Introduction

A Preview of Retirement

> The estimates done by the pros typically assume your assets will get a certain average return, that you'll get a certain percentage each year—and that may be adjusted for inflation—and that you'll live to something like your actuarial expectancy….So assuming you save a certain amount, and *if* you get the assumed investment return, and *if* you don't take out too much and *if* inflation doesn't take off, and *if* you don't get a horrible disease, and *if* you die on schedule, you'll be okay."
>
> --(Crenshaw, 2006)

Anything that's possible is inevitable!

On the final leg of my journey, I feel like I have just spent the past ten years in a Las Vegas casino playing roulette. I no longer control my fate; the croupier does with every spin of the strangest roulette wheel I have ever seen.

Each of the black and red numbers on the roulette wheel represents a risk one might face during retirement. Whenever the silver ball stops on a number that I have selected, he hands me a white risk card. On the first spin, the ball rolls round and round and lands on red 6. The croupier hands me a white risk card. I turn it over; in bold black letters, I see the following:

You face bear markets and lower returns in the future.

I flinch because my silver ball landed on one of the most dreaded risks in retirement. It's time to meditate and repeat my mantra. (Yes, I live in California.)

I retired on January 1, 2000, one of the worst times in market history. For the first three years of my retirement, the stock market dropped—10.6% in 2000, 11% in 2001, and 21% in 2002. A bear market at the outset of retirement substantially increases the odds of your going broke before meeting your Maker. In reality, your pension pot shrinks even more than the market declines suggest. Why? You are no longer contributing money to your account and buying shares at lower prices. Instead, you are withdrawing it and selling shares at lower prices. As a result, less money will be available to earn returns when the market recovers as it did beginning in 2003.

Fortunately, my retirement suffered little, if any, shrinkage during this period. By the time I retired, I had placed most of my retirement savings in the TIAA Traditional Account. It had positive returns during this three year period. Besides this good fortune, I did not begin withdrawals from my TC accounts until midway through the third year of my retirement. When I retired, Stanford granted me an early retirement bonus equal to two years' pay. (Nine years later Stanford increased the bonus to three years' pay.) I managed to live for two and one-half years by using three sources of income: the bonus, Social Security, and the rent from two cottages we own.

Just when I began to relax, a second major bear market struck. By the end of 2008, nearly every asset class dropped 40% or more. Government backed mortgages, U. S. Treasuries, and TIAA Traditional proved to be among the few safe havens. Due to the market decline, many people with 401(k) and 403(b) retirement accounts decided to delay retirement. Some retirees began to reduce their expenditures and contemplate a return to work.

The sequence of returns matters a great deal for retirees and pre-retirees alike. Milevsky and Salisbury (2006) show in their research

> how an early bear market during retirement can double or triple the ruin risk, compared to experiencing the same poor investment returns later on. The years just prior to retirement are equally important. Furthermore, this risk cannot be avoided by attempting to time the market nor can it be mitigated by transitioning to a conservative (i.e., bond) asset allocation. (Milevsky and Salisbury, p. 1, 2006)

By examining various return sequences throughout retirement, Milevsky and Salisbury (2006) demonstrated the age of exhausting one's retirement assets varied by as much as 14 years. Simply by reversing two simple return sequences (-13%, +7%, +27% versus +27%, +7%, -13%) over a retiree's lifetime, they discovered that a retiree went broke at age 81 for the first sequence and 95 for the second.

In another analysis, they explored how a bear market in the last pre-retirement year would affect how much longer a 65-year old retiree would need to work to reach his financial goal. The revised retirement age depends on the severity of the bear market. For example, a retiree who suffers a loss of 10% needs to delay retirement for two years while one whose portfolio drops 40% must delay retirement for five years.

Table 1. Revised retirement age for 65-year old by bear market return the year before retirement.

Investment return year before retirement	**Revised retirement age**
-10%	67
-30%	69
-40%	70

Bear markets, depending on their timing, have meaningful consequences for both retirees and pre-retirees who learned this lesson the hard way in 2000 and again in 2008.

