial condition and potential benefit cuts change annually as estimates are updated, but the general condition doesn't change.

Many people say they don't expect to receive anything from Social Security and aren't including it in their plans. Those are mistakes. Too many people underestimate the importance of Social Security to retirees. Even for many higher-income people who earned at least the maximum Social Security wage base for 35 years, the program replaces 28 percent of preretirement income. For low-income beneficiaries, it replaces 90 percent of preretirement income. On average, Social Security benefits are estimated to provide about 40 percent of the average retiree's income. Also, Social Security is the only income most retirees have that is indexed for inflation.

Most current retirees report depending more and more on Social Security as the years pass. They tend to spend down other assets or see the purchasing power of income and assets dwindle because of inflation. That's why it is important that you understand the role of Social Security and maximize your benefits.

If the program goes under or benefits are reduced substantially, many people will have to make major adjustments. I suspect most benefit reductions would be limited to those who aren't already retired or within 10 years of retirement, except for higher income people. Don't give up on Social Security. Instead, realize its importance to your retirement and plan to maximize and protect your benefits.

Medicare is in even worse shape and is closer to insolvency. Without change, Medicare will be bankrupt by 2022, according to the Congressional Budget Office. (Again, the specific estimate changes annually.) In recent years, there have been a few changes in the program, but more are likely. There are likely to be higher premiums, reduced benefits, more means-testing, and a later eligibility age.

Like it or not, Social Security and Medicare are the foundations of the American retirement, and you'll have a tough time replacing them.

In this book you'll learn how to shore up these foundations of your retirement plan. You'll learn to maximize the benefits you receive from these programs and avoid making the mistakes that thousands of retirees make every year. Learn the facts about Social Security and Medicare and they can be valuable assets, effectively adding many thousands of dollars to your nest egg.

Retirement Threat #2: You're on Your Own for Medical Care

Retirement medical and long-term care costs are prime worries of most Americans. About 67 percent of Americans ages 55 to 65 said medical expenses were the top retirement concern, according to a 2012 survey by

Allianz. Many other surveys over the years reported similar results. And rightly so. Medical expenses are the retirement plan wild card.

Medical expenses and health care are among the most misunderstood and underestimated expense for retirees. Consider this:

- Many Americans believe that Medicare or their employer's insurance will cover most retirement medical expenses and long-term care expenses they need. That's not even close to the truth.
- Only 28 percent of employers with more than 200 employees provide retiree medical coverage (compared to 66 percent in 1968). Most of those that still offer retirement medical benefits are reducing benefits and moving retirees to privately run insurance exchanges. Smaller employers often don't provide any retirement medical benefits.
- Medicare pays only 80 percent of *covered* expenses, so you're on the hook for 20 percent of covered expenses with no limit. Plus, there are many medical expenses that aren't covered by Medicare. You need ways to pay for all of those.
- Medicare covers only about half of the average member's annual medical expenses. The average retiree will pay $6,000 to $8,000 out-of-pocket each year for medical care, depending on whose estimate is used. That's the average, so many pay more and some pay considerably more.
- A married couple age 65 today is estimated on average to need more than $270,000 over the next 20 years to pay for their medical expenses that aren't covered by Medicare. Of course, those with above-average needs or who live past age 85 will need more.
- Long-term care expenses generally aren't covered by Medicare. The truth is, Medicare pays for only 25 percent of total nursing home expenses in the United States, and those payments largely are for short-term rehabilitation after an illness or injury. Residents, their families, and Medicaid pay most nursing home expenses.
- Most prescription drugs aren't covered by basic Medicare Parts A and B.
- Medicare now is means-tested. The higher your income is, the higher your Medicare premiums will be for both traditional Medicare Part B and for prescription drug coverage under Part D.
- The Affordable Care Act shifts money away from Medicare, especially the popular Medicare Advantage program, reducing benefits and increasing costs for beneficiaries.

Medical expenses will be one of the three biggest post-career expenses for most people, and they'll only increase as the years go on.

Even many of those who understand they are largely on their own for medical care need to know more than they do. Many pay far too much for Medicare supplement, Part D prescription drug, and long-term care insurance. Recent surveys found that many owners of these policies pay up to twice what they need to.

It doesn't do much good to save and invest for a comfortable retirement and build a legacy for your loved ones only to spend most of your nest egg on medical care and overpriced insurance. You need to stay up to date about Medicare, Part D prescription drug coverage, long-term care, and every other aspect of paying for retirement medical care.

Retirement Threat #3: Avoid the #1 Retirement Planning Mistake

"We didn't realize how much everything would cost, Bob. That's the mistake we made."

Those were the words of a woman who shared, with her husband, a large lakefront house (with an indoor swimming pool) in a secured golf course community in central Virginia. They also owned a condo in Florida to be near one set of grandchildren in winter.

They weren't scrounging for money. But after five years of retirement, the couple were concerned that they had underestimated the cost of retirement. He took some part-time consulting work, and she also found part-time work.

