How to Retire: CliffsNotes Edition!

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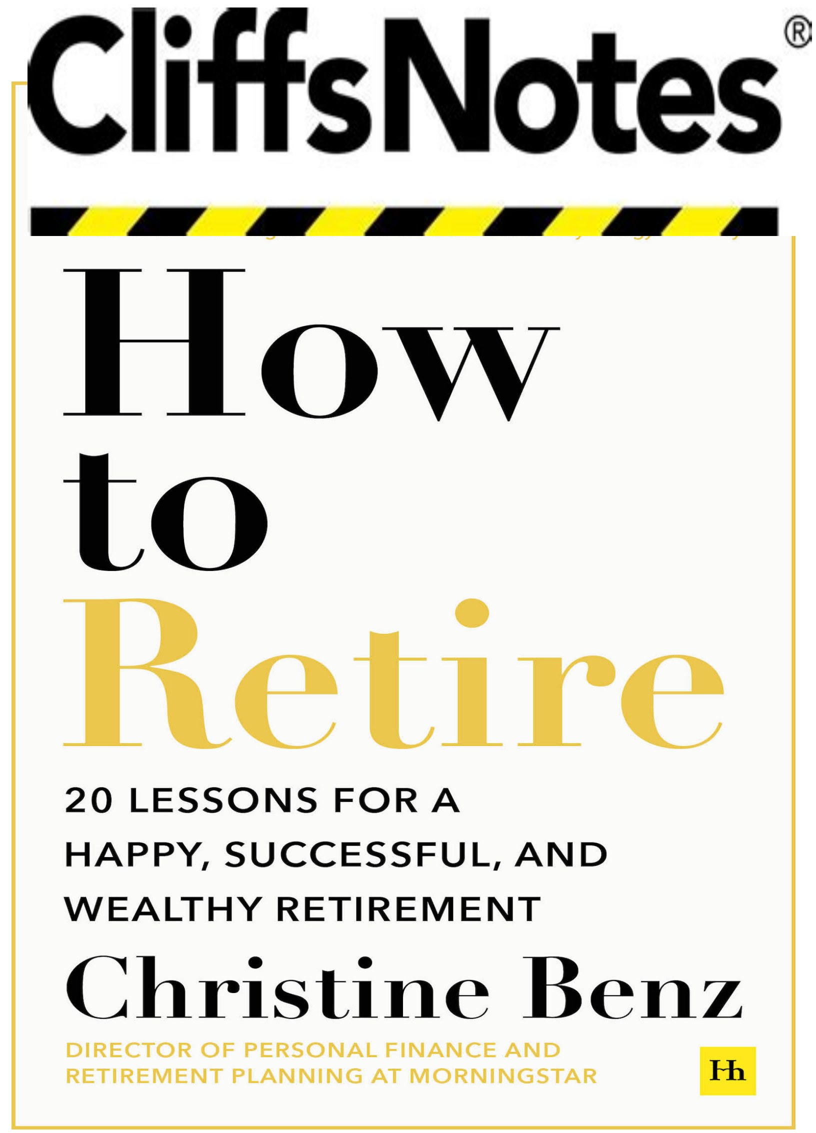
November 9, 2024



Lesson 1: Plan to Take a Holistic Approach to Planning

- Having the **money** to retire is a key ingredient
- But the best financial plans also factor in:
  - Purpose/identity
  - Relationships/family
  - Housing
  - Health/healthcare/long-term care
  - Structure
  - What you want to accomplish/be during these precious years!

Lesson 2: Take a Phased Approach If Possible

"Work is good for us. The way we work in this country isn't."

Laura Carstensen, PhD, Stanford Center on Longevity

Lesson 2: Take a Phased Approach If Possible

- Key financial benefits of working longer
  - Shortened portfolio drawdown period
  - Potential for delayed Social Security filing
  - Continued contributions to savings
  - Potential for additional tax-sheltered compounding
  - May be able to delay required minimum distributions
  - May be able to avoid sequence risk
- Plenty of nonfinancial benefits, too!
  - Relationships/socialization
  - Purpose/identity
  - Intellectual stimulation
  - Physical activity

Lesson 2: Take a Phased Approach If Possible

- Working longer carries plenty of nonfinancial benefits, too!
    - Relationships/socialization
    - Purpose/identity
    - Intellectual stimulation
    - Physical activity
    - Structure