Your chances of encountering a bear market early in your retirement are much higher than you may imagine. Over the past eighty years, bear markets occur, on average, every three years according to Ned Davis Research. Since 1950, the bear has roared nine times; the declines in the stock market ranged from 20% to 49%. On two occasions the market dropped more than 30%; on two other occasions it declined nearly 50%.

Several years into my retirement I learned that financial experts (e.g., Bogle, 2003) project lower returns from stocks and bonds in the future and offer some compelling reasons for their pessimistic forecasts. Historically, nearly 40% of the stock market total returns come from dividends, and dividends currently are near all-time lows. As for bonds, the total returns derive from interest rates (again near all-time lows) plus increases in the value of bonds. Since the value of bonds moves opposite to bond yields and interest rates are currently low, the value of bonds will decline as interest rates increase. Investors are unlikely to benefit from the strong stock and bond market returns that prevailed in the past. I have factored more conservative rates of return into my retirement planning; you should too.

Woe is me. Shortly after the end of the bear market, the croupier tosses my silver ball into the roulette wheel. The ball bounces around and eventually lands in the black 22 slot. My nemesis hands me a risk card, and I flip it over to read what appears on the back. I stare at the bold black letters and begin to sweat heavily. The fickle finger of fate has struck again.

Inflation lies ahead.

As if I didn’t have enough to worry about in retirement, inflation looms around the corner. I suspected that it would hit me and other retirees harder than when we worked. Sure enough, the Labor Department’s Bureau of Statistics reveals the grim picture I had expected. From December 1982 through September 2007, the consumer price index-E (for elderly) increased 124.9% compared with 108.1% for the CPI-W (for working). It seems that health care costs have risen twice as fast as other items over the past ten years, and the elderly spent twice as much of their income on medical costs as those still working did (Hamilton, 2007). The future for retirees drawing Medicare looks bleak. By 2025, Mulvey and Purcell (2008) expect the premiums for Medicare Part B to rise substantially. In 2006 these premiums equaled 27% of the average Social Security benefit; they project that this percentage will rise above 50% by the year 2025.

Some experts (e.g., Phillips, 2008) question the accuracy of the U. S. Government’s CPI reports and accuse it of “creative” accounting. Since the CPI may vary from one locale to another, it makes sense to calculate your own personal inflation rate. You can use one of the money management software programs to set up your personal budget, monitor your expenses, and calculate the growth in your expenses for various categories (e.g., health care, housing, and transportation). With this information you can more realistically estimate your personal rate of inflation. I use Quicken software to prepare these estimates and find them useful in planning for the future.

After stunning me with inflation, the croupier resumes his spinning. I see my silver ball roll around and eventually settle in red 28. I reach for the Excedrin as he hands me another risk card; turning it over, I see the words:

Health problems await you.

Three years into retirement my cardiologist delivers bad news. In somber tones, he says, “Cancel your trip to Costa Rica; I have scheduled you for a triple bypass.” A month later the medical bills arrived. I stared at the figure on the bottom line; it was a staggering $137,000. Thank goodness, I had Medicare and a first-rate Medicare Supplementary Health Plan. With only Medicare, I would be forced to pay 20% of the allowable costs and all of the non-allowable expenses. Since Medicare has no cap on how much one must pay for medical expenses in any given year, we could have found ourselves in bankruptcy court.

During my recovery, I counted my blessings and realized how fortunate my wife and I were to have purchased long-term care insurance when we turned sixty. No telling what other health problems (e.g., Alzheimer’s disease) might lay ahead.

My wife and I strongly support universal health care because we know first-hand the potentially devastating consequences of health problems for two of our children. Health expenses rank as a leading cause of personal bankruptcies. The leader of the Swiss government was asked this question recently, “How many people in your country declare bankruptcy due to health expenses?” He appeared startled by the question and replied, “No one; it would be a national disgrace if that happened.” Personal insolvency due to health care costs occurs in only one developed country—the USA. Until U. S. citizens become eligible for universal health care, retirees must take health care and long-term care costs into account as they plan for retirement.