This is not unusual. Ask many retirees what their biggest retirement planning mistake was, and a high percentage will say that they didn't do a good enough job of estimating retirement spending. Ask financial professionals, and they'll also say that most people don't have a good handle on how much retirement costs.

One-third of U.S. adults who haven't retired say they'll need 25 to 50 percent of their preretirement income in retirement, while another third say they'll need 50 to 75 percent, according to a TIAA-CREF survey.

The traditional rule of thumb used by financial advisors is your annual retirement spending will be about 80 percent of your preretirement income. That's far above the estimate many people use, and it still isn't a good way to estimate your retirement spending.

This simple rule of thumb, one of the great myths of retirement planning, gets many people into trouble.

You will spend less (or nothing) in retirement on expenses such as commuting, new work clothes, payroll taxes, 401(k) contributions, and a few other items. It sounds very logical.

But since you aren't working, you have time to fill. That time might be filled by activities that cost money, such as golf, travel, entertaining, eating out more frequently, going to more shows and movies, hobbies, spoiling the grandchildren, or a host of other possibilities. Over time, you also are likely to incur higher medical expenses.

With parents living longer and children needing more financial help, you could end up helping both your parents and your children. That situation has become more and more common.

The truth is that for many people, expenses stay the same or increase in the first years of retirement. The money goes to different expenses. A rule of thumb that actually works is that the higher your income, the less likely your expenses are to decline in the first years of retirement.

If you don't want to wake up in a cold sweat worrying about money a few years into retirement, ignore the general rule. The question is: How much are *you* likely to spend in retirement? Many people learn to their regret that the general rules of thumb don't apply to them. We discuss how to estimate retirement spending in Chapter 2.

Even those who correctly estimate their retirement spending often make a different mistake. They fail to consider how inflation affects the purchasing power of income and assets over time. In fact, the most common retirement planning mistake is failing to consider the effects of inflation in retirement plans. Many people develop a spending plan for the first year or two of retirement that matches their income. But they forget that prices and costs change over time.

Inflation is one of the great enemies of retirees. The average three percent annual inflation of the last few decades cuts your purchasing power in half over 24 years and by close to 20 percent after five years. A more modest 2 percent inflation cuts your standard of living by 20 percent after 10 years. It doesn't happen overnight, but it is painful over time.

And don't use the Consumer Price Index to measure inflation. It measures inflation for a basket of goods purchased by a hypothetical American family. Your household spending is different, and so is its inflation rate. In retirement, for example, you'll probably spend less on housing and more on medical care. There are other differences.

You learn in this book the right way to estimate your retirement expenses, the true effects of inflation, and more.

Retirement Threat #4: Most Retirement Investment Advice Is Wrong and Dangerous

Retirees and those close to retirement traditionally receive the worst investment advice. There've been some improvements in recent years as demand from the Baby Boomers forced changes. Yet, many still receive poor investment advice for the years just before retirement and during retirement.

That's not surprising. Most financial advisors and brokers still concentrate on investors who are going to increase their investment accounts each year. That's a growth business. There's not much growth when clients plan to spend their investment funds and draw down their accounts.

The investment advice for retirees used to be simple. As you age, move most of your portfolio into safe, income-producing investments such as short-term bonds, certificates of deposit, and money market funds. Then, live off the income.

That made sense when retirement lasted about five years, interest rates were higher, and you didn't have to worry about wide changes in the cost of living. Now, this advice could be the most dangerous thing you can do in retirement.

More recently, retirees and preretirees were told to invest like everyone else, using diversified portfolios developed using historic returns and computer programs. They were told to buy-and-hold these portfolios and to count on the long-term trends of ever-rising stock prices to fund their retirements. That's a shame, because the results since 2000 have been awful.

The strategy can work over the very long run. Unfortunately, it often produces poor results in the short run. People in or near retirement can't invest based on 80 years of history. What happens in the next 10 years or so is what matters to them, and the results over the next 10 years often vary greatly from the last 10 years and the historic averages. Investment returns in the five years immediately before and after retirement will make or break your retirement plan.

Another problem with most investment advice is that people are told they have diversified portfolios when they really don't. The truth is that when a portfolio is 60 percent stocks and 40 percent bonds, about 90 percent of your total returns and volatility are tied to the stock indexes. Your retirement security rises and falls with the stock indexes.

When the bulls are running, that's a great thing. But the volatility and poor performance of stocks since 2000 have hurt many retirees and put future retirees in uncomfortable positions.

These days, investing conservatively and for safety isn't rewarding, either, thanks to the Federal Reserve board's zero-interest-rate policy and market manipulation. The Fed is saving the economy by punishing savers and those who simply want a comfortable, safe retirement income. Savers are losing money after inflation and taxes.

You have more choices than the traditional safe, low interest investments and investing for the long term while hoping for the best in the short-term. You don't have to bounce up and down with the stock indexes or sit in cash, losing money to inflation and taxes.

Retirement Threat #5: Retirement Lasts Longer Than Most Think

For the first generation of post-World War II retirees, retirement generally lasted five years or so. Today, many people still believe they have to plan only for 5 to 10 years of retirement. The fact is, a 20-year retirement is common, and 30-year retirements aren't unusual.