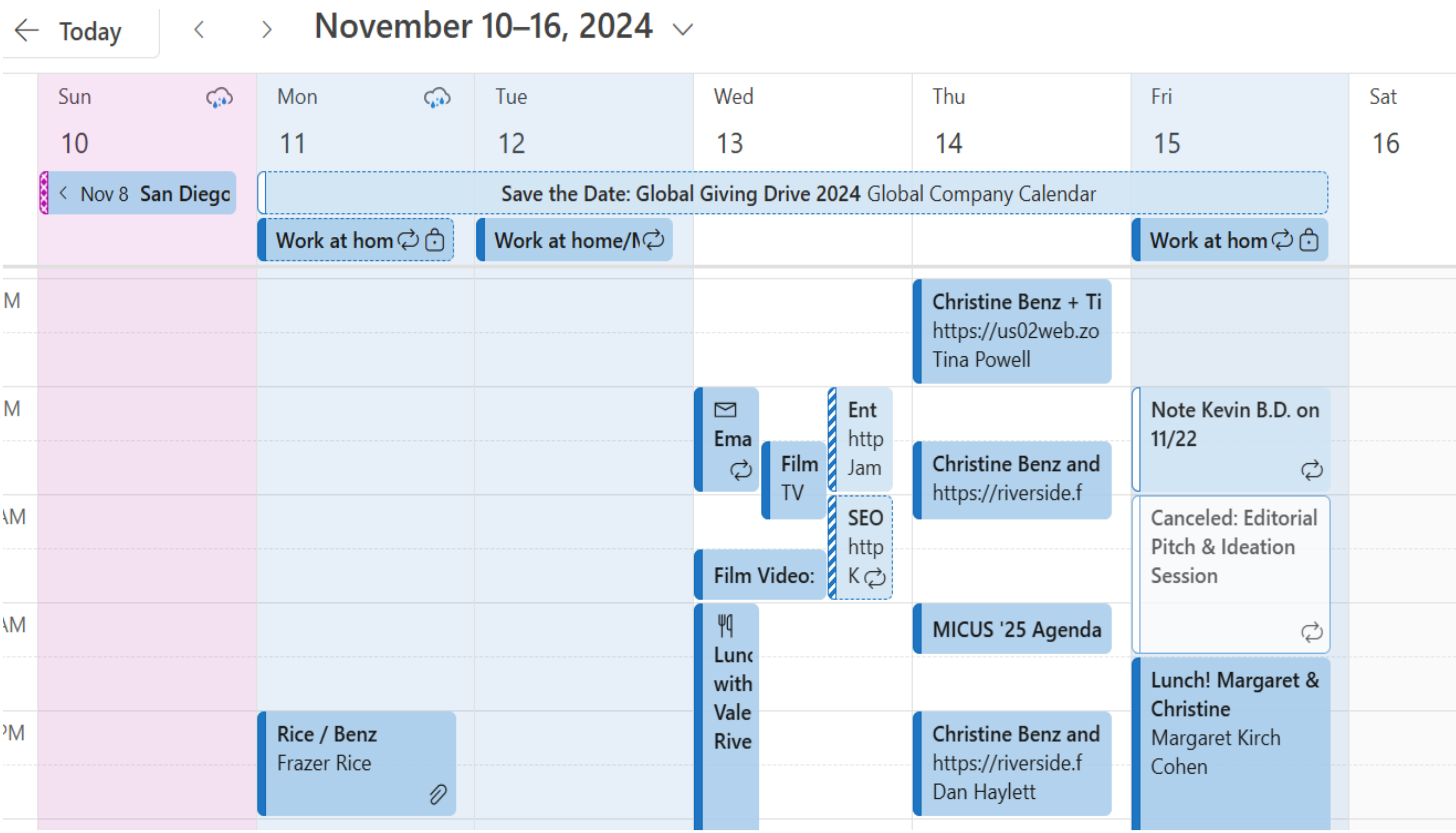
Lesson 2: Take a Phased Approach If Possible

- Potential negotiation items with employer
  - Schedule/hours
  - Remote work v. in-person
  - Type of work/chief responsibilities
- Issue: Some of the jobs that our employers want us to continue doing are the ones we like the least

Lesson 2: Take a Phased Approach If Possible

- If current job doesn't appeal, consider something completely different
  - Part-time work that is less stressful (why hello, Trader Joe's!)
  - Another position that leverages what you liked best about your old job
  - Volunteering
  - Entrepreneurship

Try My Sunday Night Calendar Test!



Lesson 3: Maximize Non-Portfolio Income Sources

- Non-portfolio income sources include the following:
    - Social Security
    - Pension income
    - Income from work
    - Rental income
    - Other, idiosyncratic types of investments such as income from farmland

Lesson 3: Maximize Non-Portfolio Income Sources

- Benefits of non-portfolio income sources in retirement
  - May be *lifetime* benefits (Social Security, some annuities)
  - May have embedded inflation protection: SS (explicit) or rental properties, working income (implicit)
  - More non-portfolio income enables lower portfolio withdrawal rate
  - Makes it easier to be flexible with portfolio withdrawals
- Caveats with non-portfolio income sources
  - Delaying Social Security or buying an annuity will be less advantageous if you have a shortened life expectancy
  - Can't purchase annuities with CPI-linked inflation protection
  - Annuities are only as good as the insurance company backing them
  - Some (many!) annuities are complicated, costly
  - Rental, work income can be subject to disruptions

