BWM

Investment
Guidance

Ten Retirement Planning Mistakes
To Recognize and Avoid

Key Point:
- Retirement planning for Financial Security!

Executive Summary

This BWM letter discusses Retirement Planning goal mistakes from the perspective of a diverse group of individuals in need of investment guidance. That contrasts from normal BWM Letters, which are written from a Registered Investment Adviser's view. Certainly not having a retirement financial plan is most important in failing to achieve financial security and discussed in closing, as the No. 1 mistake. The mistakes are eclectic and not systematically listed. Similar to the late night TV host's dialogue, specific mistakes 10, 9, 8 … are presented first and important mistakes 3, 2, 1 … are presented last. Please read on, find if any mistakes to you, and then address them.

Retirement Planning Mistakes

No. 10 Setting and Forgetting the Plan

The thoughtful couple recognizes the need for a wealth management or financial plan. Generally, they develop good savings habits and use their qualified savings plans to accumulate both contributions and growth of investments. A good foundation for wealth accumulation is set. However, both global and domestic economic conditions and personal circumstances change. A wealth management plan should not be set and forgotten. Periodic quarterly and at very least annual status reviews are necessary. U.S. economic sector conditions changed dramatically between the mid 1990's and early 2000's decade. Human capital was focused on technology in the mid 1990's and surging technology sector sales and earnings peaked with Y2K computer adjustments. Many investors rode the last stage of the technology stock price surge and did not review their holdings at the end of 2000. A simple yearend retirement portfolio review would have noted a shift in technology earnings growth and stock prices. The technology sector relative strength had peaked and the bubble was beginning to leak. A plan portfolio adjustment to sell and underweight technology stocks would have avoided further lost potential profits through yearend 2002. Personal circumstances also change. A life change, such as the death of a spouse or divorce, may also require an existing retirement investment plan change to possibly add liquidity and reduce investment risks, until matters settle a bit. In an always dynamic life, plans and circumstances should be monitored for appropriate plan resets.

No. 9 Emotional Triggers

The August 8, 2006 BWM Letter discussed negative behavior biases to ponder and control. Building adequate retirement spending sources requires self discipline. Understanding personal behaviors and market behaviors and then judging favorable opportunities is an art. Controlling personal emotions can slightly tilt the odds of the investment game in your favor. Briefly, the following are emotional preferences to control. Overconfidence is due to thinking we are more skilled than we actually are, based on lucky outcomes, which are neither clearly understood nor generally repeatable. Prospect decisions are preferences to avoid taking relatively small losses in certain situations, while moving too quickly to take gains in others. The herd following mentality affects unsophisticated investors and professionals alike. When everyone is buying an iPhone, it may be wise to review the Blackberry device features to see if it meets your needs. In investing, holding stocks, which have had a long period of relative strength without monitoring, simply because everyone else is holding them, is very risky. Regret after taking a loss makes investors feel stupid and they often vow to never make that mistake again. Emotions need to be released, decision processes checked, and possibly in 5 or 10 years, the losing investment may present a good opportunity for a future profit. General emotions of fear, greed, and hope are normal. Knowing how to recognize, when the emotions are overcoming our normal analytical approaches, and reducing their impact is hard earned wisdom.

