Debunking Common Retirement Planning Myths

RETIREMENT PLANNING GUIDE

Whether you're just starting out in your career or getting ready to retire, it's critical to have a plan in place for how you will replace your income when you're no longer working. Yet, figuring out how much you may need to support your lifestyle goals for a potential 20 or 30 years in retirement can be hard to determine on your own. It becomes even more complex when you factor in the amount of information—and misinformation—you have to sort through to determine the best strategy for your needs and goals.

This guide will help debunk common retirement planning myths and provide the information you need to confidently pursue your goals on your journey to and through retirement.

WHAT IS RETIREMENT PLANNING?

While many people view retirement planning through the narrow lens of setting money aside now for some future date, retirement planning encompasses far more than simply planning for distant goals. That's because retirement planning is part of a comprehensive approach to financial planning that focuses on how you will provide for essentials and your lifestyle needs both now and over time. It provides a framework for financial decision-making and the flexibility to accommodate change at every stage of your life. By viewing retirement planning as part of your overall financial plan, you gain a clearer understanding of how each financial decision you make supports or detracts from your ability to accomplish your goals within the time frame you determine. That begins with understanding how you'll generate the income you need when you're no longer working.

WHERE WILL YOUR INCOME COME FROM IN RETIREMENT?

Income in retirement generally comes from three primary sources:

1. Social Security retirement benefits earned over the course of your working years
2. Employer retirement plans and benefits, which may include 401(k), 403(b), and profit-sharing plans, as well as any pension benefits earned
3. Income from personal savings and investments, including traditional and Roth individual retirement accounts (IRAs) and other sources, such as real estate investment income

MYTH: "Social Security will replace my income in retirement."

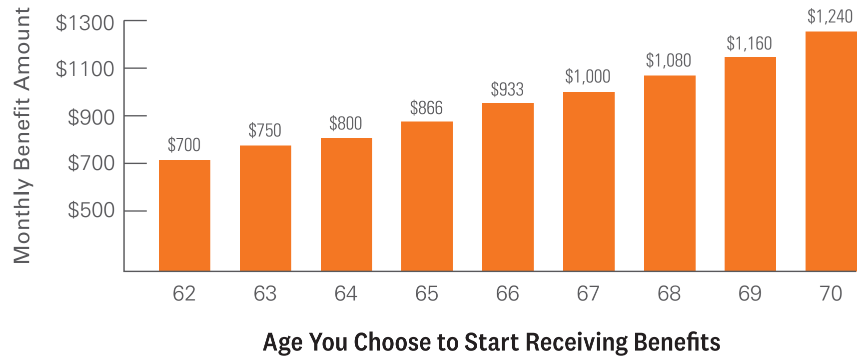
REALITY: According to the Social Security Administration, Social Security benefits will cover only 40% of the average American's income needs in retirement.

Understanding your Social Security benefits

While most people will rely on Social Security benefits to fund a portion of their income needs in retirement, how much you receive and how far it may go is largely dependent upon when you choose to begin taking benefits. You can begin taking Social Security retirement benefits as early as age 62. However, according to the Social Security Administration, if you begin taking benefits at age 62 in 2022, you would receive approximately 30% less than if you had waited to begin receiving benefits at what the Social Security Administration calls your full retirement age, which is 67 for someone born in 1960, or later. Keep in mind: That's a permanent decrease in benefits for the duration of your life in retirement.

Monthly Benefit Amounts Differ Based on the Age at Which You Start Receiving Benefits

This example assumes a benefit of $1,000 at a full retirement age of 67.



Source: Social Security Administration, 2022

When you begin taking Social Security benefits matters

As the graph indicates, your monthly benefit amount increases for each year you delay taking benefits. But notice what happens if you wait until after full retirement age to begin taking benefits: You get an 8% boost in benefits each year in the form of delayed retirement credits until you turn 70.[1] So if you wait until age 70 to begin receiving Social Security, you can expect to receive approximately 77% more than you would have received at age 62. Once you turn 70, there are no additional retirement credits, so there's no reason to wait any later to begin taking benefits.[2]

Once you begin taking benefits, in most cases, you can't stop and restart at a higher monthly benefit later. You're generally locked into a monthly amount, adjusted for inflation, for the duration of your retirement. While there are exceptions to this, penalties apply, so it's important to do your homework before claiming benefits.