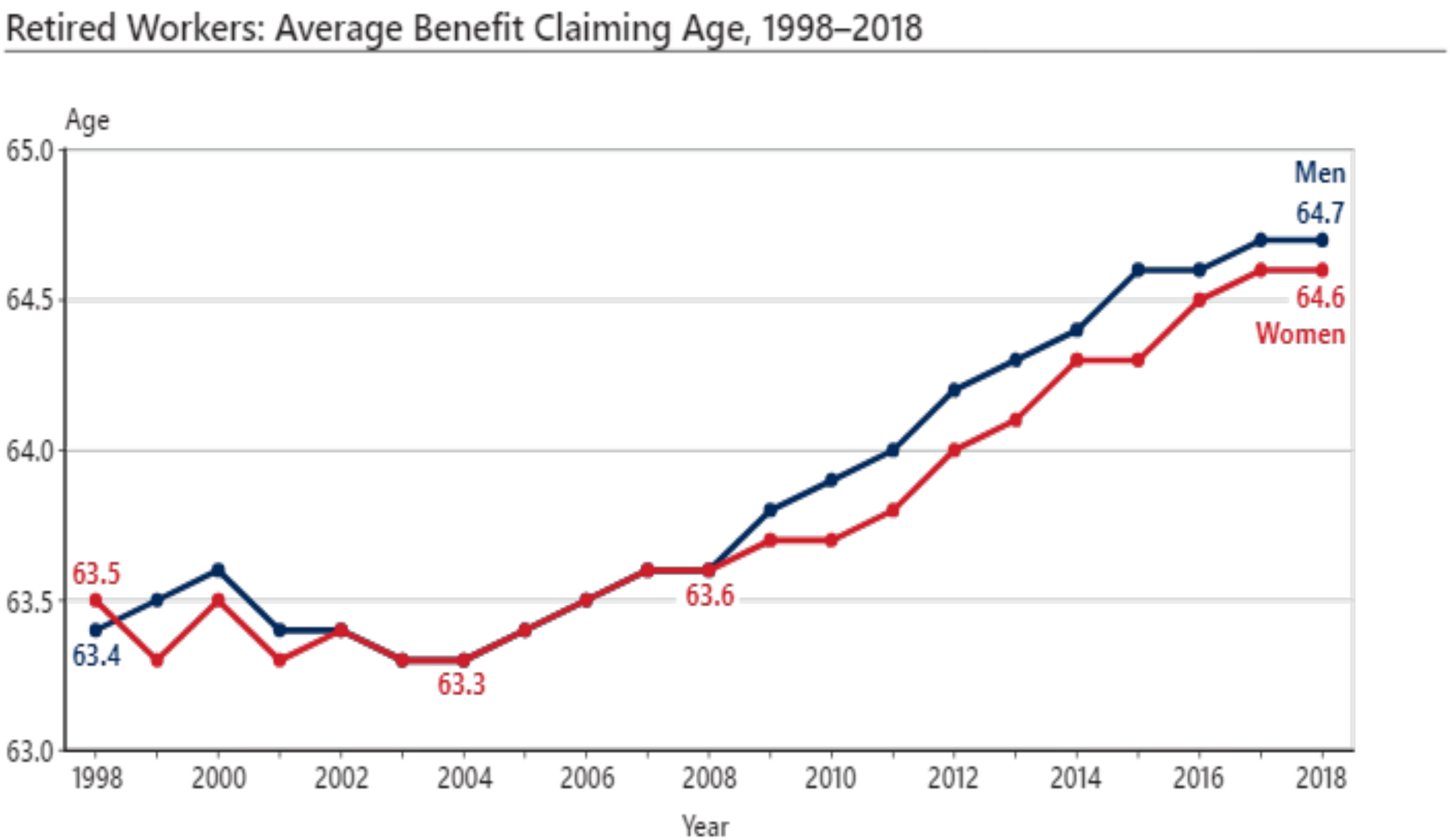
Easiest Way to Maximize Lifetime Income: Make Smart Social Security Decisions

