RETIREMENT

A QUICK & EASY PLANNING GUIDE

MITCHELL
CAPITAL MANAGEMENT

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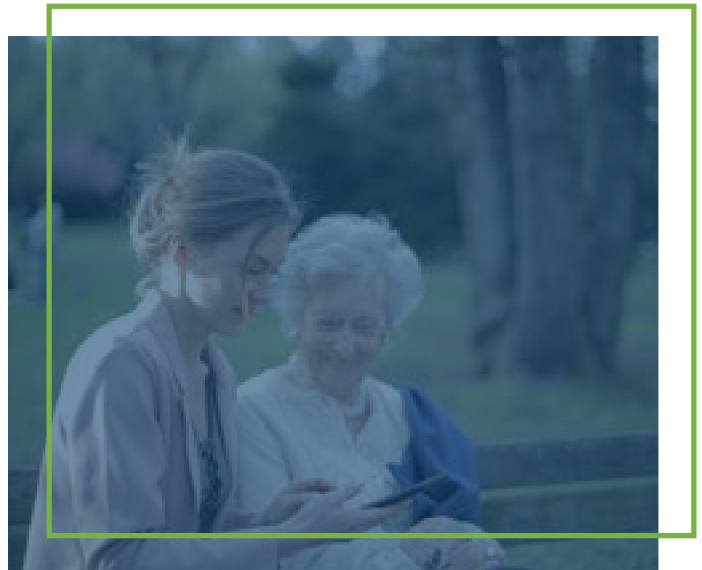
Retirement is a modern concept, at least as we understand it. Ancient Greeks did not retire. Medieval Europeans did not retire. Seventeenth Century Chinese farmers did not retire. The reason is simple; the thought was outlandish, and they could not have afforded it if the idea came to them in the first place. Only nobility and wealthy merchants had the wherewithal to live comfortably until death, but wage workers were unable to save, and simply worked until they no longer could. Then, if they survived, they depended on family to care for them.

The industrial revolution made retirement possible. Over the course of a century, defined jobs at consistent and increasing wages, along with improving healthcare and public and private pensions all made possible a time of leisure towards the end of life.

Maybe you are just starting your career and retirement seems too far away, or maybe retirement is around the corner and you keep waiting for the right moment to make that decision. In either case, or anywhere in between, the time to think about retirement is now. This guide contains three sections based around three questions.



What will retirement look like for me? Specifically, think about what your goals and objectives will be in retirement. The definition of retirement as leaving an income-producing job at a certain age is changing. You can choose to define it however you want. For some, it means more leisure time, traveling or other activities you enjoy. For others it means starting a new active phase of their lives. It's up to you.

How will I get there? Is $500,000 enough, or $1,000,000? Can you retire early, or will you need to keep working much longer? How much cash flow will you need from your portfolio once you retire? What is my investment horizon? There is no universal right answer to these questions - there is only the answer that is right for you.

When can I retire? Thoughful consideration of the 'what' and the 'how' will lead to the 'when'. This guide is designed to help you answer these questions and develop a basic plan to achieve your retirement goals.

Goals and Objectives

The first step in thinking about your retirement is to identfy your goals. What kind of financial objectives will you prioritize? The following objectives are commonly indentified by investors, but you can have your own too:

Maintain your lifestyle: You have worked hard to save for retirement and want to reap some rewards which usually means enjoying the same, or better, lifestyle in retirement. This involves growing retirement income above the rate of inflation to maintain purchasing power over time.

Increase wealth: Some fortunate individuals are able to pursue their lifestyle of choice with few financial restrictions. For these folks, their retirement goal is often to grow their wealth over the longer term for children, grandchildren or charitable endeavors.

Care for dependents: You know the future is uncertain, but retirement sometimes brings health care responsibilities that are difficult to anticipate. Longer lives sometimes come with greater medical expenses that can challenge even the best laid plans.

Avoid running out of money: This is the number one concern for many investors. They may feel their retirement cushion is too thin. Being forced to turn to children for support, or go back to work for reasons outside your control, can be a source of anxiety.

Sample Goals and Objectives	
Maintain Lifestyle	Grow the portfolio 5% annually, plus inflation to maintain purchasing power
Increase Wealth	Grow the portfolio beyond inflation without a specific target
Avoid running out of money	Generate sufficient income to cover anticipated expenses in retirement
Care for Dependents	Support costs of care for special needs children