Having recovered from my triple bypass surgery, I report on schedule for another spin of the roulette wheel. As I enter the casino, I mutter to myself, “Perhaps, this time I will be lucky, and the ball will land on 00 (no risks in store).” Unfortunately, the ball falls into red 26. The croupier hands me a retirement risk card that reads:

The government raises taxes and reduces your Social Security benefits.

During the past few years, the U.S. Government has piled up mountains of debt and a staggering trade deficit. Combine the debt and trade deficit with future commitments (Social Security and Medicare) to retirees, and we have a perfect storm brewing on the horizon. The perfect storm will leave in its wake higher taxes and/or reduced benefits, no matter which political party takes control of our government. I already have felt a bit of what lies ahead. Thus far, my Social Security cost of living increases have barely covered the increases in Medicare premiums. Many retirees with lower payments from Social Security have experienced a shortfall. The government already has begun means testing Medicare premiums, and I fully expect that Social Security benefits will be means tested as well. All of this reminds me of Ronald Reagan's famous quip, "The most dreaded words in the English language are, 'I am from the federal government, and I am here to help you.' " Rest assured the federal government is on its way to "help" you; and you need to plan for it.

With the future changes in the federal government's taxes and benefits in mind, I stare into the roulette wheel as the croupier resumes his spinning. When the silver ball slides into the black slot numbered 5, he hands me another retirement risk card; I flip it over and see the words:

Financial crisis occurs.

The whole world seems to be in a financial crisis. Our government sought to avert Great Depression II by bailing out the banks and Wall St. Interest rates plummet when the Federal Reserve lowers its short-term rates, and our country, like many others around the world, has "healthier banks and certainly poorer savers" (Editorial, 2010). I might add to this brief list poorer retirees who have counted on living off their bond yields. Before the crisis and the government's response, my bond yields were in excess of six percent. After the crisis, intermediate bond yields dropped to around three percent and short-term rates to less than two percent. This situation hurts retirees, and the Federal Reserve shows no signs of reversing its course.

Reeling from the financial crisis, I dread the next spin of the roulette wheel. Well, I should. My next retirement risk card reads:

Relatives need your help.

I am now a full-fledged member of the Sandwich Generation. Early in my career, my parents needed financial assistance, and my wife and I helped them. Much later in life, two of our children experienced health problems and required our financial assistance. We are fortunate that we could provide it; at the same time, it wasn't something that we had planned for when I thought about retiring. Some retirees will be unable to provide such assistance; others might have been able to do so if they had planned for it; still others might be able to provide it but refuse. If you want to have the option of assisting your family in a time of need, plan for it before your silver ball lands on this number. By all means, prepare a will; if you have a sizable estate, work with an attorney to prepare a Revocable Living Trust (see chapter 29).

It's time for another spin, and the croupier obliges me. He stares into the roulette wheel to see where my silver ball has landed, shakes his head, and then hands me a retirement risk card.

Large unexpected purchases await you.

During my working years, we often made large purchases such as a new car, a new roof for the house, a major remodel of the kitchen, or a new refrigerator. When I considered whether to retire, I failed to factor large purchases into my retirement planning; unfortunately, my financial planner didn't alert me to the problem either. Subsequently I learned that many retirees overlook the need to plan for these purchases before retiring. Since retiring, I have made some major purchases—new furnace, new car, new paint job for the house, and bedroom remodel. To finance these purchases, I have withdrawn more money from my retirement account than I had planned and regard as safe. Belt tightening may be in my future and yours too if you don't plan ahead.

By now, my head is spinning along with the retirement roulette wheel. I can't bear to watch the next spin and close my eyes. When I hear the wheel stop, the croupier grabs my hand and thrusts a card into it. I open my eyes and see:

Beware of predators.