Exhibit 18 Social Security Benefit % by Claiming Age, Birth Year 1960 or Later

Age	Percentage
62	70
63	75
64	80
65	87
66	93
67	100
68	108
69	116
70	124

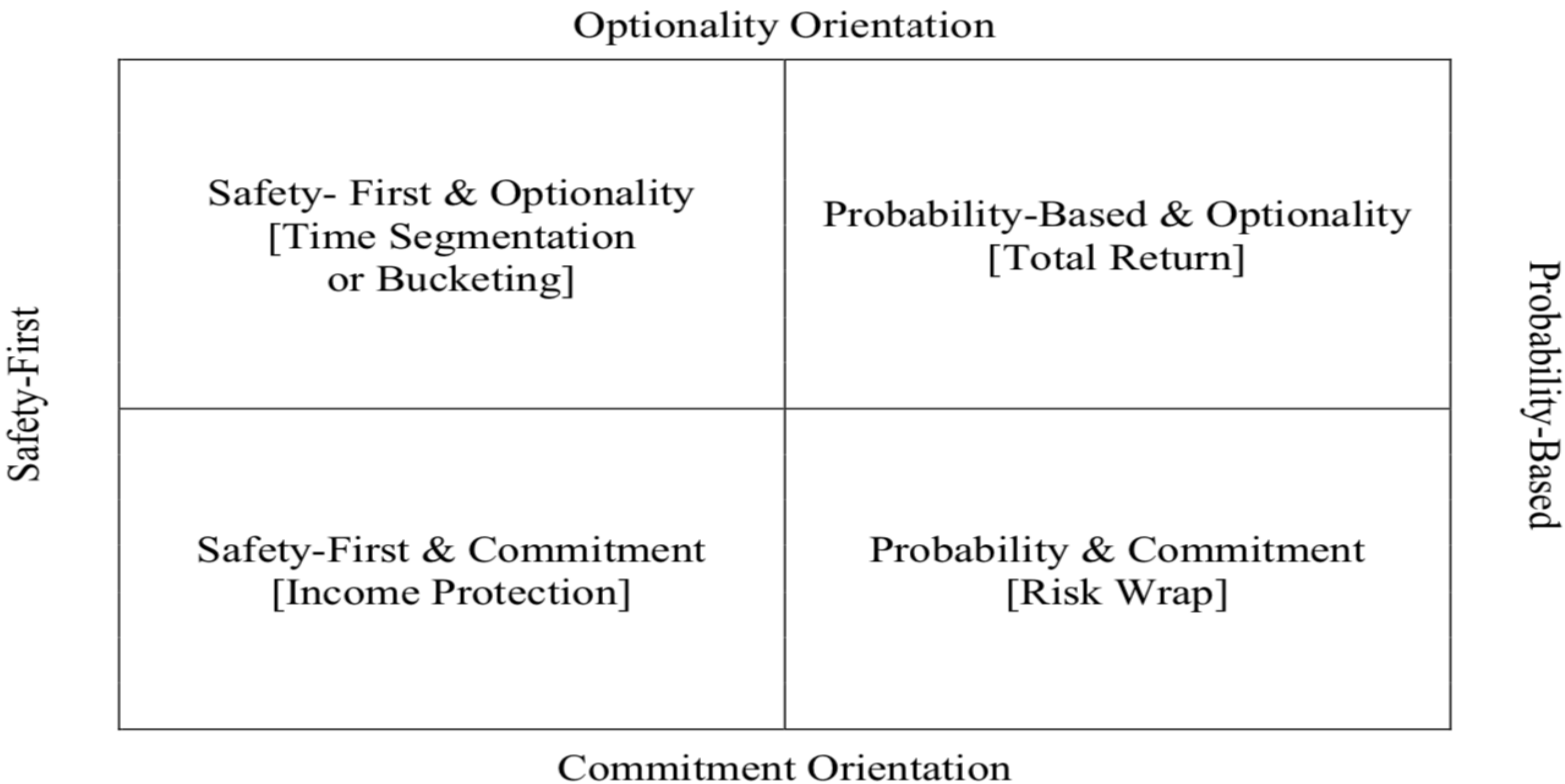
Source: Social Security Administration. Data as of Sept. 30, 2023.

Retirees Are Starting to Get the Message about Delaying



Source: Social Security Administration.

Lesson 4: Understand Your Retirement Income Style



Source: Retirement Income Journal.

Two Primary Questions on Retirement Income Styles

- **Question 1: Are you safety-first or probability-oriented?**
  - Safety first: You want guaranteed income, ideally to last your lifetime, even if that means low/no growth in your assets
  - Probability-oriented: You know that stock and bond returns aren't guaranteed but want the opportunity for your money to grow