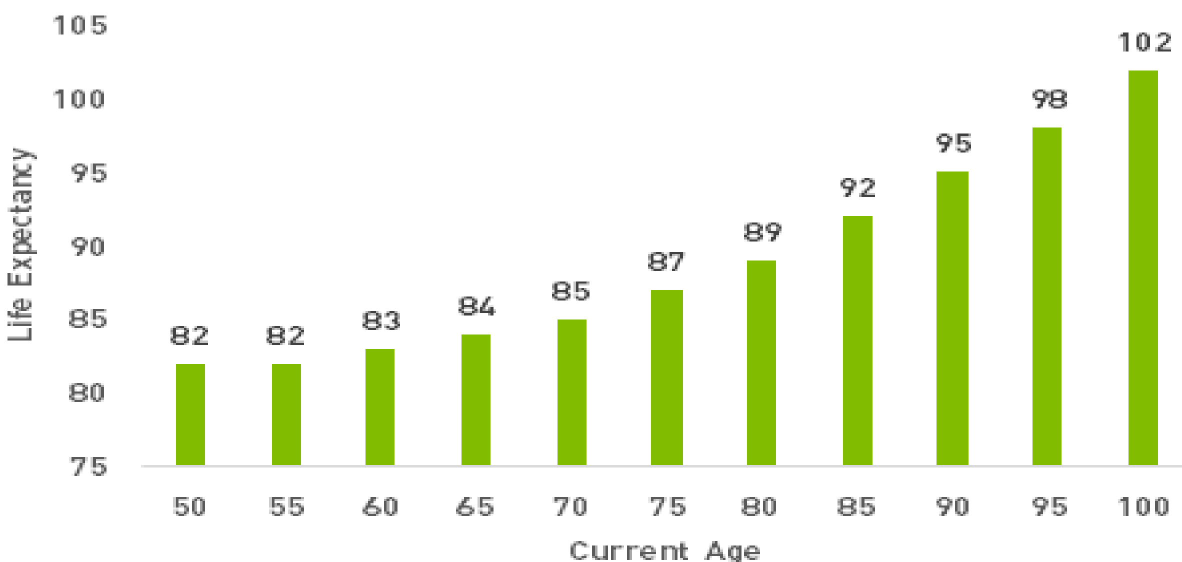
Before you focus on anything else, identify the goals that are important to you. You cannot determine a retirement date if you don't know where you are going.

How much time do you have?

Once your goals are identified, you will need to think about your time horizon - when does your retirement start and when will it end. Your time horizon is a major determinant of your total retirement cost and is likely one of the most overlooked factors among today's retirees. Let's look at the end first.

The fact is, most people will live longer than they think. The following chart shows total life expectancies for Americans, based on a range of current ages. We believe these projections likely underestimate how long people will actually live given ongoing medical advancements. Note that these are projections of **average** life expectancy. Planning for the average is not sufficient since roughly half of the people in each bracket are expected to live even longer. In addition, factors like current health and heredity can cause individual life expectancies to vary widely from expected averages.

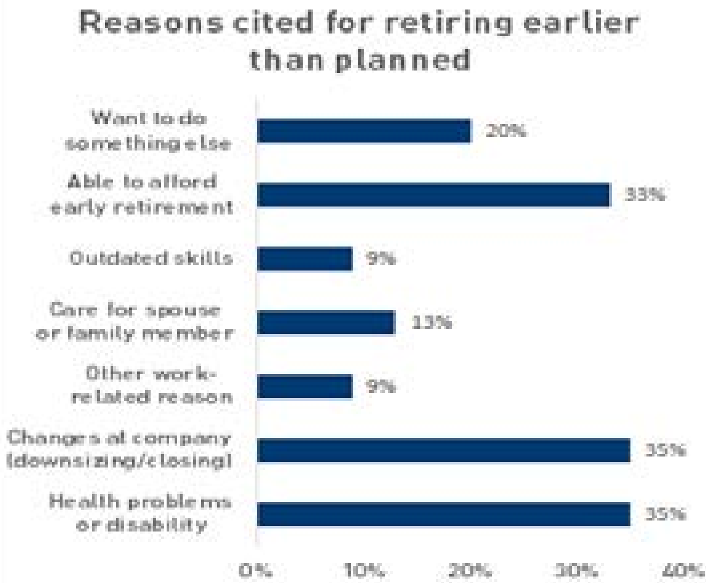
Exhibit 1: Average Life Expectancy*



* Source: United States Life Tables, 2017, National Vital Statistics Reports, Volume 67, Number 7. Life expectancy rounded to the nearest year.