The elderly, on the average, apparently are better off than their younger counterparts. As a result, con artists target seniors. These con artists take various forms—relatives, yes, I said relatives, friends, financial advisers and the like. One of my wife's aunts signed a document without reading it; her oversight cost her dearly. She signed away her right to her husband's pension when he died. She failed to follow the advice of a former President, "Trust, but verify."

What else can befall me? The roulette wheel reveals the answer after the croupier smiles and says, "This is your *final* spin." The silver ball rests on black 30. With trepidation I take the card from the croupier and begin to read the following words:

Congratulations, expect to live a long time.

I don't know whether to laugh or cry. With all the other risks in my future, now I learn that I must maintain my standard of living for twenty-five to thirty years. It may be a long, long time before I enter the check-out line. How can I manage that financially?

Most people are like me; they underestimate their life expectancy. As a TIAA-CREF participant, you can expect to live longer than the average person in this country. Take a moment to estimate how long you expect to live; now study the following life expectancy tables for TC annuitants. Women should expect to live longer than the average ages because the life expectancies listed are gender neutral.

Table 2. 2005 TIAA-CREF

annuitant life expectancy table.

(gender neutral)

Current Age	Life Expectancy
60	87.8
65	88.4
70	89.3
75	90.5
80	92

If you are married, the chances are much higher that one of you will live past 90 (74% to be more precise). Longevity and inflation loom as two of your greatest risks in retirement.

As I leave the casino, the croupier follows me to the door. Outside he says, “Let me give you a tip. Never overlook the possibility that your own behavior might endanger your financial future.” I nod my head in agreement. Studies of investors’ behavior attest to the self-defeating proclivities of the average stock fund investor. From 1986-2005 the average stock fund delivered an average annual return of 11.3%; during this period the average stock fund investor earned an average annual return of only 3.9% (Dalbar, 2006). Ten thousand dollars invested in the average stock fund in 1986 grew to $85,095; the typical investor left $63,601 on the stock floor and walked away with only $21,494. Investors who chased the hot performers and sold during bear markets played the loser’s game while buy-and-hold investors reaped a full measure of the market returns. The same pattern appeared when Dalbar (2006) examined the behavior of bond investors. Long-term government bonds produced a healthy 9.7% annual return while the average investor in bonds eked out only a 1.8% annual return. Investors can’t control the sequence of returns, but they do have control over their own behavior if they can learn to resist the tugs and pulls of the evil emotional twins—greed and fear.

Apparently, most TIAA-CREF participants have not succumbed to greed and fear. They seldom made changes to their portfolio holdings (Swensen, 2005). I suspect they, like me, were often too preoccupied with their career and families to concern themselves with the ebb and flow of the market.

Dealing with These Uncertainties

Confronted with all these uncertainties, one can easily become depressed and decide not to retire. However, some forge ahead confident they can deal with the uncertainties. What do they do?

Rely on the mutual fund industry.

When I began saving for my retirement, my employer offered only one option—TIAA-CREF. I remained with this investment company throughout my career. I never questioned the integrity of this company or doubted that it was acting in my best interests. However, when I retired, I discovered that withdrawing money from TC to finance my retirement created a host of challenges and frustrations. You will learn more about this later in the book.

Since 1964, the year I began saving for retirement, the mutual fund industry, with a few exceptions, has been transformed from a client centered profession serving the interests of the investor to a marketing business focused on salesmanship (Bogle 2005). Now owned by conglomerates, the emphasis has shifted to creating and selling products that generate a profit for the corporation. As a result, investors have one chance in seven of owning a fund whose returns parallel those of the U.S. stock market. When I started saving for retirement, investors had much better odds—three of four.

What accounts for this underperformance compared with the past? According to Bogle, there are several reasons, most notably:

- Soaring portfolio turnover (from 17% to 112%) meaning mutual funds now hold the average stock for an average of eleven months versus six years in 1945-65
- Skyrocketing operating expenses that on the average have doubled the costs of investing

Unless investors are careful, they may wind up socking their money away in a mutual fund company that services their interests the way one critic describes as "Bonnie and Clyde serviced banks." As for me, I will stick with companies with a solid, long-term reputation for looking out for the interests of their clients.

