The New Retirement Rulebook

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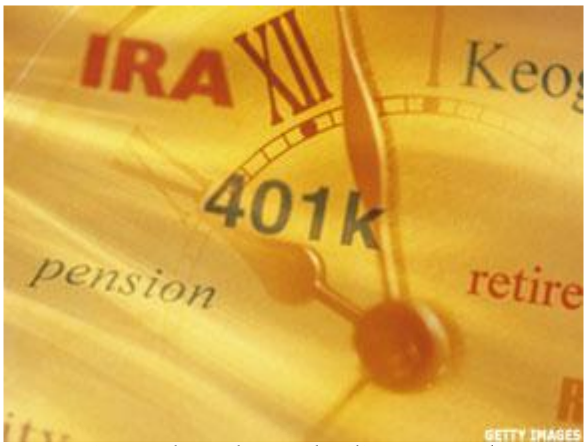
BOSTON (MainStreet) -- The rules of retirement are in need of a rewrite.

The loss of company pensions, longer lifespans, concerns over Social Security and a volatile investing world are among the forces that have made planning for a financially secure retirement more challenging than ever.



Longevity and market volatility mean that retirement goals and how to reach them have changed.

Retirement strategy has long been almost entirely focused on the accumulation of assets, but study after study has continually moved the goal post for what is needed in savings -- $500,000, $1 million, $3 million.

The problem is that big numbers of that sort can either scare investors into thinking a target is unobtainable or force them into a risky glide path in search of returns to reach that magic number. More skeptical savers point out that the very financial firms that benefit from the growth of investible assets have been the ones marketing bigger and bigger "numbers."

How much people need to retire has become more individualized, more of a moving target. Building needed assets may require more than just the standard simplicity of splitting a "buy and hold" portfolio among stocks and bonds.

"There's a lot of people who are vulnerable. When you really take a look at the most vulnerable people, any of the baby boomers fall into that category because they lack that defined benefit-pension plan, and the old three-legged stool of having a pension plan, Social Security and savings is kind of broken," says Bill Smith, president and founder of Ohio-based **Great Lakes Retirement Group**. "With the 401(k) now being the primary source for funding an individual's retirement, what happens is it becomes up to the individual to build their own pension."

Smith advocates an approach that takes into account an "individualized inflation rate" based upon standard of living. A laddered annuity approach can cover baseline expenses to "give peace of mind for lifetime income that they can never outlive."

"In theory, they can spend the rest of their money and never run out of income," he says.

That personalized inflation rate is determined by assessing basic necessities and retirement goals. Someone with a history of medical problems, for example, may need to account for the higher rate of health care inflation; those who live in a major city may also see basic expenses increase at a greater rate.

There are also what Smith refers to as "joy expenses."

"If you take one person who may like golf, or maybe they ski, an individual's costs of goods and services that they purchase may go up [to a greater extent] than the next individual who may not do the same thing," Smith says. "These are the added extra things they are enjoying that they won't do forever, but for 10 to 15 years we have to make sure they have a really good income for that. We have found that using just a flat rate of 3% may work for most people, but not for others."

Smith doesn't advocate converting all savings into annuities, but having a baseline of income provides the ability to invest in other assets to help keep pace with inflation and future needs that go beyond basic living expenses.

"[For that second layer] we potentially use preferred stocks, nontraded REITs or a very conservative fixed-income portfolio," he says. "We are using a very conservative growth rate on those assets to be able to cover those additional joy expenses down the road once they retire, and then goal expenses as well. The idea is to have peace of mind and security on their income side then show them how to actually grow the assets on the rest of it."

Pete D'Arruda, president of **Capital Financial Advisory Group**, agrees that annuities -- he suggests fixed annuities with income riders -- can build a necessary foundation of income.

Living off a nest egg for 30 or more years is a challenge, so a level of certainty and peace of mind with investments goes a long way, he says. The objective is to have a foundation of safety that enables the rest of the portfolio to take on more risk while lessening worries of day-to-day market volatility.

"You have to have some money in a core approach where you can't lose it," he says. "If I can have a percentage of that in my clients' accounts, then I can afford to take some risk with what's left, because I know that if for some reason we have another 2008 or market catastrophe the only thing that's exposed to that risk would be *that* money, and the other assets continue to grow. The more money I can get in a safe place, the more risk my clients can take with what's left. People who never thought before that they could take risk are now able to after they have some safe money in place."

D'Arruda stresses proper scrutiny of any annuity product.

"Insurance companies have stepped up and made it a lot easier with these income riders," he says. "Of course you have to know it's a good company and you have to know what's going on with the income rider ... They are not your grandmother's annuities any more, but there still are some bad ones out there. With variable annuities there are, of course, commissions and fees. With fixed annuities there are no commissions coming out, but there are some fees, so you have to know what they are. You have to deal with quality companies and quality advisers."