Mind the Expectation Gaps

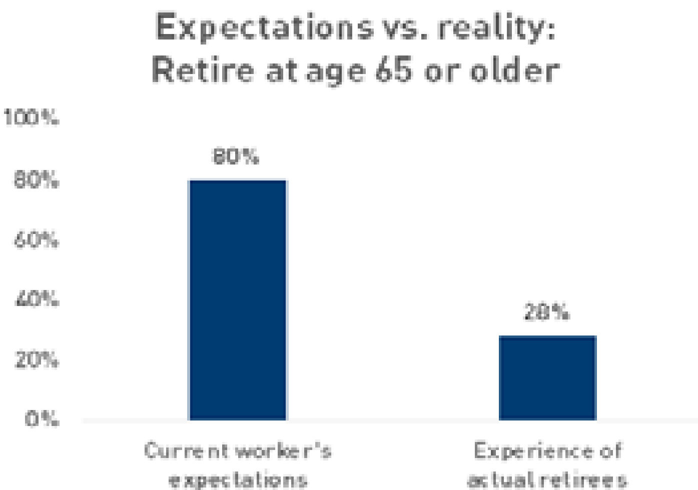
Exhibit 2:*



Retirement Age

The idea of retiring early is appealing. Who among us doesn't dream about spending our time as we wish sooner than society considers 'normal'. The caveat is that we want to do so on our own terms and timing. This isn't always the case. More and more people find themselves retiring unexpectedly early for reasons outside our control. Most of those decisions are driven by health concerns of you or your loved ones, followed by changes at your employer that lead to your departure.

Exhibit 3:*



Working for Pay in Retirement

Most workers are very likely to expect to work for pay in retirement. The reality is quite different. The percentage of workers **planning** to work for pay in retirement now stands at 80%, compared to just 28% of retirees who report they have **actually** worked for pay in retirement. As with retirement age, the factors that drive these outcomes can be largely outside your control, which is a reminder to introduce a healthy dose of flexiblity into your plans.

Your time horizon may be much longer than you realize. Prepare to retire earlier, and live longer, than you expect and make sure you have enough money to maintain your desired lifestyle.

* Source, Exhibits 2 and 3: Employee Benefit Research Institute, Mathew Greewald & Associates, Inc., 2019 Retirement Confidence Survey. Data as of March 2019

Retirement Income and Expenses Once you understand your goals and time horizon, you will need to estimate what your current and future income and expenses will be in retirement.

Income

Salary: Do you plan to work in retirement? If so, you will need to estimate how much salary you can expect. For purposes of estimating your income, just consider direct financial compensation from your employer to you.

Business and Real Estate: Do you maintain an interest in a business or an investment property that will produce income? Expect that these sources of income will be more susceptible to market or operating conditions. Plan for less reliability than other sources.

401k and/or IRAs: If you have been contributing to these accounts, they may make up a substantial part of your retirement income. Withdrawals from these accounts can be variable, due to market changes and income needs. They offer the greatest flexibility in terms of timing and amounts of income, but in most cases, withdrawals must start by age 72. And remember that withdrawals from these accounts will be taxed. If you plan to withdraw $50,000 each year, income taxes due will leave you with something less to cover your expenses.

Pension: Defined benefits plans are becoming less common. From 1980 through 2018 coverage by a defined benefit pension plan dropped in half, to under 20%. If your employer offers a pension, you should determine how much you can expect to receive on a regular basis. Will it increase or decrease over time?

Social Security: If you have started taking Social Security, you are familiar with how much to expect. If you have not yet, you will want to determine the age you wish to start receiving benefits and how much you should expect monthly. The Social Security Administration's website has a free calculator you can use to estimate your future payments (http://www.socialsecurity.gov/OACT/anypia/index.html) Social Security can be a complex maze of considerations and definitions. The decision of when to begin claiming is based on a set of factors unique to each beneficiary.

Will Social Security be enough to support me in retirement? Social Security was originally intended to take care of those who couldn't take care of themselves. It has morphed into something much larger over the years, but was never designed as a social 'retirement' plan. Social Security is a welcome source of additional cash flow in retirement, but should not be counted on for all of your income needs. In any event, relying on any one source of income makes it likely you are under-diversified. Social Security is only guaranteed in the sense that it is political kryponite to alter a program affecting so many voters. Like anything else in politics however, this can change with the times. Social Security is a direct cash transfer. You can use this money to invest, save or fund living expenses. The important thing is to recognize it as just a single piece of your overall strategy, which should be based on your time horizon, cash flow needs and goals.

Non-Discretionary Spending This is the spending over which you have little control. There may be some room to maneuver, but for the most part, you can't avoid these costs.

Living Expenses: Day-to-day, how much does it cost to maintain your lifestyle? You will want to consider everything from groceries to gas to the heating bill. If you aren't planning on relocating in retirement, you will likely have a good idea of what these expenses are already.

Debt: This can be credit card debt, your mortgage or car loans. Anything you owe must be considered when mapping out your expenses because you will have to continue to pay down the principal and make periodic interest payments.

Taxes: While taxes are often lower for retirees as they shift from salaried income to capital-gains rates, the government must still be paid. You will need to set aside money to settle your tax bill at the end of the year.

