Retirement Planning from All Angles

SOLUTIONS FOR A GROWING CRISIS

The world has changed for retirement planning, and most investors are not prepared. Some individuals have postponed saving, even if retirement is in their sights, while others have taken a "set it and forget it" approach that may not allow them to identify new opportunities and risks. Investors who want to achieve their long-term retirement goals will need to create and follow a dynamic and integrated plan that can evolve against a rising tide of obstacles.

The Changing Landscape

In the old days retirement planning was a relatively simple proposition. People would stay at one job for most of their careers, and then would retire with a pension and a government stipend. Typically, people worked until age 62, with average life expectancies in the mid- to late 60s. Most households lived on one source of income.

Today, however, traditional pensions are on the decline, and government-program payouts are not keeping pace with the cost of inflation. Life expectancies continue to climb sharply, with healthy individuals in developed countries likely to live well into their 80s or 90s. People are moving from job to job, changing careers and hometowns, re-marrying and blending families. The fabric of the modern family is more multi-faceted and complex than ever before, with dual incomes, same-sex marriages or multiple generations often living under one roof. Most people are saving less, or putting off saving altogether, as life itself gets more and more costly and complicated.

Growing Challenges to Saving

Along with higher life expectancies, healthcare costs in retirement continue to skyrocket to unprecedented levels. For example, a healthy 50-year-old couple who plans to stop working at age 65 could need well over $500,000 for healthcare costs during their retirement, according to the healthcare-cost calculator at the American Association of Retired Persons (AARP).[1]

Meanwhile, the task of saving is getting harder and harder. Fiscal policy in the U.S. and abroad has led to budget shortfalls in many countries. The U.S. debt ceiling debate, for example, will put painful budget reductions on the table every year through 2021. Taxes as a result have risen significantly, particularly in developed countries, creating new challenges for income and savings needs. For example, in the U.S., legislation that took effect in 2013 raised

[1]Source: http://www.aarp.org/work/retirement-planning/the-aarp-healthcare-costs-calculator/.

taxes on long-term capital gains for higher income taxpayers by 59%, impacting many sources of income, including interest, dividends, annuities and capital gains.

A change in U.S. Federal Reserve policy also has had broad repercussions for the markets and investing, particularly for retirement savers. Rates have been at historic lows for years, resulting in the end of a 30-year-long bull market for bonds. The Fed's decision in 2013 to slowly end its quantitative easing program has raised uncertainty about how the unwinding of its stimulus policies will impact short- and long-term rates. The gradual normalization of interest rates due to Fed policy will dramatically impact total returns for fixed income investments which typically form the basis of many portfolios.

In addition, equities are likely to deliver more modest returns given the recent double-digit gains of the S&P 500 over the past few years, particularly in 2013.

Geopolitical unrest, fueled by Middle East turmoil and a host of other global conflicts, will continue to weigh on the markets as well as investor psyches, creating challenges for people to remain focused on retirement planning and their long-term goals. Investors, who had already been shaken by the 2008 financial crisis and the recession that followed, will face continued challenges in making decisions and having the conviction to stick with their plans.

Redefining Retirement Planning

With growing challenges to saving, the impact on retirement planning is significant. Investors must come to grips with these challenges and move forward with a comprehensive plan that connects objectives, investments, tax matters, wealth planning and even their own beliefs about markets and money. Success will be defined by the extent to which investors are willing to change their outdated approaches and embrace a new path that looks at retirement planning from many different angles.

The following elements can put them back on course:

Complete income and expense projections—knowing the true cost of tomorrow

The old rule of thumb about retirement income—that people will need 70% to 80% of what they earned during their working years—no longer applies. People may need as much, or even more, money in retirement than they do while they are working. Retirement may be the most expensive time of a person's life, yet few investors have really calculated the cost.

Higher costs and a constantly changing environment will make regularly refreshed, comprehensive projections of future income, expenses and lifetime spending needs a pressing necessity. Reduced return expectations for bonds and stocks should be taken into account, along with the impact of inflation over time.

A full balance sheet view—using assets as well as liabilities

Investors rightly focus on growing, accumulating and preserving wealth in the face of rising taxes and other challenges, but they shouldn't forget about the liability side of their balance sheets. In fact, debt can be an asset when it comes to planning, particularly in a low-interest or rising-tax environment.

Constructive use of debt can help enhance a portfolio and further long-term objectives. For example, an individual who incurs an expense, such as a major tax bill, might be inclined to pay the debt immediately. However, in certain circumstances, the wiser move may be to borrow the required funds.

This would preclude having to liquidate a portfolio, pay capital gains on the sale and diminish the portfolio's return potential.

Objective-driven investing—linking goals with strategies

Objective-driven investing is a sound approach to align life goals with investment strategies. It helps identify how much money a person needs to maintain his or her lifestyle, and how much can be transferred to future generations or philanthropic causes. It allows investors to identify both lifestyle and wealth transfer goals, and then incorporate investment strategies to each as part of a comprehensive, diversified portfolio. By clearly aligning investment strategies and goals, and doing the appropriate due diligence to ensure the strategies can realistically achieve those goals, this approach also allows investors to have confidence and peace of mind. As a result they will have the conviction they need to stick with their plan.

Given the impact of higher taxes and reduced return expectations on fixed income, investors will need to think carefully about their cash flow and income needs, and how they can close the gap. They may need to consider different types of income-generating strategies, or reconsider their spending to preserve cash flow. The more open that people are to new strategies and a more realistic tradeoff between needs and wants, the more likely they will be to meet today's ongoing changes and challenges.

Rethinking old thinking—staying open to new ideas

Changing old views and outdated assumptions is an essential step in developing a sound retirement plan. Future retirees will need to be better informed—and more realistic—about their goals, their future costs and their own likely longevity. The key to closing the gap will be to remain open to new investment thinking and solutions. Investors will need access to the right investment insights and resources to understand this changing landscape, so they can properly evaluate opportunities and risks.

Conclusion

Today's generation of retirement savers will face growing roadblocks to wealth accumulation due to evolving demographics as well as complex investment and macroeconomic factors. New policies in Washington, D.C. may continue to chip away at after-tax dollars. Success will be driven by having access to the right investment expertise and global resources. Investment managers should have solid knowledge of capital markets, a footprint in developed and emerging markets and a strong focus on the importance of connecting investment strategy with wealth goals.

Investors' attitudes may be an additional hindrance, whether they are complacent, fearful or confused about the environment. They will need to make good use of the latest market insights and integrate diverse investment and risk-mitigating solutions with their financial, tax and estate planning strategies. A holistic approach to planning will help to ensure years of wealth accumulation and a fuller, secure retirement.

At BNY Mellon Wealth Management, we work with pension plans, mutual funds, institutions, advisors and individuals to understand the complex and evolving needs of investors who are planning for tomorrow against a rising tide of challenges and changes. As a global company with expertise, resources and vision, we're also thinking about the solutions from all sides.

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