No. 8 Unlimited Piggy Bank
Home Equity ATM Fallacy

Owning a home is generally the best long term investment that a family makes. It provides shelter, a reference point for a growing family, and its condition can be kept up by your own efforts. In an area, where the supply of land is limited such as a coastal or lake front area, the long term property demand will likely increase faster than the rate of currency inflation. However, there are uncertainties. The home should not be used indiscriminately as an ATM for Home Equity Withdrawals (HEWs) or considered an inflated source of future retirement funds. Let's look at a simple example. A family purchased a nice home in a desirable Midwestern location in 1987 for $225K and a $175K mortgage. The home appreciated in market value to an appraised value of $900K in 2007 or 7.2% annual appreciation. Everything looks great. Selling the big house and moving into a less urban area condominium valued at $300K seems like a good way to cash out and fund retirement spending. First notice that the home was used as an ATM and HEWs left the net mortgage at $250K. Next, notice that the housing market in your area is soft. It is a buyer's market. The house eventually sells for $845K and net of all related closing costs $785K remains prior to paying off the $250K loan. Thus, $535K is available to purchase the downsized $300K condominium. Finally, $235K remains as an investment source for retirement income (prior to a small capital gain tax on the home appreciation above $500K). With moderate risk taking, annual returns of 7% on the $235K will result in a $16K added retirement spending source prior to considering inflation. Alternatively, some of the $235K principal may be spent annually. Most people in this example expect to tap their Home Equity ATM for more retirement income!

No. 7 Counting on the kids
Dependency

Some parents implicitly feel that they raised their kids to be productive income earners and they should count on them for extended care in old age. Reverse dependency – looking to the kids for old age care – is a bad idea. The initiation of the Social Security System in 1935 and increased divorce rates starting in the 1960's changed traditional family bonds. A society dependent on the government for Social Security and later Medicare gave many adult off springs the impression that the government would take care of their parents in old age. Divorces and remarriages left many with the idea that their step father should be taking care of mother. Also recognize that people get set in their ways and adult off springs may simply not be able to cope with significant old age parent care in addition to their other responsibilities. Plan to remain self-reliant and financially independent.

Don't fall into the dependency trap.

No. 6 I don't know and am afraid to find out
Investment indecision

It is natural to put off investment decisions because of lack of understanding and uncertain outcomes. However, just like swimming, eventually you must just jump into the water to learn how to swim. There are numerous investment risks and opportunities, which are discussed in these BWM Letters. I simply try to educate readers about the key factors and give them the tools to make informed investment decisions. Putting off investment decisions because of uncertain outcomes is procrastination. Long term procrastination leads to not developing your financial resources. Holding a portfolio of money market funds over someone's 40 year working career, instead of holding a prudent mix of stocks and fixed income assets may mean the difference between 8% annual returns and 4% annual returns. Ignoring inflation and related pay raises, $5,000 annual tax deferred savings plan contributions over 40 years grows the total $200,000 savings to $1,295,000 at 8% returns and only $475,000 at 4% returns. Believe it or not, many good savers do not live comfortably in retirement because of life long investment indecision.

No. 5 Taking the wrong path
Unsuitable investments for risk tolerance

Knowing our risk tolerances is critical for development of sound investment strategies and tactics. Looking at past investment decisions and stress levels gives a good indication of risk tolerances. Last week's July 13, 2007 BWM Letter briefly described conservative, moderate, and aggressive risk tolerances in the context of long term fixed risk tolerance investing. A person must find out his or her risk tolerance in order to select a compatible investment strategy. Then a sound wealth development plan can be selected. Otherwise, stress will naturally occur due to unexpected outcomes. People then leave their investment strategy and often revert to Mistake No. 6 Investment Indecision. The various strategies discussed in these letters lead to long term returns consistent with risks taken. No magic is discussed. If a low risk tolerant person has a portfolio full of higher risk small capitalization stock funds, eventually volatility will lead to an unexpected sharp drawdown in portfolio value, stress, and the tendency to sell out at relatively low valuations. Compatible investment strategies and risk tolerances are as good as it gets – stick with "your right plan"!

No. 4 The Broken Funnel
Disconnected Spending and Income Sources

The process of financial resource accumulation and spending during retirement is analogous to a reservoir that gathers water from rivers and streams and distributes it to users. During droughts less water is accumulated and less is available for usage. Weak infrastructure points are vulnerable to breaks that limit reservoir inputs and wasted outputs, that don't reach users. Many people approach retirement with limited ideas of long term retirement spending budgets. Some expect to spend at 80% of pre-retirement levels. However, unexpected emergencies lead to higher spending levels. The spending source may be partially Social Security Income and pensions. Nevertheless, at age 65 if the retirement investment account is being spent at greater than a 5% rate, in most situations the investment account reservoir will not last for a 25 year time horizon. The reservoir and user swimming pool are disconnected. The funnel from the retirement income sources reservoir must remain connected and not run out of water.