Insurance and Health Care: We are all, on average, living longer and medical care costs go hand-in-hand with such benefits. Health care costs have historically risen faster than inflation and, for many people, have become a larger share of their budget in retirement. You may need to consider costs associated with Medicare copays, supplemental coverage premiums, long-term care and any emergencies that might require sizable payments on short notice. Health care could be the least predictable, and the most impactful, part of your retirement planning.

Discretionary Spending Once you have identified your basic living expenses, you need to account for discretionary spending. Discretionary spending is subject to your personal situation. You may think of cable TV as a luxury, but someone else may see it as a necessity. This is only one example, but if you have a hobby or other service you can't image living without, you should include it in your non-discretionary expenses. Below are some of the more common discretionary items in retiree budgets:

Travel: Many people look forward to traveling in retirement. You might want to visit grandkids more often, or pursue that ocean cruise. If you have an aggressive travel itinerary in mind when you are retired, you will need to budget for it today.

Hobbies: Retirement is a great time to revisit old hobbies or try some new ones. Ready to finally learn to play your baby-grand piano, or reconnect with your woodworking skills? Hobbies almost always incur some costs, even if many are small.

Luxuries: This is individual and subject to your own definition of luxury. But whether you enjoy expensive cigars or regular trips to the spa, you will need to factor non-essential purchases into your expenses.

Discretionary Spending continued...

Children and Grandchildren: For many, this category includes aspects of many others. Spending time with your family could involve travel, require luxury purchases and include your favorite hobby, all at once. If you need a generous budget to make children and grandchildren a focus in your retirement, you will need to think about how much cash flow you will need to support it.

New Career: For more and more soon-to-be retirees, the definition of retirement means a new career, and income is optional. It might involve a not-for-profit, or a small business venture, or learning a new trade. Will such a shift require new training, or other professional investment or associated travel? What other costs can be identified now?

For retirees with more time than money, discretionary spending offers the greatest opportunity to arrest a good retirement plan in its tracks. Maybe you impulsively decide to purchase a second home without considering the financial impact. Perhaps you feel compelled to provide a financial lifeline to a family member or friend. Decisions like these under the right circumstances can be low impact, or even prudent. But those made in the heat of the moment that bypass due diligence or the counsel of trusted advisors can cause damage that proves difficult to repair. The good financial habits that helped you reach retirement will be even more important once you get there.

Inflation Another factor many forget to include when estimating future income and expenses is inflation. Inflation can wreck even the best plan. It decreases purchasing power over time and erodes real savings and investment returns. Many fail to realize how much impact inflation can have. Since 1913, inflation has averaged just over 3% per year.* If that average inflation rate continues in the future, a person who currently requires $50,000 to cover annual living expenses would need nearly $70,000 in 10 years and about $95,000 in 20 years just to maintain the same purchasing power.

Another expectations gap. Many people target 70-80% of their pre-retirement income, which basically represents 100% of their pre-retirement spending (income less previous retirement savings and other work-related costs). They expect few changes to account for the new lower income level. However, once people transition to retirement, expenses often rise as new activities replace work time and new spending takes the place of old, easily making a new claim on the ‘income gap’. Discussions about expense reduction or income boosting usually follow.

We believe planning for 100% of your pre-retirement income is the best target. In the first years of retirement, your spending is likely to rise before falling off to a lower plateau later.

* Source: Federal Reserve Economic Data (FRED) from the Federal Reserve Bank of St. Louis, Consumer Price Index for All Urban consumers: All Items - Not Seasonally Adjusted.

Determining What You Need From Your Portfolio Now that you have determined what your expenses are likely to be and how much income to expect, the worksheet below can help you put it all together. You can also recreate the following worksheet in a spreadsheet program like Microsoft Excel or find free templates on the internet. This is just a starting point - make changes as necessary to fit your own situation.

Income			**% of Total**
Non-Investment Income			
	Salary	$	%
	Pension	$	%
	Social Security	$	%
	Business and Real Estate	$	%
	Other	$	%
TOTAL INCOME		**$**	**%**

Expenses			% of Total
Non-Discretionary Spending			
	Basic Living	$	%
	Mortgage	$	%
	Credit Card Debt	$	%
	Taxes	$	%
	Insurance	$	%
	Health Care	$	%
	Non-Discretionary Subtotal		%
Discretionary Spending			
	Travel	$	%
	Hobbies	$	%
	Luxuries	$	%
	Gift to Family/Charity	$	%
	Other	$	%
	Discretionary Subtotal		%
TOTAL EXPENSES		**$**	**%**
NET INCOME (subtract Total Expenses from Total Income)		**$**	**%**

Once you have defined your goals, time horizon and estimated expenses and income, the next step is to answer: **How will I get there?** This question will be answered differently for everyone since it depends on your personal goals and situation, but it starts with savings.

