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summaries

SIGMA
INVESTMENT COUNSELORS

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Can You Afford To Retire?

One of the favorite parts of my job is telling a client they can comfortably afford to retire. For the majority of our clients, this is their number one goal. When they initially tell me they are considering retirement and ask if they can afford it, the question can take significant time and consideration to answer. Everyone's "magic portfolio value" is different and depends on a number of varying factors.

How do I know if I can retire?

When assessing prospective retirement for our clients, we typically start with a review of a comprehensive and sophisticated financial model of their financial lives, using a web-based program called MoneyGuide Pro. The model inputs include age, life expectancy, social security earnings, pension income, investment assets, real estate, outstanding debt, and risk tolerance. While some of these inputs are simple, others such as risk tolerance take a little more time to evaluate.

The program includes Sigma's forecast and real returns for various asset classes over a long time horizon. It applies these returns to an investment portfolio over a given period of years, and uses three different methods to discern probable outcomes. The first method is a straight line appreciation - as if the market went up a steady number every year (obviously not realistic but it is a useful starting point for illustrations). The second method uses what is called Monte Carlo Analysis to randomize the returns. This method runs hundreds of different paths that the markets may take over a time horizon and plots each ending point on a chart, resulting in a probability of success. The third method is a "worst case" scenario. Under this last method, in the first three years of one's retirement the primary assumption is that equity markets decline significantly. It results in a "loss cushion" or amount one can stand to lose in the portfolio and still maintain his or her income level.

What should you be invested in during retirement?

Using our own individual judgment and Sigma guidelines, the MoneyGuide Pro software can help us select the appropriate asset mix for your portfolio throughout retirement. We aim to invest in the portfolio mix that has the highest return for the least amount of risk necessary. This results in long term asset allocation guidelines of equities, fixed income, and cash investments.

Recent market volatility has not inspired confidence in those in retirement or looking to retire in the near future. For many investors, maintaining the appropriate asset allocation throughout retirement can be one of the most difficult tasks. When you need to begin withdrawing savings, the stock market dips can appear much deeper and volatile than the swings you experienced while still being able to save and recoup losses. I have often heard clients say "Why don't we just get out now, and then get back in when the market starts going up?" Trying to time the market is very dangerous.

From October 4th to the 11th, the S&P 500 rose a whopping 11%. One week of performance was equivalent to what would be thought of as a "good year" in the market. Staying invested with an appropriate stock allocation and keeping a long term outlook can be tough through these large swings, but the alternatives can be much worse. Risk perception changes, and short term volatility can't overshadow the longer term risk of inflation.

How much should I spend in retirement?

Typically, planners have used an 80% income replacement ratio in retirement. This means in retirement you would need 80% of your employment income to maintain a similar standard of living. This is a good rule of thumb to use for young people just starting to plan for retirement, but as you get closer to retirement age, budgeting planned expenditures can be a much better tool.

A few years ago, I was counseling a couple who were looking at retirement. The husband wanted to retire and the wife did not think they could afford for him to stop working, unless they made some significant cuts in their spending. She thought they were overly extravagant, and he thought they were too frugal. They had no budget and really had no idea where they were spending. I had them go home and set up separate "ideal" budgets on their own and bring them back to me. When we compared their budgets, surprisingly they were almost identical, and their portfolio could more than meet their goals for retirement. Unfortunately, I think they left my office even more upset because they did not know what they were going to argue about anymore!

Having a plan as to what you are going to spend each month and communicating it with your spouse or partner can be very helpful to make sure you are staying on target. Large expenses like housing and health insurance should be closely monitored. Someone who wants to retire prior to qualifying for Medicare coverage could have significant health insurance bills for a number of years. Selling a second home, or downsizing to a manageable house might also be considered. A very common mistake people make when budgeting for retirement is underestimating their onetime expenses. The wedding they want to pay for their daughter ends up costing $40,000 instead of $20,000 or the trip around the world costs $120,000 instead of $80,000. When budgeting for retirement, it is often better to overestimate these expenses and come in below budget.