Two Primary Questions on Retirement Income Styles

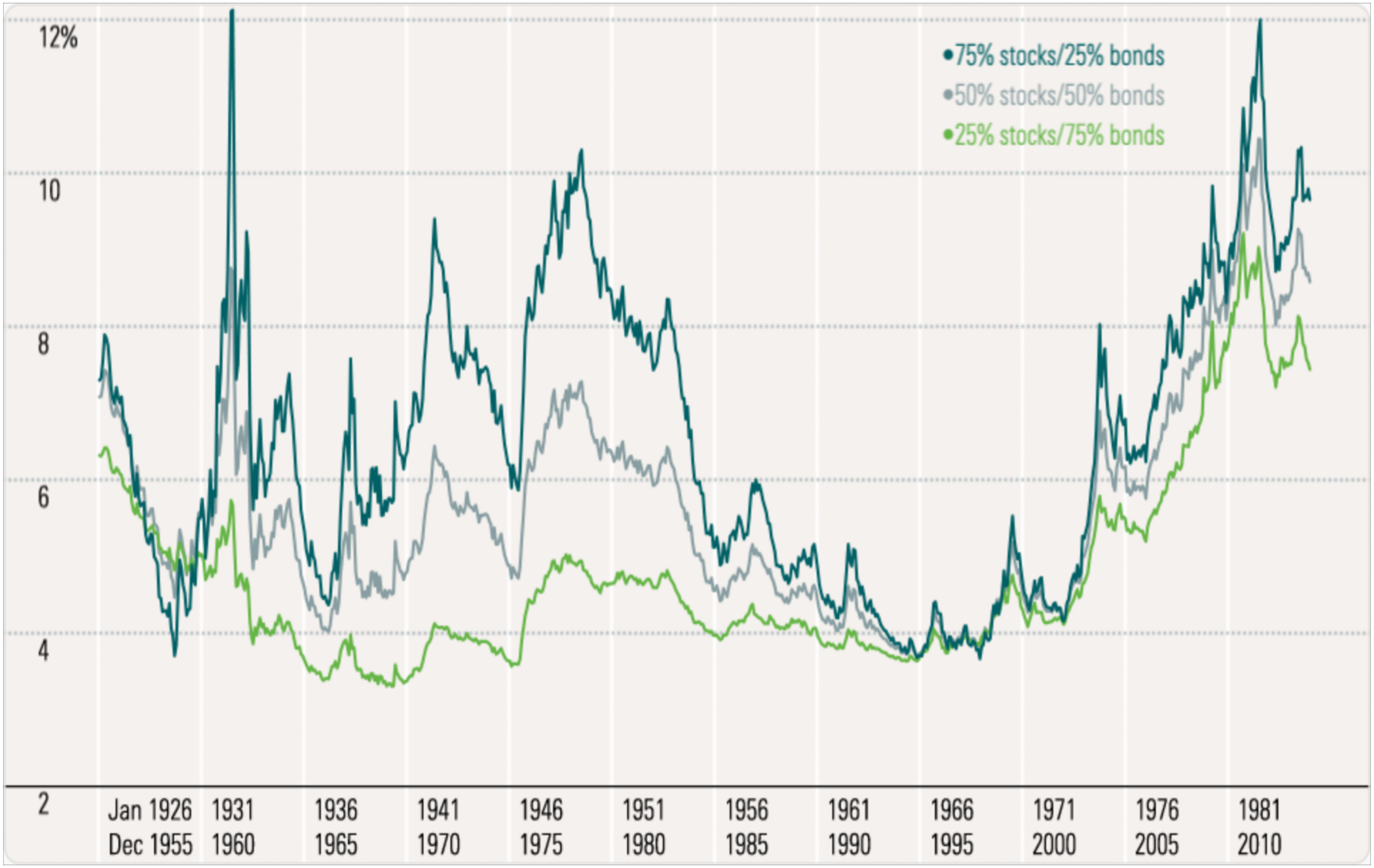
- **Question 2: Are you commitment-oriented or do you seek optionality?**
  - A commitment orientation means that you want to lock down a retirement income solution and not have to worry about it again
  - An optionality orientation means that you want access to your capital on an ongoing basis and want to be able to control and make changes to your investments

Which Describes You?

- **Safety-first and commitment**
  - Want stable guaranteed income and want to lock it down
  - Best example: Basic income annuity
- **Probability-based and optionality**
  - Want growth potential of investment assets, are OK with variations in portfolio cash flows
  - Best example: Total return portfolio with periodic withdrawals
- **Safety-first and optionality**
  - Want safety but don't want to be locked into an annuity
  - Best example: Bucket portfolio w/stable cash flows
- **Probability-based and commitment**
  - Want opportunity for growth, market participation but seek a lifetime solution
  - Best example: Variable annuity

➢ No-go years: ~Age 85-95
  - ➢ Some people may experience cognitive decline
  - ➢ Greatest need for long-term care in this age band