Savings Habits Your savings habits will have the greatest impact on your retirement decisions. They are one component of your retirement planning over which you exercise complete control, so it is something of which you should take advantage. Unfortunately, many people suffer from something called the wealth effect. During economic expansions when the value of stocks and homes increase, Americans tend to save less than during recessions, when they are less confident of the broad value of their portfolios. The best savings programs routinely save 10-15% of income for retirement, but you can see below that most Americans fall short and have been for some time*. The recession from 2007-09 reversed that, but only for a bit.

Whether you're just starting or you are well along the path towards retirement, set a savings goal and commit to it, through good times and bad. Take advantage of the power of compounding over the long term.

* Source: Federal Reserve Economic Data (FRED) from the Federal Reserve Bank of St. Louis

Asset Allocation Asset allocation is the single greatest determinant of portfolio returns and the likelihood of being able to afford the retirement you want. At its core,the allocation decision determines what assets you will hold and in what proportion. For most investors, this means stocks (equity ownership) or bonds (fixed income) or, in rare cases, cash. Equities are generally considered riskier than fixed income but they have also provided greater returns over time. The level of risk undertaken in your portfolio is a combination of your goals and objectives, your time horizon, and the flexibility built into your expected income and expenses.

But risk is kind of a strange word in investing and we are talking about retirement, where our time horizons are much longer than a month or a year. If your goals are aggressive, or your time horizon is long, or your income-expense flexibility is limited, you might want to consider taking on more risk. By not doing so, the bigger risk may be missing out on greater returns that will better support your goals and objectives and better meet the needs of your time horizon. And the asset allocation decision is as specific as your retirement plan; rules of thumb don't apply.

Asset allocation represents how an investor feels about risk, which goes hand in hand with investment returns. Some investors have enough assets to feel comfortable accepting more risk without giving it much thought. Most, however, will need to consider their personal goals and situations to determine their own answer.

To illustrate, many think investors who are the same age or have similar portfolio sizes should have similar asset allocations. If you accept a common rule of thumb such as "your allocation to stocks should be 100 minus your age" they would have the same allocation. Even advice to increase 100 to 110 or 120 to account for longer lives misses the point. Consider Ellen and Joe.

	Ellen	Joe
Age	55	55
Annual income	$200,000	$100,000
Married	No	Yes (47 years of age)
Portfolio	$1,000,000	$1,000,000 (partly funded through an inheritance)
Children	None	Four
Education costs	N/A	One child in college, three in middle/high school
Home	Owned	Mortgage outstanding

Though they are the same age, Ellen and Joe have different financial needs and their portfolios should be managed accordingly. Once you consider their individual situations and goals, their portfolios should reflect those differences.

Exhibit 4: Average Annualized Asset Class Returns

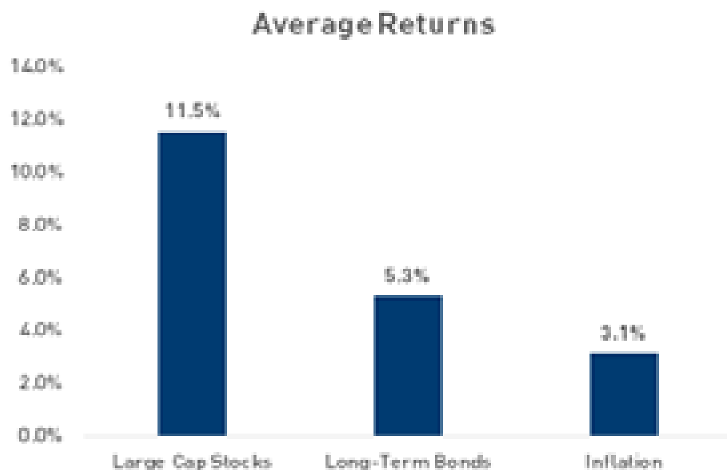


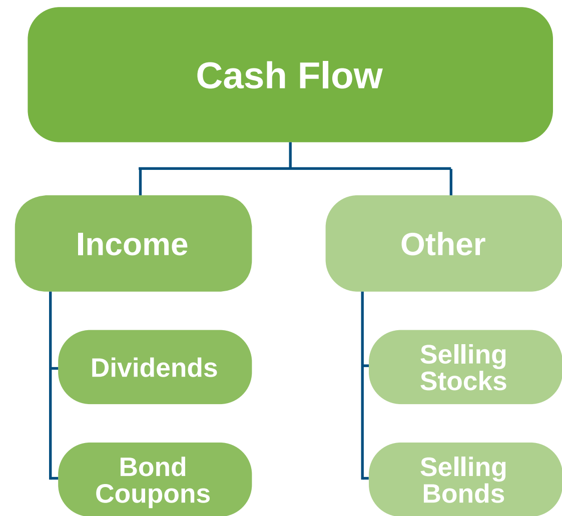
Exhibit 4 shows average annual returns for stocks, bonds and inflation since 1928. The risk return tradeoff is reflected in the higher average return on stocks over bonds. If you look at almost any long-term measurement period, stocks have outperformed bonds, muting their short-term volatile nature. "Playing it safe" by putting too much money in bonds has a price, with inflation taking half your return. That will make it that much harder to reach your goals and allow you to set aside enough to meet your planned needs in retirement.