Go it alone.

Over the years I've heard people say, "I prefer to manage my own investments even if it costs me money." Unfortunately, it does. As we earlier pointed out, many investors lack an understanding of investing and let their emotions rule their judgment. At times greed overtakes them, and they chase the hot performers. At other times, fear overwhelms them, and they sell shares when they should have been buying more of them. As I have learned through my study of behavioral finance, this pattern of buying into rising markets, selling when markets fall, and repurchasing shares long after the market has risen is a common one. Consequently, the annual returns for individual investors has been far below what the market returned as shown repeatedly in the research on investor behavior (e.g., Bogle, 2005, Creech, 2005, and Dalbar, 2006).

Follow the media.

Since most investors lack knowledge of investing, they are inclined to do as I did. I obtained much of my investing information, better yet "misinformation," from TV, media articles, investment newsletters, and analyses from the so-called financial gurus. Whenever I followed their advice, I often regretted it. Over time I discovered that these false prophets are in bed with the media. The media lend these fortune tellers a strong measure of credibility. One day they feature the top performer in one or more sectors of the market; the next day, it is the market timer who called the most recent bear market. The media insist that these gurus tantalize viewers with a few hot sectors of the market or stocks on the move with the usual disclaimers about any potential conflicts of interest. An uninformed listener erroneously concludes that these so-called experts are bona fide fortune tellers and acts on their recommendations. Volumes of research debunk forecasts that rely on technical analysis and attribute occasional investment home runs to luck, not expertise. Even stopped clocks are right twice a day. One correct prediction does not make someone a reliable forecaster.

Bear in mind that the financial media benefit from leading the investment public to believe that they are a credible source of the latest information. They appeal to the naiveté, greed and fears of investors; those who succumb to this appeal rarely benefit from the advice. Don your skeptical hat whenever you hear one of these gurus advising you to place your bets.

A better way: educate yourself.

When I finally realized that the options I had tried were as risky as the uncertainties I was trying to manage, I decided to educate myself about the risky business of investing and retirement planning. In schooling myself, I adopted the mind-set that I had used as a social scientist for the past forty-six years. I distinguished between fact and opinion and scrutinized the evidence behind every author's claims; moreover, I searched for research that might corroborate or refute these claims. In the process, I learned a great deal about the route I should have taken to retirement from the time I accepted my first academic appointment to the time I submitted my intention to retire. Join me as I relive my long journey so that you may avoid my wrong turns and succeed in reaching your ultimate destination, a worry-free retirement, despite the risks and uncertainties you will surely face when you retire.

> "It's very hard to make predictions, especially about the future."
>
> --Yogi Berra

Worksheet: Risk Analysis

As you approach retirement, you may wish to inventory the risks you may face in the future and assess their probability, as well as the magnitude of the personal impact. To facilitate your risk analysis, we have prepared a chart that lists the possible risks and asks you to estimate the probability and the severity of the impact on you and/or your beneficiaries. When you have completed this chart, consider how you may mitigate those risks with a high impact/high probability (Scadtizzi, 2010), as well as those with a high impact regardless of probability level.

Risk	**Probability** (High, moderate, low)	**Personal Impact** (High, moderate, low)
Bear markets immediately prior to retirement or after retiring		
Lower returns from the stock market		
Inflation		
Health problems		
Higher taxes		
Reduced Social Security benefits		

Lower bond yields		
Relatives needing financial assistance		
Large unexpected purchases		
Living a long time in retirement		
Exhausting financial assets prematurely		
Predators		

When you have completed the chart using admittedly crude measures of probability and personal impact, circle the risks with the highest probability and personal impact. As you read this book, actively look for ways that you can mitigate these risks. Bear in mind that some of these risks may be beyond your control.