Lesson 5: Get a Sensible Spending Plan



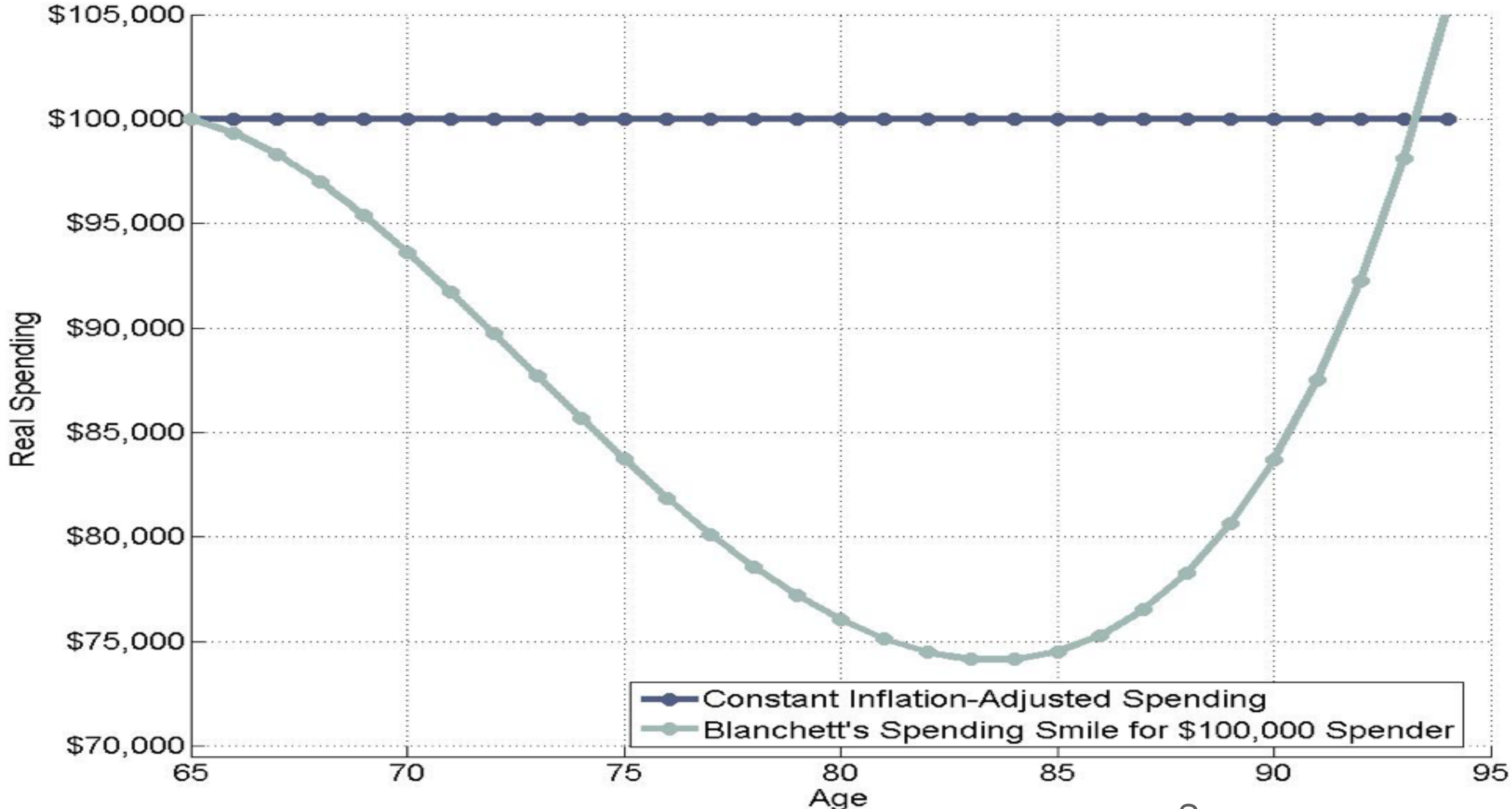
The 4% Guideline: A Good Starting Point

- Stress-tested over market history
    - Initial research by William Bengen (1994), corroborated by the Trinity Study (1998)
    - Morningstar's 2023 research, using forward-looking 30-year asset class return assumptions, also concluded that 4% is a safe starting withdrawal percentage for balanced portfolios
- Assumptions
    - Retiree takes 4% of balance in Year 1 of retirement
    - Inflation-adjusts that dollar amount thereafter
    - Example: $1 million portfolio
        - Year 1 withdrawal: $40,000
        - Year 2 withdrawal: $41,200 (assuming 3% inflation)

The 4% Guideline: Caveats Abound

- The 4% guideline is based on a worst-case scenario
  - May lead to significant underspending if conditions are better
- Assumes static inflation-adjusted spending throughout retirement, similar to Social Security
  - Retirees don’t actually spend that way!
  - Spending tends to be higher earlier

How Spending Changes During Retirement



Source:
Retirementresearcher.com.

Being Flexible with Withdrawals Helps Elevate Initial, Lifetime Spending

Method	Starting Safe Withdrawal Rate %	Lifetime Withdrawal Rate %	Year 30 Cash Flow Standard Deviation %	Median Year 30 Ending Value ($ millions)
Base case	4.0	4.0	**0.0**	**1.5**
TIPS ladder (100% success rate)	4.6	4.6	**0.0**	0.0
Forgo inflation adjustment	4.4	4.1	5.4	1.4
RMD	4.4	**5.4**	43.7	0.2
Guardrails	**5.2**	4.8	29.4	0.8
Actual spending	5.0	3.9	**0.0**	1.4

Source: Morningstar. Data as of Sept. 30, 2023.

Flexibility Works Behaviorally, Too!

"Retirement spending is one area where your feelings line up with what's in your best interest. Because when conditions say it would be helpful to take your foot off the gas, that is exactly what you want to do."

Financial Planner Jonathan Guyton, CFP.