Exhibit 5: Annual Stock Market Returns

Exhibit 5 is a histogram of Annual Returns for US Stocks from 1928 through 2018. Each column represents the number of annual returns in that group. Of the 91 years in the sample, 66 of those years were positive. Equities are tied to the economy, and when profits drop during recessions, equity prices do too. This usually explains the overreaction in equity returns in negative years, but equity returns eventually catch up to their growth path, which is tied to the economy's growth path.

Source, exhibits 4 and 5: Ibbotson Stocks, Bonds, Bills and Inflation Data. Annual rate of return from 12/31/1927 through 12/31/19. Equity return based on S&P 500 Total Return Index. The S&P 500 Index is a capitalization-weighted, unmanaged index that measures 500 widely held US common representative of the broad US equity market. Bond returns based on the returns of the 10-year US Treasury Bond.

In our view, if you have a longer time horizon and/or higher return needs, you should consider allocating a greater proportion of your asset allocation to stocks than you previously thought. This can be especially true when you factor in withdrawals over the course of your retirement. If you're withdrawing $50,000 annually from a $1,000,000 portfolio, you're more likely to deplete it if your rate of return is too low. You would need a 5% total rate of return every year just to keep your balance the same - and that's before you factor in inflation and taxes. If you are worried about having "safe" investments, consider the bigger danger that lies in running out of money because of a low rate of return over the lifetime of your investments.



Income vs. Capital Gains Cash flow is the goal of every retiree. It is the fuel that satisfies planned expenses. Dividends and bond coupon payments are examples of income - typically prized by retirees. Selling a security also generates cash flow which, for the purposes of your spending plans, is no different than income. Both are two completely acceptable sources of funds. Cash flow withdrawn is the priority and should make no distinction as to the source. Your focus should be the total return of your portfolio which is made up of both income and capital gains. These two components provide the support of your retirement spending and should be viewed in tandem in measuring the success of your overall retirement strategy.

Consider: if you have a portfolio of $1,000,000 growing at 10% a year and you realize $100,000 in annual gains, this isn't any different than a portfolio paying $50,000 in dividends and you realize $50,000 in annual gains. The total cash return of $100,000 (i.e., capital gains + dividends) is the same on a pre-tax basis - and, depending on your situation, selling a security and paying tax on the capital gains may be more tax-efficient than dividend income.

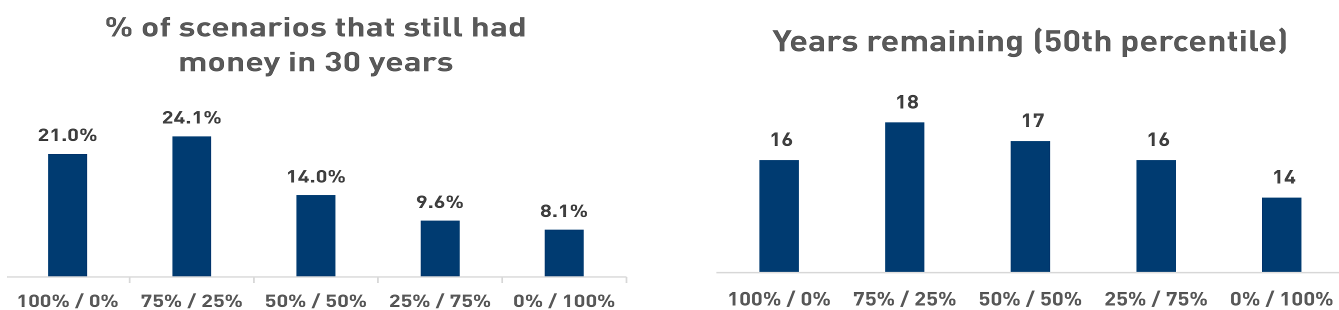
When it comes to paying for your retirement, you should really only be concerned with the total return of your portfolio and after-tax cash flow-not whether it comes from selling stock or regular income.

Cash Flow Analysis It is critical to understand how withdrawals will impact your portfolio in retirement. Like many investors, you may have unrealistic expectations of how much money you will be able to safely withdraw each year during retirement.

The two following hypothetical scenarios show the impact of different rates of withdrawal on $1,000,000 portfolios under different asset allocations. These were run using a simulator to determine a likely average outcome given different inputs; all withdrawal amounts are adjusted for inflation to maintain original purchasing power. In these examples, Ellen and Joe are approaching retirement age and have the same investment time horizon - 30 years. Ellen plans to withdraw 10%, or $100,000 per year in retirement while Joe will only take 3%, or $30,000 per year.

