NORTHERN TRUST

RETIRING IN A LOW INTEREST RATE ENVIRONMENT

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Crafting thoughtful and thorough retirement plans.

Planning for retirement is a high priority consideration for many people. Meanwhile, the pace of retirement is accelerating and the average lifespan is extending. Although one may be able to target a retirement date or time frame, market conditions and changing interest rates may not behave in a way that yields the level of returns a retiree is planning for, potentially resulting in savings that may not sustain through the entirety of their retirement years. It becomes crucial to carefully examine retirement plan strategies, including a thorough evaluation of income streams and risk management.

RECENT TRENDS IN RETIREMENT

According to the U.S. Census Bureau population projections, an estimated 20 percent of the population will be 65 or older by 2030 and 20.7 percent of the population will be 65 years or older by 2050.[1]

In 2050, the population age 65 and over is projected to be 83.7 million, almost double its estimated population of 43.1 million in 2012. The baby boomers are largely responsible for this increase in the older population, as they began turning 65 in 2011.[2]

Assuming a traditional age of 65 for retirement, analysts anticipate that there will be 80 million people retiring in the next 20 years, or approximately four million each year.[3]

Today the average retirement age is 63 with an average retirement length of 18 years.[4] According to data compiled by the Social Security Administration:[5]

- A man reaching age 65 today can expect to live, on average, until age 84.3.

The potential of a 30-plus year retirement creates greater risks and uncertainties in wealth plans.

- A woman turning age 65 today can expect to live, on average, until age 86.6.
- About one in every four 65 year olds today will live past 90.
- About one out of ten will live past age 95.

These statistics point to the possibility that a retiree will may have a 30-plus year retirement. The length of this time horizon poses increased risks and uncertainties on a retiree's wealth plan.

WHAT A LOW INTEREST RATE ENVIRONMENT MEANS TO A PRE-RETIREE OR NEW RETIREE

Historical Approach

Historically retirees have sought security and income in retirement from bonds. Simply stated, bonds are debt instruments issued by governments, municipalities and corporations that are used to finance projects and growth. In return for a specific sum (principal), the bond purchaser will receive back their original principal plus interest, based on a pre-determined schedule reflecting market conditions and pricing at the time of purchase.

As they approach retirement, many retirees tend to reduce risk in their portfolios by reallocating from equities to bonds. The expectation is the bonds will generate sufficient income to sustain their lifestyle and goals. In a low interest rate environment, bond yields also remain low. Therefore, returns in the portfolio may not sufficiently match the desired level of cash flow for the longer retirements that retirees generally face. Depending on portfolio construction, discussing other opportunities to generate cash flow with your advisors is an important step to take.

Sample questions to consider when nearing retirement:

- What is your timeline to retirement?
- Would you be willing to work longer to increase income?
- Based on your current lifestyle, are there opportunities to adjust your expenses?
- Are there certain goals that you could delay until later, in favor of increasing your retirement savings?

Managing Risk in Wealth Plans

Interest rates are gradually increasing, but remain low. The timeline for further increases depends on a number of variables, alongside the fact that market activity constantly changes. For these reasons, coupled with typically low bond yields, it is important to work with your advisors to have a risk management framework in place to help navigate market downturns, volatility or other life surprises such as a loss of a job or significant change in health. This type of safety net would allow for distributions during times of stress while allowing the remainder of the portfolio to recover.

WEALTH PLANNING TIPS TO CONSIDER

In a low interest rate environment, what should you do?

- **Factor in Inflation:** With life expectancies rising, you may need to plan for a 30-35 year retirement. That means your investments will need to outpace inflation, which has averaged approximately three percent annually. With three percent annual inflation, the price of goods and services will more than double in 24 years.
- **Factor in Rising Health Care Costs:** The average 65 year old couple living into their 80s may need up to $300,000 in health insurance premiums and out-of-pocket health care expenses. This does not include the cost of long-term care or nursing home costs. Consider purchasing long-term care insurance for you and perhaps your parents or others who may depend on your financial support to mitigate this potentially large risk.
- **Weigh the Cost of Ownership for Luxury Items:** The ongoing discretionary expenses of owning vacation homes and other luxury assets may far outweigh the cost of alternative ownership structures, such as renting or leasing.
- **Social Security:** It is important to analyze the right age at which to start drawing Social Security. If possible, wait until the full retirement age or later (up to age 70) to take advantage of full benefits.
- **Home Equity:** If you are thinking about downsizing, do not put off these plans. While your home may have changed in value, so have other properties. Making this transition creates liquidity to fund your desired retirement lifestyle.
- **Part-Time Work:** Some people want to work part-time for the stimulation and social interaction. Also consider the fact that a part-time job paying just $20,000 a year is about the same cash flow as a $1 million bond portfolio that yields two percent.
- **Tax Efficiency Strategies:** Seek tax-efficient investment strategies. Taxes are your largest expense; as yields go down, tax efficiency becomes more and more important.
- **Risk Management:** Begin building your retirement safety net as you approach retirement. Talk to your wealth management advisor about what is the best time to put this risk reduction tool in place.
- **Wealth Transfer:** Be prudent with irrevocable wealth transfer techniques. As your retirement progresses and asset sufficiency becomes clearer, you can become more aggressive with wealth transfer strategies.
- **Distribution Options:** Consider carefully the annuity versus lump sum distribution options of your pension, deferred compensation plans, and other compensation schemes.

CONCLUSION

Do not wait to talk to your advisors until you are about to retire; start the conversation early and revisit the discussion periodically. Carefully aligning your assets and future inflows with your financial goals, alongside detailed evaluation of how your plan may change throughout retirement and the associated risks will lead to a more thorough and prepared wealth plan to support you and your goals during retirement.

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If you would like to learn more about these and other services offered by Northern Trust, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.

[1] Holder, Kelly A., and Sandra L. Clark. "Working Beyond Retirement-Age." *U.S. Census Bureau*. Housing and Household Economics Division Labor Force Statistics Branch, 2 Aug. 2008. Web.
[2] Jennifer M. Ortman, Victoria A. Velkoff, and Howard Hogan. "An Aging Nation: The Older Population in the United States." *US Census Bureau*. N.p., 06 May 2014. Web. 13 Oct. 2016.
[3] Kessler, Glenn. "Do 10,000 Baby Boomers Retire Every Day?" *Washington Post*. The Washington Post, 24 July 2014. Web. 13 Oct. 2016.
[4] Harden, Seth. "Retirement Statistics." *Statistic Brain*. U.S. Census Bureau, 04 Jan. 2016. Web. 13 Oct. 2016.
[5] Social Security Association. "Calculators: Life Expectancy." N.p., n.d. Web. 13 Oct. 2016.

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