MYTH: "I'm too young (or too old) to start saving for retirement."

REALITY: You've heard it before, but it really is true: You're never too young or too old to begin saving for retirement or other long-term goals. However, the earlier you start, the greater the potential benefits due to the power of compounding. By contributing regularly to qualified retirement plan accounts, such as a 401(k) plan or IRA, your money can potentially grow even faster due to tax-deferred compounding.

WHAT IS FULL RETIREMENT AGE?

Full retirement age is the age at which a person may first become entitled to full or unreduced Social Security retirement benefits. For example, if you were born in 1959, your full retirement age is 66 and 10 months. For anyone born in 1960 or later, full retirement age is 67. Visit SSA.gov to determine your full retirement age based on the year of your birth.

77%

The additional amount you can expect to receive if you wait until age 70 to begin Social Security versus starting benefits at age 62.

Source: SSA.gov., 2022

BENEFITS OF PARTICIPATING IN AN EMPLOYER-SPONSORED RETIREMENT PLAN

- Plan contributions can grow tax-deferred while in the account.
- Many employers offer matching contributions up to a certain percentage of your contribution.
- Plans offer a variety of investment choices to fit your goals and risk tolerance.
- Portability: If you leave your current employer you can transfer assets to a new employer's plan, move it to an IRA, or cash it out. You can also leave it in your former employer's plan (if permitted). A combination of these options is also possible.

Qualified retirement plans offer significant tax benefits

Qualified plans are simply retirement plans that comply with Section 401(a) of the tax code. The most common types of qualified plans are IRAs, profit sharing plans (including 401(k) plans), defined benefit pension plans, and money purchase pension plans.

What is a 401(k) plan?

A 401(k) plan is an employer-sponsored plan that allows you to make before-tax retirement plan contributions and direct how that money is invested within your account. Distributions from 401(k) plans and most other employer-sponsored retirement plans are taxed as ordinary income and, if taken before age 59½, may also be subject to a 10% federal income tax penalty. Generally, once you reach age 72, you must begin taking required minimum distributions (RMDs).

Many 401(k) plans allow you to make traditional or Roth contributions. Both allow contributions and earnings to compound on a tax-deferred basis. The primary difference is how and when plan contributions and withdrawals are taxed.

- **Traditional 401(k) plans** allow you to defer taxes on the portion of your salary contributed to the plan until the funds are withdrawn in retirement, at which point contributions and earnings are taxed as ordinary income. In addition, because the amount of your pretax contribution is deducted directly from your paycheck, your taxable income is reduced, which in turn lowers your tax burden.
- **Roth 401(k) plans** feature after-tax contributions, but withdrawals are tax-free in retirement. While there is no immediate tax benefit under a Roth plan, plan balances have the potential to grow tax-deferred; you pay no taxes on qualified distributions.

One of the biggest advantages of a 401(k) plan is that many employers match part or all of the contributions you make to your plan. Typically, an employer will match a portion of your contributions: for example, 50% of your first 6%. Under a Roth plan, matching contributions are maintained in a separate tax-deferred account, which, like a traditional 401(k) plan, is taxable when withdrawn. Note that employer contributions may require a "vesting" period before you have full claim to the money and its investment earnings.

Most 401(k) plans provide you with multiple investment options. These may include stock funds for growth, bond funds for income, or cash equivalents for protection of principal. This flexibility allows you to spread out your contributions, or diversify, among different types of investments, which can help keep your retirement portfolio from being overly susceptible to disparate events that could affect the markets.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

What is a 403(b) plan?

A 403(b) plan, also known as a tax-deferred plan, is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations, and certain ministers. Similar to a 401(k) plan, 403(b) plan investment earnings are tax-deferred until withdrawn. Earnings and returns on amounts in a Roth 403(b) are tax-deferred if the withdrawals are qualified distributions. Employees aged 50 or over can make catch-up contributions to both plan types, and employees may be eligible for matching contributions, which vary by employer.

What is an IRA?