No. 3 Great Grandma's Misfortune
Life is not too short!
Outliving spending resources

People are living much longer today than a century ago. Great Grandma is a prime candidate for longevity risk – living longer than her mother and her mother's mother. Grandpa most likely did not educate her in financial matters. Even with Social Security and various pensions, she probably needs other retirement income sources to pay for higher medical bills, assisted living, and the simple gifts she likes to give to great grand children and her favorite charities. Selecting a reasonable time horizon based on relevant factors and adding a little buffer is critical for all the eventual Great Grandmas and Grandpas. I use a 95 year life expectancy in BWM Letters for planning examples - a 30 year time horizon for a 65 year old retiree. Older people offer a wealth of wisdom. Longevity risk needs to be addressed so spending resources are available for their financially secure long lives.

No. 2 Give me what I want!
Instant Gratification
No Savings Habit

U.S. consumers have generally bought into the idea that regular savings is unnecessary. Credit cards are solicited through airlines, car rental companies, and banks. Most people are hooked by age 25 to buy anything on credit. Little is left to save. In addition to the instant gratification of consuming "what I want right now," rational middle age people justify poor savings habits. They consider a year of large portfolio gains or home value appreciation to be a substitute for this year's savings. During the following year of portfolio losses, they rarely have the funds to increase savings to fully make up for losses. These attitudes explain why most Americans do not build and accumulate the resources needed for a comfortable retirement. Congress recently encouraged savings through default enrollment in employer qualified savings plans. Yet, without understanding investment compounded growth many savings plan participants contribute the minimum possible and continue conspicuous consumption. In summary delayed consumption or a regular savings habit is needed to set the foundation or provide the seed money for retirement account growth and accumulation. Starting the savings process early provides a longer period and more seed money for the retirement account to grow and meet goals.

It really is that simple.

No. 1 There's always tomorrow
No Planning
No Financial Security

Planning and organizing take more effort than most people are willing to consistently make. Yet, lack of wealth planning means many people don't achieve retirement financial security. Putting off wealth planning at age 30, leads to putting it off at age 40, etc. The conversion of our human capital into financial capital or earnings is squandered, if there is no saving and investing plan. Eventually, earnings capacity diminishes and financial security goals are not met. Those without plans simply settle for a lower retirement standard of living. Wealth management is simple, but not easy. Many investment strategies developed in BWM Letters are boring. They just require self discipline. That is what investment guidance focuses on. **If this discussion of Retirement Planning Mistakes makes sense to you, and you don't have a wealth development plan, please read about my services following the summary.**

Summary: Ten Retirement Planning Mistakes
- No. 10 Setting and Forgetting the Plan
- No. 9 Emotional Triggers
- No. 8 Unlimited Piggy Bank
- No. 7 Counting on the kids
- No. 6 I don't know and
- am afraid to find out
- No. 5 Taking the wrong path
- No. 4 The Broken Funnel
- No. 3 Great Grandma's Misfortune
- No. 2 Give me what I want!
- No. 1 There's always tomorrow

BWM Services

$99 Financial Wealth Checkup

The answers to the following 3 questions are analyzed to give you an independent assessment of:
- Your retirement plan
- The chances of achieving it

1. What is your retirement spending goal? include life expectancy, current age, and working status
2. What is your financial and human capital? include current portfolio of assets, current earnings, savings rate, and expected future earnings
3. What are your risk taking attitudes?

The financial wealth checkup is not a wealth management or personal financial plan. I offer investment guidance plans also beginning with $100,000 accounts as described with disclosures at the www.banachwealthmanagement.com website Services page. A sample Investment Advisory Agreement (IAA) is available there for review.

Please call me at (720) 493-8707