

Money Magazine: Ask the Expert

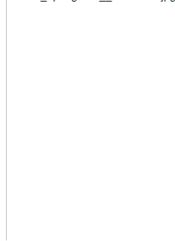
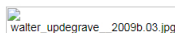
Be ready for the 3 stages of retirement

By Walter Updegrave, senior editor March 23, 2010 9:38 AM ET Sign up for the Ask the Expert e-mail newsletter

(Money Magazine) -- Question: Most people assume that your income needs will remain constant throughout your retirement years. But my wife and I plan to retire early and do a lot of international travel and volunteer work while we're still young. I can't see us continuing the same travel schedule in our late 70s as in our late 50s. So wouldn't it be safe to assume that our income needs will go down as we get further into retirement? How should we plan for that? --Brad, Arlington, Virginia

Answer: Intuitively you would expect your spending to start to fall as you get older and become less active. Indeed, some advisers have contended that spending isn't constant after you retire.

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Walter Updegrave is a senior editor with Money Magazine and is the author of 'How to Retire Rich in a Totally Changed World: Why You're Not in Kansas Anymore' (Three Rivers Press 2005).

Ultimate Guide to Retirement: Getting started 401(k)s & company plans Investing Annuities IRAs Self-employment plans Pensions and benefit plans Social Security Insurance Estate planning Living in retirement

In a book titled "The Prosperous Retirement: Guide to the New Reality" that was published in the late 90s, financial planner Michael Stein divided retirement into three stages.

The first is the go-go stage, the early retirement years when people are looking to travel and engage in other active pursuits now that they've got a lot more free time and are still healthy and robust.

The second is the slow-go stage, a time when they still look forward to getting out and about but not as often as when they first left their jobs.

Eventually people move into the no-go stage, when physical or mental limitations or setbacks like the death of a spouse lead to a much more sedentary lifestyle. Each stage can affect your spending differently.

Money problems? Ask the Expert!

More recently, Wisconsin financial planner Ty Bemicke published a paper in which he asserted that at some point after settling into retirement retirees' spending begins to drop, rather than rise with inflation as conventional wisdom holds.

In an interview for a story I wrote several years ago, Bemicke described this process as "a tug of war, with inflation pulling spending up and Mother Nature pulling it down as we get older and become less active."

But while I agree that this notion of spending eventually winding down makes sense, the question becomes how much do you want to count on that happening? And how much do you want to push your spending early in retirement with the expectation that you'll be able to compensate by laying out less in your later years?

Clearly, it would be a shame to pass on trips, visits with far-flung family members and other splurges in the years immediately after retiring for fear of running out of money, only to find yourself sitting on a big pile of moulah in your late 80s or 90s when you may not be able to enjoy it.

On the other hand, you also don't want to spend freely in those first intoxicating years of freedom from the shackles of a job only to find that your spending hasn't actually fallen very much. The last thing you want in those slow-go years is the anxiety of wondering whether your savings are going to hold out as long as you do.

Finding a balance

I wish there were some handy formula I could give you for dealing with this issue. Something straightforward, like spend 8% of your nest egg in the first five years of retirement and then drop it by a percentage every five years thereafter. But I can't because no formula or rule of thumb can deal with life's uncertainties.

Some of us may move into the slow-go and no-go stages much sooner than others. Some of us may never reach them. Some people may find that their spending falls precipitously once they hit a certain age. And some of those very same people may then find it starts to rise again as they have to shell out a lot more money for health care. As the Nobel Laureate physicist Niels Bohr once remarked, "Prediction is very difficult, especially about the future."

Given this kind of uncertainty, I think you want to try to arrange your spending so you can enjoy life today while still being prudent about tomorrow. One way to do that is to put together a rigorous budget of your intended retirement spending, both for necessities and discretionary items. That way you'll have a better idea of how much wiggle room you have should you need to cut back at some point. The interactive budgeting worksheet in Fidelity's Retirement Income Planner can help you create that budget.

People retiring in their late 50s and early 60s should probably figure on spending 35 or more years in retirement. That usually means limiting draws of their retirement portfolio to about 4% initially and adjusting that amount for inflation subsequently. If you want to withdraw more, fine. Just be aware that the more you take out early on, the less you may have later on -- which could be problematic if your spending doesn't drop as much as you expect.

Whatever level of spending you decide to do initially, be sure to monitor it regularly, say, every year or so. If your portfolio's value is growing despite your withdrawals, you may be able to boost your spending a bit and travel more or whatever.

If, on the other hand, your nest egg takes a big hit due to a market downturn like we had in 2008, you may want to trim outlays a bit to give your portfolio a chance to recover. To see how long your money might last given its current value and your present rate of spending, you can go to a tool like T. Rowe Price's Retirement Income Calculator. By running a variety of scenarios

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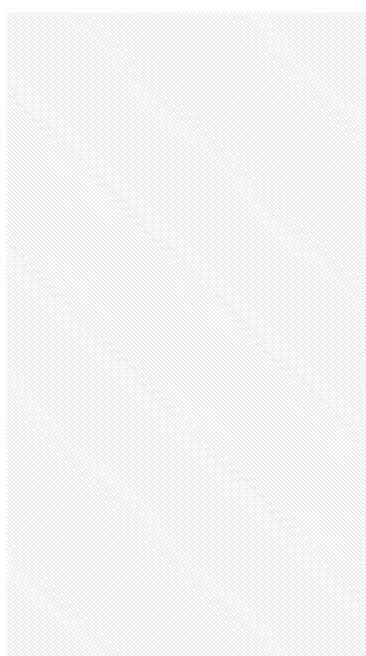
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Markets

Table with columns: US Indexes, Market Movers. Rows include Dow, Nasdaq, S&P 500, Treasuries.

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... retirement means **calculated** by running a variety of scenarios with different levels of spending and different investment assumptions, you can come away with a decent sense of whether you're in danger of going through your stash too quickly -- or on course to leave a big fat balance to your heirs.

Finally, keep in mind that, regardless of what happens to your savings, you will have Social Security to fall back on. But if you don't think you'd be able to live on that alone -- or you have doubts as to how much of **your projected benefits** will be there for you -- you may want to consider devoting a portion of your savings to an investment that can provide a guaranteed lifetime income, such as an **immediate annuity**. That way, you'll be assured of having some money flowing in even if you miscalculate and spend way too much early on.

To sum up, your best shot at making sure you enjoy retirement early on without sacrificing your financial security late in life is to keep tabs on your spending, stand ready to make adjustments and, in the face of life's inherent uncertainties, be as resourceful as you can. ■

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