

INVESTING SPECIALISTS

Will Your Income Needs Trend Down as You Age?

Christine Benz · 18 Nov 2013



The 4% rule for safe withdrawals during retirement is a widely cited rule of thumb, probably because it's easy to use and remember. But it also has its share of detractors, who have reasonably pointed out that it's an overly simplified take on an exceptionally complex problem.

Under the 4% rule, retirees withdraw a fixed dollar amount of their portfolios per year, adjusting that amount upward each year with inflation. The trouble is, that static spending rate ignores the fact that the portfolio's value is fluctuating underneath the surface. By turning a blind eye to market conditions and portfolio performance and sticking with a fixed dollar amount withdrawal, the retiree may be taking out an outsized share of the portfolio in bad years and too little in good ones.

The other big problem with static spending rates is that they don't jibe with real life. Emergency expenses and planned splurges cause all of us--whether retired or still working--to spend more in some years and less in others.

Retirement researchers have also examined the extent to which spending fluctuates by life stage in retirement, slicing and dicing the data by age, income level, and spending categories. In general, the data show that spending tends to go down during the retirement years. That might seem like good news, in that it would seem to suggest you might not have to save as much for retirement as you thought. However, there are some important considerations to bear in mind before you take those data to heart when crafting your retirement plan.

What the Data Say

Financial planner Ty Bernicke was one of the first researchers to conduct an in-depth analysis of retiree spending patterns back in 2005. Using data compiled in the Bureau of Labor Statistics Consumer Expenditure Survey, he showed that spending trends down steadily throughout people's later years. A recent run of the same data, summarized nicely on the Bogleheads site, confirms that phenomenon. Households led by people ages 65-74 spent, on average, \$40,685, about 12% less than those in the 55-64 age band. Those age 75 and above demonstrated an even sharper drop-off in spending: Their average expenditures of \$30,946 were 24% lower than those of the 65-74 cohort. Spending surveys conducted and compiled by the Survey Research Center at the University of Michigan for the National Institute on Aging (also summarized on the Bogleheads site), which improves upon the CES methodology by tracking expenditures for *the same households* from one time period to the next, shows a similar downtrend in expenses over the household's life cycle.

Those statistics corroborate what many of us know from personal experience: As people age, health issues may slow them down. And even if they're well, they may not feel like traveling and engaging in other active (and possibly costly) pursuits as they once did. In his book *The Prosperous Retirement*, CFP Michael Stein divided retirement into three stages: "Go-go," "go slow," and "no go."

What You Should Do With It

At first glance, one easy takeaway from these data might seem to be that you need less in retirement than you might have first thought, but financial planners urge caution before incorporating tapered-off spending into your retirement plan.

For starters, it's tricky to disentangle how much of the spending cutbacks were voluntary and how much were borne of necessity. When I interviewed financial planner Harold Evensky about retirement planning, he opined, "While statistics demonstrate that [people spend less as they age], I think there are two problems with those statistics. One is that they're yesterday's statistics, and two, the fact that people are spending less doesn't necessarily mean they wanted to spend less. It may very well mean that they had to spend less."

In his paper on age-related spending declines, Bernicke argued that the spending cutbacks were likely voluntary because spending declined across income levels. Why would wealthier folks cut back if they didn't actually want to? But that assertion has since been questioned by retirement researcher Wade Pfau and others due to vagaries in the CES data. (Pfau's thought-provoking analysis of spending trends in retirement can be found [here](#).)

Perhaps more important for retirees aiming to use these data to plan for their own retirements is the risk in extrapolating conclusions from averages, particularly in an area as personal as spending. On his *Nerd's Eye View* blog, financial planner Michael Kitces argued that a household's level of wealth is likely a significant swing factor in whether living expenses go up, down, or stay the same as one ages; more wealth likely means greater spending cutbacks in retirement. That's because discretionary categories like travel and dining out take up a bigger share of budgets for higher-income households than middle- and lower-income ones, and those are the categories that tend to see the largest cutbacks in expenditures as people

categories that tend to see the largest cutbacks in expenditures as people age. By contrast, individuals or households who use much of their income for basic needs like housing and food--which tend to decline little, if at all, in the later years--will likely see less of a drop in their overall spending rates as they age. But as sensible as that guidance might seem, individuals might have different experiences: You'd hate to turn 85 and still have a zeal for travel but no ready cash to fund the trips because you didn't expect to still be traveling at that age.

Finally, the real wild card in all of this is health-care costs, one of the few categories of expenditures that trends up consistently as people age. Indeed, for some senior households, their spending patterns are more of a "U" shape--higher in the early years when discretionary and travel expenses are in full swing; lower in the middle years of retirement; and back up again late in life, when health-care costs spike.

On average, cutbacks in other categories more than offset rising health-care expenditures later in life, leading to overall spending declines in old age. As Kitecs points out, there are also caps on the out-of-pocket costs for people with Medicare and supplemental policies; he estimates the maximum out-of-pocket health-care outlay for a couple earning less than \$170,000 a year would be \$10,000 a year. That's a level that more affluent households may be able to absorb without undermining their standard of living too much, but high health-care costs could rapidly erode the standard of living for less-wealthy seniors who have less room for error in their budgets. That's yet another argument for less wealthy households planning for fewer, if any, spending cutbacks in their later years.

It's also worth noting that long-term care needs could drive a household's health-care-related outlay above \$10,000 in the space of a few months; individuals or couples without long-term care insurance could see their out-of-pocket health-related costs skyrocket. That means that if you're one of the growing chorus of people saying they plan to cover long-term care costs out of pocket, it's crucial to get your arms around what that actually entails.

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