People on average still retire before age 65. Though many people now say they plan to work longer and the average retirement age has been increasing, about half of people retire involuntarily and before they expected. The fact is that retirement could last a long time, even if you plan to continue working, because you might not retire when you thought. Even for those who retire at age 65 or later, retirement can last a long time. People simply are living longer than they used to.

Here's a sample of what you need to know about longevity. In a married couple in which each spouse is age 65 today, there's about a 20 percent chance either spouse will live to 95. When both spouses are 55, there's a 43 percent chance at least one will live past 95, according to annuity mortality tables. In about 15 years, the odds will increase by about 50 percent, according to the insurance actuaries.

Many people born in 1946 and later can expect to spend more than 30 years in retirement. Some will spend more time in retirement than they did in their careers.

There's another twist to consider. Life expectancy increases with wealth and education. The wealthier and better educated a person, the greater on average is the life expectancy. Such a person has access to better medical care and is more likely to make smart lifestyle choices. The person's career probably wasn't physically demanding and was unlikely to result in injuries or disability. These factors make an above-average life expectancy more likely, probably about four years longer than the average for his or her age.

Life spans are likely to increase in coming years as science discovers new treatments and cures.

There are many benefits to longevity and longer life spans. But there's one giant negative. The nest egg needed to pay for all those years of retirement can be substantial. You have to save enough money and keep that nest egg growing to pay for all those years of retirement and protect the purchasing power from decades of inflation.

Retirement Threat #6: Your Taxes Won't Go Down in Retirement

It used to be a truism that taxes and tax rates would decline in retirement. That's no longer the case.

These days, someone's taxes and tax rate are less likely to decline after retiring. Even if they do, they're likely to creep up during retirement. In many cases, a person's marginal income tax rate actually increases in retirement, and retirees face some of the highest marginal tax rates in history. Average tax rates are likely to stay the same or increase.

You have to be on constant guard against politicians devising new and creative ways to get their hands on your nest egg. It's only going to get worse as the population ages.

The bottom line is that for most retirees, taxes are one of the three largest items in their budgets. The situation is likely to get worse. Congress and state and local governments are far more likely to increase your taxes than to cut them.

You'll learn effective tax reduction strategies throughout the book, but we focus on ways to plan for lower taxes in Chapter 9.

You Can Create Safe, Secure, Sustainable Lifetime Income

You don't have to stand there meekly and let these risks destroy your nest egg. You can fight and win. You can build a fortress around your assets and generate reliable cash flow.

I believe today is a great opportunity for those who prepare for retirement and adapt to the recent changes and those to come. Be clear that there isn't a magic formula, silver bullet, or single ideal investment. You'll have to look elsewhere for gimmicks and fads. You can create a successful retirement by using a toolbox of strategies and a solid plan. You'll also need to ignore the status quo, conventional rules of thumb, and standard Wall Street advice.

I find that simple solutions often are the best. You need to push past the complexity so beloved by Wall Street and Washington and find strategies that will maximize your cash flow.

Most importantly, remember a retirement plan is a process, not an event. As you've seen, the rules and circumstances keep changing. You can't set-it-and-forget-it. Be sure you're aware of changes, carefully analyze how they affect you, and choose a course of action that will work for you.

We know that retirement in the future will be as different from the retirement of the past as night is from day. Those who planned for retirement only 15 or 20 years ago would be shocked by the task faced by their counterparts today. Many of the issues and questions to be addressed today weren't even on the radar screen not long ago.

The first real generation of American retirees, those who retired in the 1960s and 1970s, developed the image of retirement that many Americans still hold today. For most of the second, third, and fourth retirement generations, things will be different. Sometimes they will be shockingly different.

Many observers paint a gloomy picture of retirement in the coming years. Yet there is no reason for the majority of people to experience a retirement that is less satisfying than was experienced by the first generation of retirees. Most of us should be able to create the retirement we desire.

Retirement is an opportunity. It is an opportunity to do things you never could find the time for. It is a chance to plan how to spend your *next* 50 years. But to take advantage of the retirement opportunity, you have to plan and prepare. Most of all, you need to know the new rules of retirement planning.

In the coming chapters, we'll explore the financial concerns of retirees and preretirees and how they are affected by the trends I've identified. We'll look at how to estimate retirement spending and how much money you should accumulate for retirement. I'll explain the medical expense options and how to pay for long-term care. You'll learn how to invest before and during retirement. I'll show you how to plan an estate, cut taxes, and provide for loved ones. We'll cover these topics and much more. I'm not going to give you the obvious advice, such as start early, invest the maximum in a 401(k) account, and invest for the long term. Think of this book as your instruction manual for the new world of retirement.

You can have the retirement you desire, but you must act now to stay ahead of the dramatic, rapid changes that are taking place. Even those who already are retired are affected and must act. Those who don't learn about and understand the shifting world of retirement will have retirement years filled with worry and anxiety. Those who understand the new rules of retirement will make decisions with confidence and be able to take advantage of all their retirement opportunities.