Retiring in a Boom Market

BY STEVE SULLIVAN

If your clients think a booming market is the perfect time to retire, your job may be to help them think again

When 403(b) advisors counsel their clients, it's important that they not allow emotion or bias to affect their judgment. It's also important that they realize their clients are under no such constraint. Many, if not all of the decisions their clients may make are often based on rumor, unsolicited and unprofessional advice, and gut feelings. It may seem counterintuitive, but when it comes to money, particularly the large and important sums associated with retirement planning, rational behavior often goes out the window.

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To illustrate, here's a hypothetical exchange between Stan, an employee, and Linda, an advisor:

Stan: *Linda, thanks for sitting down with us. I know you're busy but we've been doing some thinking and we wanted to run it by you before we did anything. You know I'm turning 57 next month, and frankly I'm burned out. I've had it. I know we haven't quite reached our goal yet, but Stella says she's willing to keep working until she's 65. I figure we could cash out part of the nest egg and buy an annuity or something, and let the rest of it keep working in the market. My brother-in-law watches the market like a hawk and he says it's been like gangbusters for six straight months now. He says there's never going to be a better time to retire. So what could possibly go wrong?*

Linda: *[OMG!]*

The dialog may be hypothetical but it's certainly not farfetched. Once Linda's over the shock, how should she respond to Stan? What questions should she ask? What course of action should she advise?

"First," says J. Bruce Weinstock, a GWN Securities registered rep with Kades-Margolis in Kensington, PA, "I tell my clients never to base any financial decisions on advice from anyone who isn't a licensed financial advisor. You don't listen to hearsay about the greatest stock offering or investment, and you should always avoid the genius financial wizard in the faculty lounge. Over 39 years I've constantly seen people who get burned by the 'wizards.' They come back with their tails between their legs asking to be rescued from a plan that has surrender charges for 15 or 20 years and the guaranteed rate really wasn't 8 or 9%. Sometimes I can help; sometimes I can't."

Jody Detillier, TGPC, a principal with the Sonny Detillier Agency in Lutcher, LA, calls it "the brother-in-law problem." "Let's assume the brother-in-law is absolutely correct, the market has been doing really well for six months," he says. "But that doesn't tell us anything. Six months from now it could be totally the opposite. We're talking about a retirement that could last 30 years. What the stock market is doing right now is irrelevant."

Nevertheless, there is research that suggests that some people decide when to retire—against all advice to the contrary—based on what the stock market is doing at the time. This is the finding of a paper, "Market Performance and the Timing of Retirement," published last year by Dr. Rui Yao, an assistant professor of personal financial planning in the College of Human Environmental Sciences at the University of Missouri, Columbia.

The Research

Yao began with data from the Health and Retirement Study (HRS), a national biannual longitudinal survey conducted by the University of Michigan. The HRS, launched in 1992, has interviewed more than 27,000 Americans of diverse backgrounds over the age of 50. The interviews occur in two-year cycles and cover questions about their health, the state of their finances and their interactions with family and others in their communities.

The HRS covers more territory than the respondents' economic circumstances, but the economic information it gathers is quite detailed. According to the HRS website, the study collects information about "sources and amounts of income; composition and amounts of assets; and entitlements to current and future benefits such as those provided through Social Security, Medicare, Medicaid, employer pension plans, and employer-sponsored health insurance. Data describing the movement of assets, including gifts and bequests, time (*e.g.,* to provide daily living assistance), and housing within families, are also collected, as are data about earnings, savings, and spending of individuals and families as they approach retirement and over the course of their retirement until death."

Yao's study, published in the *Journal of Personal Finance* and funded by a grant from Prudential Insurance, reviewed the financial and retirement status of more than 4,000 of these respondents between 1992 and 2008. It's the first study to use these data to look at retirement behavior over that period of time.

"The study respondents in my paper were 51 to 61 years old, born between 1931 and 1941," says Yao. "We wanted to focus on pre-retirees, not people who were too young and weren't planning to retire. Nor did we want to look at anyone who was too old and already retired."

The Findings

As employers transition from defined benefit plans to defined contribution plans, the risk of retirement is shifting from employers to employees. Though the professionals who run DB plans base their decisions on hard numbers and probability, individuals don't usually have the same kind of analytical skills or

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access to the same data.

"We know that pre-retirees make bad decisions all the time," says Yao. "That's why I felt the need to do this study, because retirement is one of the most important financial decisions we make in our lives. It's a decision that's not revocable; once you retire, it's very difficult to get back into the workplace."

Yao's study found that the decision to retire is often based on what the market is doing at that particular point. If the market is up, they'll see it as a sign that this is the perfect time to retire. Behavioral economists call it the "recency effect," the phenomenon that people tend to remember things at the end of a list or only the most recent events in time.

"The problem with this strategy is that the economy runs in cycles," Yao says," meaning that after a peak, the market will inevitably take a downturn. People who have retired shortly before an economic downturn run a serious risk of losing a significant portion of their retirement savings, which will shorten the longevity of their retirement income. This could result in many retirees outliving their retirement savings and facing financial hardships toward the end of their lives."

Advisors need to help their clients think more like actuaries, according to Yao. "They need to do the math. They need to project life expectancy. Nobody knows when they're going to die but they all have some kind of expectation based on family history."