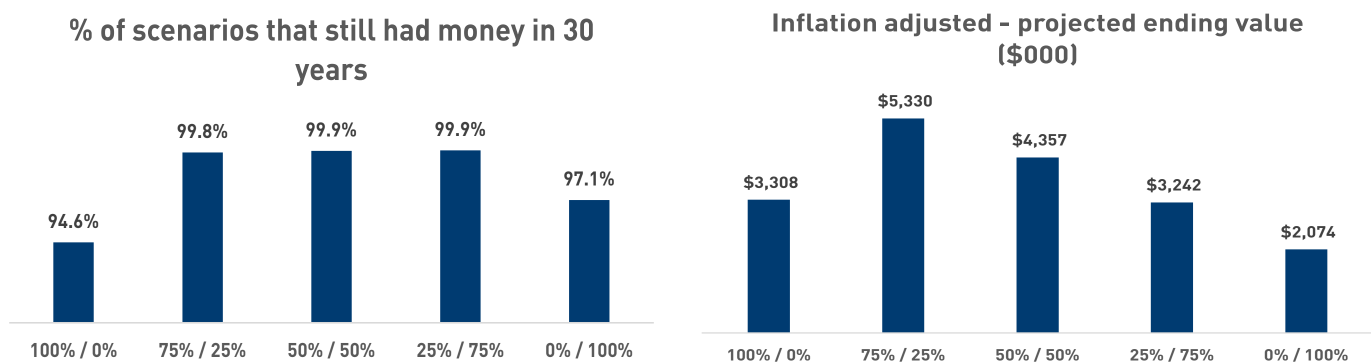
The probability of Ellen's portfolio lasting for 30 years - let alone growing - is low. This is true for each for the asset allocations seen in exhibit 6 below. The most optimistic scenario reveals a 24% probability of having money left in 30 years and most likely would run out of money in 18 years. These odds are discouraging and should lead to a change in plans and expectations. If Ellen has a longer time horizon, she may need to consider delaying retirement, reducing her projected spending or a combination of both in order to ensure she can reach her goals. .

Exhibit 6: Ellen's portfolio simulation with 10% Withdrawals*



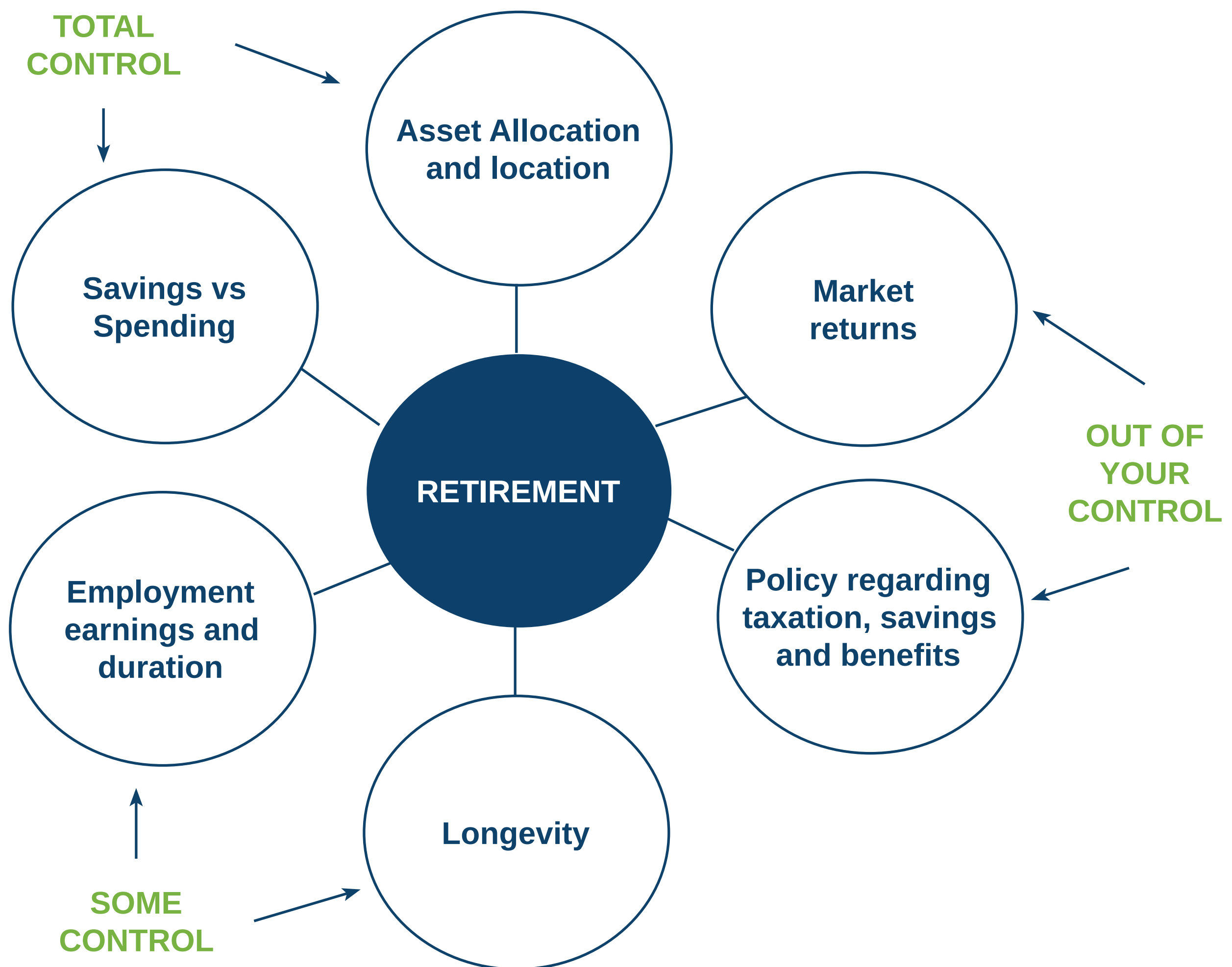
On the other hand, Joe's portfolio in exhibit 7 shows much more comfortable probabilities of asset survival and even growth. In each allocation scenario, odds of having money remaining after 30 years is almost assured, giving Joe much greater comfort that he will outlive his money. Joe might even have the flexibility to consider retiring earlier, or increasing his withdrawal amounts.