IRAs can be a good choice for individuals who are not eligible to participate in an employer-sponsored plan, or those who have already contributed the allowed maximum to their employer's plan and meet the eligibility requirements to invest more through an IRA.

- **Traditional IRAs** are funded with pre-tax contributions, and taxes are applied at ordinary income rates when the funds are withdrawn, usually after retirement age. Contributions may be deducted for the tax year in which the contribution was made. However, if you or your spouse is covered by an employer-sponsored retirement plan and your income exceeds certain levels, you may not be able to deduct your entire contribution. Unless certain criteria are met, IRS penalties and income taxes may apply to any withdrawals taken from Traditional IRAs prior to age 59½. RMDs must generally be taken by the account holder within the year after turning 72.
- **Roth IRAs** are funded with after-tax contributions. Withdrawals of both contributions and earnings are tax-free in retirement, as long as they are considered qualified. Limitations and restrictions may apply. Withdrawals prior to age 59½ or prior to the account being opened for five years, whichever is later, may result in a 10% IRS penalty tax.

2020 AND 2021 RETIREMENT PLAN CONTRIBUTION LIMITS*

401(k) Plans	**2021**	**2022**
Maximum contribution (under age 50)	$19,500	$20,500
Catch-up contribution (over age 50)	$6,500	$6,500
Total contribution*	$26,000	$27,000
Individual Retirement Accounts (IRAs)	**2021**	**2022**
Maximum contribution (under age 50)	$6,000	$6,000
Catch-up contribution (over age 50)	$1,000	$1,000
Total contribution	$7,000	$7,000

*Total contributions, including employee and employer portions, plus any after-tax contributions, as applicable, not to exceed $58,000 ($64,500 including catch-up contributions) for 2021; $61,000 ($67,500 including catch-up contributions) for 2022. Find more information at https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

HOW MUCH WILL YOU NEED?

While studies indicate that many people are likely to need between 60% and 80% of their final working year's income to maintain their lifestyle in retirement, many retirees may need significantly more. Because of the declining availability of traditional pensions and increasing financial stresses on Social Security, future retirees may have to rely even more on income generated by personal investments than today's retirees.

Determining how much money you may need to support your life in retirement depends on a number of factors, primarily how much you will need to cover your daily living expenses, including housing, food, clothing, transportation, and healthcare. Also consider how you will spend your time in retirement. Will you travel, enjoy a hobby, or spend more time cooking at home or eating out?

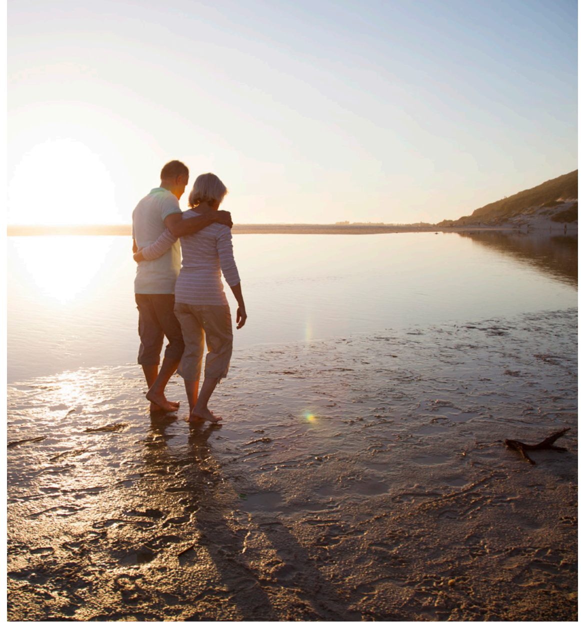
While these are costs you can reasonably anticipate, other circumstances are outside of your control, such as how long you may live in retirement or whether you'll require long-term care due to a decline in health. That's why a dollar amount alone can't answer the question: Will you have enough income in retirement? Only a thoughtful planning process including an evaluation of your goals, needs, and potential unpredictable expenses can help determine how much you may need.

That's why identifying your goals is the first step in the planning process when you work with a financial advisor. Your advisor will help you clarify and document your goals and work with you to develop strategies aligned with your needs and goals.

