Rodger on Retirement

Inflation—Have You Done The Math?

Michael Caine said, “Save your money. You're going to need twice as much money in your old age as you think.” You are probably thinking, “Why do I need a plan for my income to increase by two and a half times in retirement?” Let me walk you through the math. Assume you are 30 years old, married and you plan to retire at age 62. Your joint life expectancy is age 92, which means that the last of you and your spouse to pass would be age 92—after a 30-year retirement. Assume you currently earned $135,000 per year, and further assume that you would require $110,000 a year in retirement. After all, you would no longer have work-related expenses such as a second car, commuting, clothing needs, dry cleaning etc.

If you were to retire today when you are age 30, your income requirement would be $110,000 annually. At a 3.5% assumed annual rate of inflation, your annual retirement income needs would skyrocket to $330,738 by age 62. Why did I choose a 3.5% annual inflation rate? According to the Advisor Perspectives website, the Consumer Price Index for Urban Consumers (“CPI”) has increased at an average annual rate of 3.79% since the end of World War II. This is a sufficiently long time period to provide needed perspective. When planning on how you will create significant increases in your retirement income over time, do not be drawn into the trap of “But inflation rates are low.” Maybe this will add some perspective: *At an average annual inflation rate of 3.5%, prices will double approximately every 20 years!*

My belief is that the greatest risk you will face in retirement is that your income will not be able to keep pace with the increases in your expenses. As you liquidate parts of your principal to make up for the needed income, you start a downward spiral because now there is less principal with which to create income. The problem is due to inflation, which averages between 2% and 4% annually over longer periods of time. If you retire at age 65 and live until age 80, that is 15 years. It is certainly not a short period of time. What if you decide to retire at age 62 and live until age 93? That is 31 years of rising expenses. What is *your* plan to deal with that? Yes, I am providing example after example to spur your own thinking and prodding you to consider your own situation.

Now suppose for a moment that you are thinking of retiring in 18 years. You are now a healthy 44 years of age and you dream of stopping work at age 62, which seems to be a popular age to retire in the U.S. You figure that $68,000 per year would be a great retirement income. That works out to be about $5,666 per month. You believe that Social Security will kick in about $20,000 per year so you only have to “worry” about generating a $48,000 income. Here is where you put on your *deer in the headlights hat*.... If inflation were to be approximately 4% annually as it has been over the last 50 years, you need to dust off your calculator. In 18 years, you will need to be able to generate about $97,000 of annual income. Now, how do you suppose you will generate almost $100,000 per year with that shiny new car in your garage? And, by the way, that car comes with monthly payments.

More on inflation in a future posting(s)....

*Opinions expressed are those of Rodger Alan Friedman. All opinions are as of this date and are subject to change without notice.