What am I going to do in retirement?

Life expectancies continue to rise, so a 50 year old who is planning to retire at age 65 will likely be much more productive in retirement than someone retiring today. Once you retire, you give up your job and title, which often is a big part of your identity. It can also be very isolating, not having work colleagues to chat with, or somewhere to go every day. Many studies have shown intellectual engagement to be crucial to good health. Staying engaged in both physical and mental activity can be essential to keeping your brain quick and staving off depression. Many of our clients consult, work part-time, or volunteer throughout retirement for this very reason.

If you are starting to think about retirement but have not reached out to your Sigma investment professional because you think that it is unlikely that you will be able to retire anytime soon, please call without further delay. The tools at our disposal allow for a very constructive discussion about the timing and financial character of retirement. Choices that can be made to accelerate retirement may not be as costly as you think. We would also be pleased to consult with your friends or family members on this very important topic if you think we can be helpful.

Marisa A. Lenhard CFA, CFP®

The Economic and Market Environment

In Sum: Desirable options are limited for resolving the European debt crisis. Optimists suggest that merely acknowledging this longstanding problem is a sign of progress. Global economies continue to expand moderately, but are susceptible to external shocks. Loose monetary policy prevails as interest rates remain low (except for credit challenged borrowers). It would appear that government spending will be constrained and few tax increases will be implemented in the near term. Common stocks have held up surprisingly well, although the year has been punctuated by frequent, wide price swings. This bodes well from a longer term trend standpoint.

Geo-political: The pan-European debt crisis is unfolding in real time and serious questions are being raised about the future of the common currency, the Euro. Greece, Italy, and inevitably, Portugal, Ireland, Spain (and then to a lesser degree, France) will all be debating the details of how they reduce/eliminate structural budget deficits in order to get their excessive debt positions under control. Options for elected officials are limited primarily to spending reductions as tax increases may tilt economies back into recession and also spur even greater non-compliance. Looming in the background is the world response to credible reports that Iran is close to being able to produce nuclear bombs

Economic: Three years after the financial shock that precipitated the sharpest global economic contraction since the Great Depression, signs of improvement abound, although the rigor of expansion is anemic. Most economies have grown during the past year with the exception of Japan (earthquake and tsunami) and Egypt (political revolution). Dependent upon developments on the European debt crisis, unforeseen outcomes (larger defaults than expected or the hint of defaults where none was anticipated) could spook consumers and investors and result in a slowing of growth. More favorably, the fact that the crisis has been grudgingly acknowledged, and fixes are being discussed, may lead to more sound fiscal policies which would be constructive for economic growth over the longer term.

Monetary: Central bankers continue to err on the side of loose monetary policy in order to forestall deflation and the attendant problems this would cause. The European Central Bank recently reduced interest rates while the central banks of most of the other developed and developing economies have been accommodative for the better part of the last three years.

Fiscal Policy: See Geo-political above, sentence two and three. Wash, rinse, repeat.

Equity Markets: Wash, rinse, repeat again. Equity prices have swung wildly all year, looking for a catalyst to sustain a trend. It does appear that a modest upside bias is in place. A transition from a secular bear market to a secular bull market also seems to be emerging as deep price declines have spurred opportunistic investment, arresting said declines. It should be noted that a transition, if it is materializing, is a process and not a point.

Fixed Income Markets: In January, we suggested that interest rates would begin to rise from their abnormally low levels of the past few years. We adhere to that outlook.

Robert M. Bilkie, Jr., CFA

This is the time of year that Sigma's investment professionals typically execute trades to harvest capital losses for income tax management purposes. This is done largely to shelter future realized capital gains. Even if clients have realized losses being carried forward from prior years, this still is a practical strategy. Typically, such trades are reversed after 31 days to comply with IRS regulations. If you note a trade that seems out of character (such as a sell of an investment recently purchased) keep in mind that it is probably a tax driven transaction. Of course, feel free to call us if you have any questions.

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