Budgeting now and in retirement is important

Once you've established your goals, it's important to develop a budget for each stage of your life in retirement—from the early stages when you may be more active and spend more money traveling and socializing, to the later stages when a larger portion of your income may be needed to pay for healthcare expenses.

Yet, retirement isn't the only stage of life where establishing a budget is critical. As you accumulate assets during your working years, it's important to budget to ensure adequate savings for daily living expenses, emergencies, and your short- and long-term goals, which include retirement savings.



THE THREE STAGES OF SPENDING IN RETIREMENT

EARLY — Ages 60–74
Retirees in the early stage of retirement tend to be the most active and spend the most money. Many will need 80% or more of their annual pre-retirement income to support their lifestyles. However, overspending at this stage can impair your long-range goals if it leads to a reduction in the investment principal needed to generate the additional income you'll need in later stages of retirement.

MID — Ages 75–84
Spending tends to level off in mid-retirement for a number of reasons, including paying off a mortgage or downsizing, selling a second car or boat that you no longer use, pursuing a less active lifestyle, or losing a spouse.

LATE — Ages 85+
Spending tends to pick up again in late retirement, primarily due to the increasing costs of goods, services, and medical expenses associated with aging. Even retirees in good health who move to an independent living facility may see an increase in daily living expenses such as rent and other facility charges if they had previously been living mortgage-free.

of adults age 55 and older have left the labor force due to retirement. In the past two years, the number of U.S. retirees has grown by 3.5 million.

Source: *Pew Research Center: Amid the pandemic, a rising share of older U.S. adults are now retired, Nov. 4, 2021*

Regardless of your income level, a budget can:

- Provide a clear and consistent picture of your cash flow—what's coming in versus what's going out.
- Help identify ways to optimize savings and spending, and seize important opportunities to grow your wealth.
- Enable you to pursue your personal and financial goals with confidence.

Best of all, budgeting doesn't have to be tedious or complicated. Dozens of online and mobile apps make it easy to aggregate data in real time from accounts at different financial institutions. To stay on track, review your budget at least once a month and keep an eye out for trends in spending that need to be addressed or reined in.

MYTH: "If I need more, I'll just keep working in retirement."

REALITY: While many Americans plan to continue working in retirement either by choice or out of necessity, it's important to keep in mind that unexpected circumstances can derail even the best-laid plans. For example, an injury, illness, layoff, or other situation outside of your control can force you to stop working earlier than you planned. So relying solely on income from work to support your daily living expenses later in life can be a risky proposition.

Managing retirement risks

At its core, retirement planning is about anticipating and managing the various risk factors that could otherwise derail your plans and your lifestyle in retirement. Three of the most common risk factors in retirement are:

- Longevity: As life expectancy continues to rise, retiree savings will need to last for a longer period of time. In addition, the longer people live, the more likely they will require long-term care.
- Inflation: The inflation rate measures the rise in the cost of goods and services over time. It's a particularly important economic indicator for retirees, as inflation decreases buying power, which has the impact of shrinking your income over time.
- Market and economic events: Market and economic risks include the day-to-day fluctuations in asset prices as well as more dramatic impacts from periods of increased volatility, market declines, or economic recession.

MYTH: "Medicare will pay all of my healthcare costs in retirement."

REALITY: While Medicare Parts A and B ("original Medicare") cover a portion of healthcare costs in retirement, the costs that aren't covered can add up quickly.[3] Also, keep in mind that Medicare does not cover some of the highest costs retirees may incur in retirement, such as long-term care and extended skilled nursing care.[4]

AVERAGE COSTS OF LONG-TERM CARE IN THE U.S.

The national median cost for assisted living in the U.S. is roughly $51,600 per year, while home health aide services average nearly $55,000 per year. Nursing home care—the most expensive of all—runs about $93,000 annually for a semiprivate room to over $105,000 for a private room. These are only averages; the costs for care in different states or regions of the country can vary greatly.

Source: Genworth: Cost of Care Survey 2020

Weighing the impact of longevity and healthcare costs

As retirees enjoy longer average lifespans, healthcare costs will remain a significant expense in retirement. This is particularly true for women, who, on average, live longer than men and may need to pay for healthcare costs for a longer period of time in retirement. That makes a comprehensive approach to planning critical for evaluating how key retirement risk factors—such as longevity, rising healthcare costs, or the need for long-term care—may impact your strategy.