Lesson 6: Structure Portfolio to Support Cash Flows

Bucket 1

For: Years 1 and 2

Holds: Cash

Goal: Fund Living Expenses

Bucket 2

For: Years 3-10

Holds: Bonds, Balanced Funds

Goal: Income production, stability, inflation protection, modest growth

Bucket 3

For: Years 11 and beyond

Holds: Stock

Goal: Growth

Sample In-Retirement Bucket Portfolios

Assumptions

- 65-year-old couple with $1.5 million portfolio
- 4% withdrawal rate with annual 3% inflation adjustment ($60,000 first-year withdrawal)
    - 2 years' withdrawals in Bucket 1
    - 5-8 years' withdrawals in Bucket 2
    - Remainder in Bucket 3
- Anticipated time horizon: 25 years
- Fairly aggressive/high risk tolerance (total portfolio is ~ 50% stock/50% bonds and cash)

Sample In-Retirement Bucket Portfolio: ETF

Bucket 1: Liquidity Portfolio for Years 1 and 2: $120,000

$120,000 in CDs, money market accounts/funds, other cash

Bucket 2: Intermediate Portfolio for Years 3-10: $480,000

$100,000 in Vanguard Short-Term Bond ETF BSV

$150,000 in iShares Core US Bond Market IUSB

$150,000 in Vanguard Short-Term Inflation-Protected Securities VTIP

$80,000 in Vanguard Dividend Appreciation VIG

Sample In-Retirement Bucket Portfolios: ETF

Bucket 3: Growth Portfolio for Years 11 and Beyond: $900,000

$350,000 in Vanguard Dividend Appreciation VIG

$225,000 in Vanguard Total Stock Market Index VTI

$250,000 in Vanguard FTSE All-World ex-US VEU

$75,000 in Vanguard High-Yield Corporate VWEHX

Sample In-Retirement Bucket Portfolio: Mutual Fund

Bucket 1: Liquidity Portfolio for Years 1 and 2: $120,000

$120,000 in CDs, money market accounts/funds, other cash

Bucket 2: Intermediate Portfolio for Years 3-10: $480,000

$130,0000 in Fidelity Short-Term Bond FSHBX

$150,000 in Harbor Bond HABDX

$100,000 in Vanguard Short-Term Inflation-Protected Securities VTAPX

$100,000 in Vanguard Wellesley Income VWIAX

Sample In-Retirement Bucket Portfolio: Mutual Fund

Bucket 3: Growth Portfolio for Years 11 and Beyond: $900,000

$400,000 in Vanguard Dividend Appreciation VDADX

$250,000 in American Funds International Growth & Income IGIFX

$125,000 in Vanguard Total Stock Market Index VTSAX

$125,000 in Loomis Sayles Bond LSBRX

Now Do Minimalist

Bucket 1: Liquidity Portfolio for Years 1 and 2: $120,000

$120,000 in CDs, money market accounts/funds, other cash

Bucket 2: Intermediate Portfolio for Years 3-10: $480,000

$480,000 in Vanguard Total Bond Market ETF BND

Bucket 3: Growth Portfolio for Years 11 and Beyond: $900,000

$900,000 in Vanguard Total World Stock ETF VT

Now Do Taxable

Bucket 1: Liquidity Portfolio for Years 1 and 2: $120,000

$120,000 in municipal money market fund

Bucket 2: Intermediate Portfolio for Years 3-10: $480,000

$150,000 in Vanguard Short-Term Tax-Exempt Bond VTES

$330,000 in Vanguard Tax-Exempt Bond VTEB

Bucket 3: Growth Portfolio for Years 11 and Beyond: $900,000

$525,00 in Vanguard Total Stock Market ETF VTI

$375,000 in Vanguard Total International Stock ETF VXUS

Lesson 7: Pay Attention to Tax Considerations

- Most retirees bring 3 main account types into retirement

  Traditional tax-deferred: Possible tax break on contribution, no taxes as long as funds stay in the account, taxable upon withdrawal, required minimum distributions, new rules for inherited IRAs

  Roth: No tax break on contribution, no taxes as long as funds stay in the account, no taxes in retirement, no RMDs, no taxes when inherited but estate tax may apply

  Taxable: No tax break on contribution, taxes due on income and capital gains as received, capital gains tax due on investment gains at time of sale, step-up when inherited

Lesson 7: Pay Attention to Tax Considerations

- Some of the key tax considerations re. investments
  - Which account types should you fund? (Pre-retirement)
  - Asset location: Which assets to hold where for tax minimization? (Pre-retirement/in retirement)
  - Sequence of withdrawals: Which assets to liquidate first and which to hold for later? (In retirement)
  - Which assets to earmark for heirs and charity? (Pre-retirement/ in retirement)
  - Whether to convert traditional tax-deferred accounts to Roth
  - Any opportunity to avoid/reduce know-on taxes like IRMAA?

- Overarching advice: Get some help!

