

## Money and You: Rethinking retirement

by *Carrie\_Schwab\_Pomerantz*

Recently, I had a heart-to-heart chat with a good friend of mine, who confessed she was worried about retirement. I was surprised since she's a very successful businesswoman who is in her late 40s and earns a good salary. But she'd recently divorced with no settlement, and is putting her son through college.

"My focus right now is on him," she told me. "Putting away a lot for retirement just isn't going to happen anytime soon."

Now my first thought was to offer the standard advice I give to everyone: You've got to prepare for your retirement now, by saving and investing aggressively so that you can take advantage of what is still a longtime horizon - even if it means skimping on current wants and needs (including your son's education).

After all, financing a secure retirement is the challenge for most Americans, and it's a challenge too many are simply ignoring. One sobering statistic: approximately 60 percent of people 45 or older have less than \$100,000 in retirement savings, according to a survey by the Employee Benefit Research Institute, or EBRI - and that's nowhere near enough for anything but a very meager standard of living.

But as I reflected on her story, I also realized that retirement planning was simply not a near-term priority for my friend. She knew it was important, but her more pressing goals were to rebuild her life after her divorce and to get her son through school. So instead of admonishing her, I tried to provide a different perspective.

In essence, there are two ways to look at retirement planning. First is the good old-fashioned and prudent approach: You save, save, save (and invest, invest, invest) throughout your life so you can build up a great big nest egg that will supplement Social Security.

But the harsh reality is that a lot of people, and perhaps my friend, won't be in a position to "retire" in the traditional sense. For them, there may be a second path: Keep working. This phase of their life might more aptly be described as "rewiring," not "retiring." There are plenty of people who want to keep active and stay engaged by remaining in the workforce, starting a small business, or by discovering an entirely new career or occupation. But this can be a risky strategy, since you cannot know for sure if you'll be able to keep working during your golden years. A debilitating injury or accident, for example, may prevent this. This means you'll still need to save and invest, as aggressively as possible. But if you're able, a "rewired" retirement could extend your income-generating years and reduce your need for the classic nest egg.

I mentioned this possibility to my friend, but I also insisted that she not bury her head in the sand. Bottom line is whether you're 25 or 55, or whether you want to retire early or work forever, you need to make a plan

with real numbers.

My approach is simple: For a traditional retirement, assume you'll need the same income you enjoy on the day you retire. Sure, you may be able to live on less but will you want to? Most people want to maintain their standard of living, and some expenses - notably health care - are much more likely to go up than to go down when you get older. To estimate what your retirement assets should be, here's a useful seat-of-the-pants calculation: You'll need 25 times as much as you plan to withdraw in the first year of your retirement, assuming your retirement lasts 30 years.

Let's say you can retire comfortably on \$80,000 per year. How will you generate that income? You'll probably be eligible for Social Security benefits, but don't count on too much. In 2007 the maximum monthly benefit is just over \$2,100, or about \$25,000 a year. In this case, you'd still be on the hook for another \$55,000. Keep in mind, of course, that future Social Security benefits could easily be lower.

Using the 25x rule of thumb, you'd need to have saved \$1,375,000 on the day you retire in order to withdraw that \$55,000 during your first year as a retiree and have a high degree of confidence that your assets will last as long as you do. Put another way, you can withdraw approximately 4 percent in year one, with this amount increasing each year with inflation. This rough calculation assumes that you'll earn an average 7 percent annual return on your savings.

My friend believes that she can't save \$1.375 million over the next two decades. But by remaining in the workforce, she'll need less in the way of assets. Still, I urged her to save as much as she can today and to increase the amounts as soon as possible. I recommended that she max out her retirement plan contributions, which is exactly what I tell everyone, even if they are 22 years old in their very first job. And I suggested she take advantage of the catch-up provision when she turns 50 to get more money into tax-advantaged accounts (currently up to \$5,000 annually for 401(k) plans; up to \$1,000 a year for IRAs and Roth IRAs).

There's one additional advantage of postponing retirement. If you can also postpone taking your Social Security benefits, you'll probably end up with a higher monthly benefit.

Clearly I couldn't erase my friend's worries. But she did say that our talk helped bring things into focus - and although she liked the idea of a "rewired" retirement, she also saw the necessity to make a concrete plan and keep plugging away at a retirement nest egg. Of course some of us will want to continue working as long as possible; however, in the meantime, don't let short-term realities prevent you from preparing for life's biggest financial challenge.

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