In 2020, health care spending in the United States grew 9.7%, reaching $4.1 trillion or $12,530 per person. As a share of the nation's Gross Domestic Product, health spending accounted for 19.7%.[5]

What does that mean for you, and what can you expect to pay over the course of 20 years or more in retirement? According to a study on retiree health care costs, a 65-year-old couple retiring in 2021 would need $295,000 to cover healthcare and medical expenses throughout retirement, up $10,000 from the previous year's estimate.[6]

Managing investment risk

Contributing the maximum amount to your retirement accounts annually, including IRAs and employer plans such as 401(k) plans, is an important step toward building your retirement assets. But how you allocate your assets within and outside of your retirement accounts can be just as important. Asset allocation is how your investments are distributed across asset classes such as cash, stocks, and fixed-income investments, such as bonds. Each class generally carries a different level of risk or potential for gain, and the percentage you choose to allocate to each will depend on factors such as your risk tolerance and years to retirement.*

MYTH: "I'll avoid market risk by turning to cash during periods of uncertainty."

REALITY: By avoiding the stock market, you're not eliminating risk, but shifting it to the possibility that your money may not keep up with inflation over time. That can have serious implications when it comes to managing the risks posed by longevity or the need for long-term care. That's why your investment portfolio is often designed to keep working for you throughout your years in retirement to generate new income even as your draw down on your accounts.

While investing involves risks, a long-term, disciplined approach to portfolio management—emphasizing broad diversification across different investment types and asset classes—can help manage risk resulting from a downturn in any one investment or asset class as you remain invested through different market cycles. Having a disciplined buy-sell process in place can also help reduce the risk of emotional decision-making during periods of uncertainty.

*Asset allocation does not ensure a profit or protect against a loss.

QUESTIONS TO ASK AT EVERY STAGE OF THE RETIREMENT PLANNING PROCESS

Saving and investing for retirement

- How much do I need to save annually?
- How do I determine the right investment strategy for my circumstances and goals?
- Am I eligible to invest more through an IRA?
- I'm self-employed. What are my retirement plan options?

Nearing retirement

- Are my retirement assets properly allocated?*
- Should I consider converting my traditional IRA to a Roth IRA?
- Do I need long-term care insurance?
- When can I afford to retire?
- Can I retire earlier than planned?

Living in retirement

- Are my retirement assets properly allocated?*
- Will my income last the full duration of my retirement?
- How can I guarantee income will be there when I need it?
- How will required minimum distributions (RMDs) affect my income and taxes in retirement?

* Asset allocation does not ensure a profit or protect against a loss.

HOW WE CAN HELP

While there's no question that the retirement planning process can be complex, requiring significant time and effort, you don't have to go it alone. Your financial professional can do the heavy lifting for you, bringing the value of experience and insight to developing a strategy to address your income needs while helping to monitor and manage your risk exposure at every stage of your journey to and through retirement. Yet, choosing who to work with is critical. You want to make sure your financial professional has a vested interest in the success of your strategy and is able to serve your needs.

Partnering with an experienced, independent financial professional who places your best interests first can help you not only work toward your goals, but make confident decisions about your wealth and your future by:

- Developing a written financial and retirement plan based on your goals and objectives
- Providing experienced guidance, insight, and advice
- Recommending opportunities to optimize your strategy and asset allocation
- Monitoring your progress against goals
- Helping you adjust your strategy over time

QUESTIONS?

If you have questions about saving for or structuring your income in retirement, contact us to schedule time to talk about your retirement planning needs.

[1] https://www.ssa.gov/benefits/retirement/planner/delayret.html

[2] https://www.ssa.gov/pubs/EN-05-10147.pdf

[3] https://www.medicare.gov/your-medicare-costs/medicare-costs-at-a-glance

[4] https://www.medicare.gov/index.php/what-medicare-covers/whats-not-covered-by-part-a-part-b

[5] https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical

[6] https://www.fidelity.com/viewpoints/personal-finance/plan-for-rising-health-care-costs

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