Lesson 7: Pay Attention to Tax Considerations

- Post-retirement, pre-RMD (age 73) years are ripe for tax planning maneuvers such as:
  - Converting tax-deferred accounts to Roth
  - Accelerating withdrawals from tax-deferred accounts to reduce future RMDs
  - Making charitable contributions from tax-deferred accounts (qualified charitable distributions): Can start QCDs at age 70.5

Tax-Efficient Withdrawal Sequencing Meets the Buckets

ACCOUNT:
Taxable
STARTING BALANCE:
$120,000
ASSETS:
$120,000 in cash and cash equivalents

ACCOUNTS:
Taxable and Traditional IRA
STARTING BALANCE:
$480,000
ASSETS:
$380,000 of short- and intermediate-term bonds held in the taxable account + $100,000 of intermediate-term bonds held in the traditional IRA

ACCOUNTS:
Traditional IRA and Roth IRA
STARTING BALANCE:
$900,000
ASSETS:
$400,000 of equities/equity funds held in the traditional IRA + $500,000 of equities/equity funds and higher-risk high-yield bond funds held in the Roth IRA

Assumption: 65-year-old retiree has $1.5 million split equally across traditional, Roth, and taxable accounts.

Lesson 8: Formulate a Long-Term Care Plan

- Two key dimensions for long-term care planning
    - How to pay for it
        - Government-provided care (not Medicare!)
        - Insurance products
        - Self-fund
    - How do you wish to receive care if you need it?
        - Receive help from family members or paid caregivers?
        - Receive help in-home or in assisted living/memory care?

Image Sourc: Kitces.com

Lesson 8: Formulate a Long-Term Care Plan: Government Resources

- Medicare doesn’t cover long-term care expenses
- Medicaid does, but eligibility is subject to strict income and asset limits
    - Medi-Cal considers income but not assets in determining LTC eligibility
    - Remaining estate required to pay back LTC costs
    - In states where asset limits apply, Medicaid has a 5-year lookback period for pre-emptive gifts to family members
- Will be limitations on where you can receive care and whether you can receive care at home

Image Sourc: Kitces.com

Lesson 8: Formulate a Long-Term Care Plan: Insurance

- Traditional/pure long-term care policies
  - Premium hikes
  - Mixed results extracting payment from insurers
  - Shrinking pool of insurers offering
  - May not qualify or could be cost-prohibitive, esp. after a certain age
- Hybrid life/long-term care policies
  - Life insurance or annuity w/LTC rider
  - Easier to quality
  - Purchased with lump sum: Can do 1035 exchange from whole life-only policy
  - Can be opaque/difficult to comparison-shop

Image Sourc: Kitces.com

Lesson 8: Formulate a Long-Term Care Plan: Self-Fund

- Data can help inform how much to hold
    - Typical length of long-term care need is 1.5 to 2 years (longer for women)
    - Women more likely to need than men
    - Average cost of care: $120,000/year (more in high-cost urban centers: $182,500/year in San Diego)
- Consider a fourth “bucket”
    - Segregate from spendable portfolio
    - Invest based on proximity to care need
    - Traditional tax-deferred account can make sense (high deductible health care outlays match high withdrawals)
    - If you don’t need LTC, then money can go to heirs, charity or use as longevity hedge
- Home equity can be a good backup

Lesson 9: Draft an Estate Plan

- Key components include:
  - Beneficiary designations
  - Power of attorney for health care, financial matters
  - Will
  - Living will/advance directive
  - Trusts in some cases
  - Executor
- Plan to revisit with major life changes (loss of spouse, new family members) or as financial profile changes
- Recommend an estate planning professional or hybrid software/professional approach

Lesson 9: Draft an Estate Plan

- Don’t neglect the “softer” side of your plan
  - Attitudes toward end-of-life care (beyond living will; “The Conversation Project”: www.theconversationproject.org)
  - Plans/wishes for pets
  - Plans for distribution of special personal articles (can be part of your estate plan)
  - Attitudes toward disposal of your personal property (do what’s easiest or take great care/try to get top dollar?)
  - Plans/wishes for your funeral/memorial

Lesson 9: Draft an Estate Plan

- Create a “master directory” listing the following:
    - Financial accounts, account numbers
    - Financial professionals you deal with (financial advisors/planners, accountants, attorneys) and their contact info
- Write a simple overview of the investment strategy that you employ
- Share instructions about where to go for cash on an ongoing basis
- Share any cautions that your loved ones should bear in mind—e.g., tax implications of selling certain assets

Lesson 10: Simplify!

- As retirement progresses, take steps to simplify your financial life
- Key steps include:
  - Reducing number of financial providers
  - Reducing number of financial accounts
  - Simplifying investment types
    - Fewer: Individual stocks, actively managed funds, niche investment products
    - More: Index funds and ETFs, multi-asset/balanced funds for smaller accounts
- DIY types might also consider delegating to a financial professional

Questions? Comments?

My new book: ***How to Retire: 20 Lessons for a Happy, Successful, and Wealthy Retirement,*** Harriman House, 2024.

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