

ROBERT POWELL



March 7, 2010

Five steps to rethinking your retirement plan

By Robert Powell, MarketWatch

One year after the start of the crash, your 401(k) or IRA is pretty much back to even, according to some studies, at least. Now you can get on with the rest of your life, and with planning your future finances. Rather than thinking about how much money you lost, now is a good time to incorporate all the new retirement research and possibly some new products into your plan.

Here's a five-step plan for reworking your retirement-savings strategy:

1. Think about you.

It all starts and ends with you, says Mitch Anthony, author of *The New Retirementality*. No matter whether you're working, semi-retired or fully retired, think about what you want out of life.

In essence, you need to focus first on the life and lifestyle you want and then the money needed to fund it. "Too often, numbers and strategies are formed outside of the very context they are intended to address: our quality of life and our sense of emotional well-being," Anthony wrote in *Retirement Income Redesigned: An Advisor's Guide for Funding Boomers' Best Years*.

"You cannot number-crunch your way to emotional well-being and quality of life, nor can you achieve these ends without crunching the numbers and making the necessary adjustments."

But how do you figure out the life you want?

"As we attempt to build a bridge between means and meaning in our lives, we can ponder what Viktor Frankl, author of *Man's Search for Meaning*, called the three values of meaning: experiential values, creative values and attitudinal values," Anthony said in an e-mail. Here are some questions Anthony developed around these ideas that you can ask yourself.

Experiential:

What are some experiences that I have been putting off that I can put on this year's calendar?

Where do I want to go this year, and who do I want to go with?

Creative:

What is it that I do that brings the most value to others?

How can I get better at it?

Who do I most enjoy working with?

What tasks are the most energizing? How can I spend more time doing those?

Attitudinal:

For whom am I a role model?

What attitudes and behaviors do I want to demonstrate for them this year?

2. Your balance sheet.

With the answers to those questions in hand, start to think about the money side of what Anthony calls the "financial life-planning" equation. There, the first order of business is getting a handle on your household's balance sheet -- what you own and what you owe.

Be sure to create a balance sheet that looks at your entire household's assets and liabilities, not just your personal balance sheet. That's the first step in creating a life-cycle plan, according to the Retirement Income Industry Association.

But in the new, post-financial-crisis world order, this balance sheet won't quite look like the one with which you're familiar, the one with assets on one side of

the ledger and liabilities on the other. These days, assets still include the usual suspects such as taxable and tax-deferred accounts, but that column also includes the net present value of your Social Security benefits and the discounted value of your future wages -- that is, your human capital.

"Your human capital is the most valuable asset for most of your working life," Moshe Milevsky writes in *Your Money Milestones*, published in January. And all forms of capital belong on what Milevsky refers to as the "holistic" balance sheet. "You must add your human capital to your financial capital to truly understand your financial position in life."

Likewise, the liability side of your balance sheet looks a bit different now. It includes the present value of your minimum consumption or lifestyle needs in retirement, the present value of any bequests, as well as funds that could be used for other liabilities, including both discretionary spending and unforeseen expenses.

His rule of thumb: "Don't add assets without subtracting any corresponding liabilities."

3. Your cash flows.

The next order of business is getting a handle on what your fixed and discretionary expenses, plus your income sources, will be in retirement. In an ideal world, you would try to use your fixed sources of income (annuities, Social Security, interest income from bonds and CDs) to pay for your fixed expenses or, better yet, your minimum standard of living, "your floor," according to the Retirement Income Industry Association.

And then you would use what some call your "risky" assets to pay for discretionary expenses. In an ideal world, you want a financial capital-to-consumption ratio that makes it less likely that you'll run out of money.

Milevsky suggests you plan to spend your resources evenly and smoothly over time. You want to "devise a long-term spending plan that spreads your total resources over your entire life cycle." His advice: "Think long-term and avoid foreseeable disruptions by budgeting for all predictable liabilities."

4. Retirement risks.

Long before you start thinking about how to invest your money given your desired lifestyle, your balance sheet and your cash flows, experts say you need to factor retirement risks into your plan, including but not limited to inflation, healthcare and longevity.

"The big risks in retirement include outliving assets, healthcare, long-term care and inflation," said Anna Rappaport, president of a consulting firm and chairwoman of the Society of Actuaries' Committee on Post-Retirement Needs and Risks. "Actuaries are particularly concerned that people fail to think about the long-term and outliving assets."

But you have to think about these and all the retirement risks -- the Society of Actuaries has identified at least 15 -- in a thoughtful way. As part of this exercise, consider reading, for instance, *Risk: A Practical Guide for Deciding What's Really Safe and What's Really Dangerous in the World Around You* by David Ropeik and George Gray. The authors suggest that you assess whether the risk involves an identifiable hazard, whether you have exposure to it, whether the consequences are too severe to ignore and the probability of negative consequences.

Identifying your retirement risks is one job, but managing them is another thing entirely. You might decide to manage risks through diversification, insurance, hedging or risk-free assets. The net effect of this exercise is that you'll create a portfolio that has some percentage of assets allocated to each of those risk-management techniques, with some percentage used to create a minimum level of consumption in retirement.

5. The right products.

Once you've figured out how much to invest in each basket based on all things considered -- your desired lifestyle, balance sheet, cash flow and risks -- you can start thinking about which products should be used to produce a minimum standard of living and which could be used for all else, or what the Retirement Income Industry Association calls "upside." For his part, Michael Zwecher, author of *Retirement Portfolios: Theory, Construction and Management*, suggests that some products can be used to build a floor, while others should be used solely for upside, and still others could be used to for flooring and upside.