The volatility of the past four years has led D'Arruda to suggest that consumers think of financial guidance the same way they consider medical care.

"I think this is the year of a second opinion," he says. "Maybe you get two advisers, one who is a 'risk' adviser and who is a 'safe' adviser. Then you have them work in synergy though a quarterback like a CPA or somebody you really trust and have both advisers put together what they really think is the best and combine them -- a hybrid kind of a plan."

D'Arruda says people can be so locked into studying their savings statement by statement that they lose sight of the fact that "the most important thing is what you started with and what you have now."

"When you go to a shopping mall you have to find that map that can get you to where you want to go," he says. " But first you have to look for that big red X that says, 'You are here.' Before you decide where to go you have to figure out where you are right now -- and that's mentally, emotionally and financially all together. That's what adds up to a full financial plan. It's not just about numbers any more."

Like Smith, D'Arruda agrees that having "safe" money provides the ability to invest a portion of assets into a wide variety of strategies, some not normally thought of in terms of retirement planning.

"You can take what is left for risk and divide that into stocks, maybe a bond or maybe some Master Limited Partnership, REITs or alternative investments. You have correlated and noncorrelated assets all working together on that risk side, but your safe money is still trucking along and you don't have to worry any more."

Kelli B. Send, senior vice president for **Francis Investment Counsel** -- which offers investment advisory services to plan sponsors as well as education and individualized advice services to plan participants -- says many 401(k) plans do not "offer the kind of portfolio or the kind of investment options that they really should today. " When they do, international exposure is usually too Eurocentric.

"What we typically see is an average in the industry of 10-12 funds and maybe one international," she says. "Well, we know what has happened to the traditional international option. It has gotten hammered in 2011 because it is so focused on Europe."

Send says that 401(k) menus, as they have been pared down for simplicity's sake, need to be rethought and include alternatives, hard assets, commodities, emerging-market equities and emerging-market fixed income.

"You not only have to add them to the plans, you have to educate the employees on how to use them," she says. "The standard asset allocation models out there today still do not include those types of choices."

The average 401(k) investor's exposure to international funds is just 8% of assets, according to a study conducted by Vanguard. According to the *Callan DC Index*, retirement plans had less than 0.5% of plan assets invested in emerging-market equity funds.

In making sense, and returns, from the current investing environment, participants need options and the wherewithal to use them.

"So much in behavioral finance is about the inertia out there," Send says. "Once people check mixes they tend to stick to them. There is a fine line between long-term investing and neglect. What happens is people pick a mix when they are 30. Now they are 52 and they are finally going, 'Oh I'd better make some changes.' It's crazy that with the demise of pensions people just do not know what to do and the industry really hasn't figured out a way to really help people drive change. Even when you offer the brochures and the newsletters [full of advice], people don't change their mix."

"The problem is twofold," she adds. "The employer really has to offer new-world thinking with their portfolio choices, but then the participant has to be given help to get them implemented."

Send says the call for better choices is amplified as retirees needing to make money last throughout a longer life are stuck with having to either work longer or lower their standard of living because their investments haven't kept pace with need.

"There is some discussion about wage replacement," she says. "Do you really need to replace 70% to 80% of your pay? Well, if you really want to retire badly enough you are going to figure out a way to do it on 60% if that is all you can do."

There may not be much current retirees can do given the corrosion of their assets caused by market motion in the past few years, Send says. Her hope is that younger generations see the need to plan for retirement much earlier.

"The thing we are seeing is that younger Americans are more leery about investing in equities and they shouldn't be," she says. "I always say to folks, 'Repeat after me ... you are too young to care ... you are too young to care. Just keep repeating that mantra and you'll be fine.' Yet they are hearing horror stories and with today's media you just get it everywhere and then they are hearing grandparents and parents talking about how they lost thousands of dollars. The young ones are getting scared away, and I think that's a mistake."

"That's where that investment menu in the 401(k) world becomes very important -- because of our natural tendencies, that inertia and the whole 'set it and forget it,'" she adds. "If we know that's the tendency, then it's important for the plan sponsor to offer an investment menu that fits today's new realities. We need to understand that whatever employees pick will really determine what their returns are going to be. I don't mean is it a good fund or a bad fund. I mean the whole asset allocation. We need to make sure that a younger participant has the ability to get kind of a new-world asset allocation, and I don't think a lot of 401(k) plans measure up like that today."

"Even if you've given up on investing, that doesn't mean you should give up on savings," is the warning of David Hefty, co-founder of **Hefty Wealth Partners**. "They are two different things. People equate their 401(k) to the stock market. Last time I checked, every 401(k) in the country has some type of fixed-income option. There are people who are not even getting their company match. My goodness, how many self-inflicted wounds can they give themselves?"