Exhibit 7: Joe's portfolio simulation with 3% Withdrawals*



*The portfolio simulation uses a non-linear statistical method that, based on a random sampling of historical stock bond and cash returns, allows for the assignment of probabilities to various outcomes. This informational analysis makes numerous assumptions, including but not limited to the use of S&P 500 Stock Index and/or US Long-Term Government Bond Index historical returns. All values are expressed in today's dollars, 05/31/20. The index(es) used may not be the benchmark(s) selected for clients. No assurance can be given that these returns will be achieved. This analysis is for informational purposes only. It has been formulated with data provided to Mitchell Capital and assumed to be reliable. Returns may not take into account fees, market or economic conditions. Mitchell Capital makes no claim to its accuracy. Investing in securities involves a risk of loss. Past performance is never a guarantee of future returns.

Creating a retirement plan you can pursue requires a significant number of inputs. Each of these will play a role in the ultimate success of your plan and its execution. Among those inputs are those over which we have total control, those over which we exert some control, and those over which we have no control at all. Take charge of those inputs under your control. Exert whatever influence you can on those over which you have some control. And be aware of, and allow flexibility in responding to, those over which you have no control.



3. WHEN CAN I RETIRE?

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Retirement planning has many facets, but it doesn't have to be complicated. There are numerous things to consider, so you need a well-thought-out plan to determine when you can retire. What will your retirement look like? Understand your goals, time horizon and estimated income and expenses in retirement. How will you get there? Choose an appropriate asset allocation and benchmark aligned with your goals. Then analyze what level of cash flow you can sustainably withdraw from your portfolio in retirement. Once your portfolio is able to provide a sufficient level of cash flow to meet your needs for the rest of your time horizon, you can realistically consider retiring.

Determining when you can retire may require trade-offs, such as accepting more short-term volatility in your portfolio to achieve higher returns. Another trade-off you may have to consider is between different discretionary purchases. There are endless opportunities to spend money in our consumer-driven society. We should not deny ourselves everything, but a balance is essential. In order to meet your investing goals, you will need to be clear about what is affordable. It is not advisable to risk depleting your portfolio for non-essential spending. This isn't to say helping with college or a vacation are off the table; rather, they need to be realistically budgeted in the context of your overall goals, cash-flow needs and return expectations.

It's also helpful to be clear with yourself and other stakeholders about how much you can spend. Once the spending becomes a counted-upon given, emotions come into play and you could end up with a bigger bill than you're comfortable with. Any time you're regularly withdrawing more than 5% of your portfolio a year, you are greatly increasing the risk of depleting your assets too quickly.

Finally, Mitchell Capital can help you work towards your financial goals in retirement by helping you stay disciplined and provide resources and services along the way. Remember, there is no universal right answer for the ideal retirement age or portfolio size - there is only the answer that is right for you.

Still have questions?
Not sure what's best for you?
Need help getting started?

Mitchell Capital has helped hundreds of investors with their unique goals and objectives planning for retirement. Call us at **913 428-3222** to find out how we can help you work towards the retirement you want.