Jody Detillier uses a powerful website, Livingto 100.com, to help lower this uncertainty. Answering about 50 questions about your living habits, medical history, immediate family's longevity, etc. can bring you about as close as you're ever going to get to predicting your life expectancy. Using this estimate instead of the standard life expectancies, says Detillier, provides a much better basis for planning.

Incipient retirees also need to project how much they want to spend and project the value of their retirement income, says Yao, then compare this present value with their wealth accumulation. If their accumulated wealth can cover retirement, then there's no problem. They can retire.

"If their retirement target is $1 million," she says, "and they reach their target at the peak of the market, they've achieved it only because of the up market. If they retire now and stay in the market, chances are their $1 million won't be worth the same next year or the year after. They'll probably want to stay around for a couple more years to see if their $1 million is stable."

And what about married couples who want to retire together? After all, it's a natural thing for spouses to coordinate their retirements so they can enjoy their leisure together. In that case, says Yao, advisors have to specifically point out that they won't have any cushion if they retire at the wrong time. If they retire together at the end of a market peak, and there isn't a working spouse who can hedge against the risk of mistiming, they may be in trouble.

And if they don't intend to retire together, how long is the spouse prepared to work? "From 39 years of experience," says Weinstock, "I can tell you that very rarely, if ever, will the spouse stay employed longer than three years after the first spouse retires. You can just image all the reasons why, the spoken and the unspoken—'it's freezing cold and I have to get up and go to work and you don't.'"

Point of No Return

Still, Weinstock adds, many clients worry about how they'll know when it's time to retire. If it's not based on what the stock market is doing, then what should they base it on?

"I tell them not worry because there will be a triggering event. If you're an educator on the front line in the classroom and you feel your focus is slipping or your enthusiasm is waning, what you don't want to do is make one bad slip, no matter what that may be. The next thing you know you're in a legal battle to try to keep your retirement because you did something that may not have been correct. That's my worry for people who teach for a long period of time; sometimes they hang in there too long and unknowingly put themselves at risk because they're just not at the top of their game."

So if there is truly a triggering event that's taken them to the point of no return, their first course of action is to understand their current contract. Weinstock makes sure his clients know the answers to some important questions:

- When do you have to give notice?
- What's the timeframe for receiving all the benefits you're entitled to, including sick days, retirement incentives and loyalty pay?
- What will your income be from your state teachers' retirement system?

"All this has to be covered before we even start to talk about the money," Weinstock says. "When you go through all these steps, the money is the last thing you discuss, but it's a natural follow-up to everything that's gone before. Allocating the money, designing a plan, is the easy part."

Detillier agrees. "A lot of people look at retirement as just surviving over the next year or two," he says. "That's important; you have to be able to pay your bills. But as a financial planner I have to make sure they can provide an income for the rest of their lifetime. If Stan retires at 57 and has to go back to work at 65, I really didn't do a very good job for him."

Detillier makes sure to include Social Security planning as part of the mix. He uses software that will analyze every possible method of claiming one's Social Security retirement benefits.

"Individuals have several options for when to start taking Social Security benefits," he says. "Couples have even more. When you throw in alternative strategies like file-and-suspend and filing a restricted application, you've got more than 350 ways a couple can select their benefits. Using the software can determine which choice can yield the most money over the course of their lifetime. If I can get them an extra $200,000 in Social Security benefits over the course of their lifetime, that takes more pressure off their assets."

Even absent brothers-in-law and faculty room wizards, there's no shortage of people willing—even eager—to make irrational decisions about their finances. And with so many variables involved in deciding when to retire—Social Security, longevity, contractual restrictions—there are enough uncertainties without trying to time it to the market. Both the empirical research and advisors' anecdotal evidence agree: Markets go up and down; they always have and they always will. Which may be meat and potatoes to day traders and speculators, but it could be the kiss of death for people with finite resources who are on the brink of retirement. b

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INVENTORY WITHOUT CRYSTAL BALL

By Jill Snyder

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First of all, in the example at the beginning of this article, unless Stan's brother-in-law has a crystal ball, he should probably refrain from offering advice. Even so, I would do a financial inventory lining up all their assets against their liabilities. The numbers don't lie and if the reason for retiring early and not sticking to the original plan is emotional, then the math may help them realize that retirement simply isn't an option right now. I'd ask the following questions as well:

- **Will either of them be receiving a pension upon retirement?**
- **What are their plans for collecting Social Security? The ordering and timing of collecting payments is much more strategic than folks think. Software is available to help couples make this decision.**
- **What about health insurance until age 65? Since many of our clients are in education, this is often a benefit they receive upon retirement.**
- **What about long-term-care needs?**
- **What are their plans in retirement—spending time with grandkids, traveling, hobbies, returning to some sort of part-time work?**
- **Will their living space change as a result of retirement? Will they be downsizing, selling a home, buying a second home?**

With answers to those questions and a spreadsheet of their "real numbers" for how long their money might last (based on a "reasonable" growth rate) this will give us an idea if that income can support their lifestyle in retirement.

My parents live quite comfortably in retirement on around $30,000 a year. They have no debt, they have emergency funds in savings, they travel (via air) maybe once a year, have LTC insurance, and are frugal about spending. They know the limits they have to work within. They have an active social life that costs little monetarily, but it's their most valuable asset in retirement! b