Consider Inflation When Planning for Your Financial Future

Tweaking Your Income After Retirement

by Alexandra Armstrong, CFP

In our last couple of articles, we helped you project what your income and expenses might be when you first retire. We warn you, however, that even if your initial projections show cash left over, you can't relax. Keep in mind the two enemies of retirement planning: longevity and inflation.

Although inflation has been moderate in recent years, most expenses will increase over the years. Even at the current moderate 2 percent rate of inflation, if your expenses remained the same as they were initially (which is doubtful), they would double over 36 years. If inflation was 3 percent, they would double in 24 years.

In addition, we're all living longer. Depending on what age you retire, your money may have to last for 30 or more years! In fact, according to a recent report from the National Institute on Aging, the number of centenarians jumped from an estimated few thousand in 1950 to more than 340,000 worldwide today with the highest concentrations in the U.S. and Japan.

Reviewing Your Income Sources:

■ Social Security

The first decision you must make is when to start taking Social Security payments and withdrawals from your retirement plans. As we mentioned in a previous article, we recommend you wait at least to your full retirement age to take Social Security payments. After that age, you can earn any amount of money and still receive your Social Security income. Many advisers recommend waiting until age 70, when you must start taking Social Security payments, so that you can receive the maximum payments. Here again this decision depends on the state of your health and that of your spouse as well as your other sources of income.

The amount of Social Security income you receive is based on 35 years of working history. If you continue to work past full retirement age, you might be dropping some low-income years when you first started working and adding higher-paying years so that the amount you're entitled to receive will go up. This is particularly true for women who have dropped out of the work force for a time or earned low wages in their early working years.

■ Your Retirement Accounts

The next decision is when to start taking withdrawals from your retirement accounts and at what level. At least with this decision, you can change your mind, at least before you're required to withdraw money by the Internal Revenue Service. As I'm sure you know, you can start receiving income from these accounts as early as age 59½ and you must start receiving income from these accounts starting the year you turn 70.5, according to the schedule provided by the IRS. You may decide to receive this income sooner than that depending on your other sources of income.

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■ Personal Investments

Finally, you want to look at your nonretirement investments and determine what you want to take from these to provide you with retirement income. Some people are able to defer their Social Security and retirement plan incomes until later and live on income from their investments. Of course, this all depends on how much you'll receive from Social Security and how much you have in your retirement plans and individual investments.

As to how much to take from your investments, we discussed this in greater detail in our November 2015 article. The rule many advisers still use is the "4 percent rule," where you withdraw 4 percent of principal the first year and then 4 percent plus inflation in subsequent years. Another approach is the "bucket approach," where you put aside three to five years expenses in a cash account and then invest the rest in a portfolio with 40 percent bonds and 60 percent stocks.

Where to Invest Retirement Money

In the past, someone came up with the formula of subtracting your age from 100 and that was the percentage you should have in stocks. So, if you were 80 then you should only have 20 percent in stocks. We think this rule makes no sense, particularly for astute BetterInvesting members!

Since Social Security income is a form of an annuity, we consider it to be a bond equivalent. So, if you're receiving $21,000 a year from Social Security, this equates to approximately $700,000 paying 3 percent in bonds. The same would be true of pension or annuity income. Thus, we think you could have more invested in stocks than this formula suggests, particularly if you invest in stocks that pay dividends.

Another consideration is how all this income is taxed. If your taxable income as a couple exceeds $44,000, or $34,000 as a single person, 85 percent of your Social Security payments are added to your taxable income. Withdrawals from your retirement accounts (except Roth individual retirement accounts) are taxed as ordinary income. So the only taxable income you can control is that generated from your personal investments.

Thus, you might invest in bonds in your retirement accounts and in stocks that generate less income in your personal investments. But countering this advice would be the current rising interest rate environment that causes bond prices to decline.

How to Receive Your Retirement Money

■ Retirement Income

Most of us are used to receiving a regular paycheck. We suggest that once you know what your retirement income will be, you have it all paid directly into your bank account. This way you know when the income will come into the account and won't have to worry about checks getting lost or not being deposited when you're out of town.

■ Earned Income

You may be required for economic reasons or you may choose to work after traditional retirement age. Today, rather than abruptly ending your work career, many are working part time. In the United States 19.3 percent of people over the age of 65 continue to work, according to the Organization for Economic Co-operation and Development.

With the graying of America, employers are finding that the retiring population can offer valuable expertise. They're also willing to be flexible about the hours these employees work. In the case of self-employed professionals, many are able to choose when and how long they work.

Conclusion

As you can see, there are many decisions to be made as you get ready to retire and in some cases, once you make a decision you can't change your mind. We strongly recommend you consult a retirement expert to help you make the decision that's right for you. One solution does not fit all. We realize you'll have to pay for this advice, but we would suggest this is one of the best investments you could make — after all, it's planning for the rest of your life! In our final article on retirement planning we'll discuss adjustments you could make to your expenses when you retire.

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