Retirement Planning for a New Paradigm

Are you thinking about retirement? There's the good part – the travel, time with family, catching up with yourself or achieving long-held dreams or goals. But then there's worrying if you've saved enough and you'll be able to afford the life you want.

In our new reality of volatile financial markets, higher interest rates, higher inflation, and ever-increasing medical costs, it can feel like retirement is even more complicated.

The good news is that you can do many things to make sure your plan is on track. It's not just about saving, although that's a big part of it. Tailoring your plan to the environment we are in now and doing some thinking about your future can go a long way.

Take Advantage of the IRS Catch-Up Provision

Saving as much money as possible while you are working gives you the most flexibility later. With investing, time is on your side. The more you save now, the more potential investments have to provide returns in the future despite increased volatility. By taking advantage of the IRS catch-up provision that allows those aged 50 and up to contribute an additional $7,500 to a 401(k) and $1,000 to an IRA, you're also lowering your taxable income in the year you make the contribution.

Social Security Is Guaranteed, Inflation-Adjusted Income, and Some of it is Tax-Free

Getting the most out of Social Security means delaying as long as possible. The larger amount you are entitled to once you hit full retirement age (FRA) and beyond can be meaningful. The life expectancy of people retiring today has increased, so the breakeven point when those bigger checks outweigh the money you passed up before FRA is more attainable. The amount increases automatically by 8% for every year you delay taking your benefits past FRA up until age 70.

Not all Social Security income is tax-free; it depends on your total income level, and up to 85% of Social Security may be subject to tax, but that 15% that is always tax-free can be a meaningful part of your income plan.

If you want to stop working before FRA but still want to delay Social Security, one way to do it is to use the funds in your tax-advantaged accounts. You'll owe taxes on the amounts you withdraw, so withdrawing them when you don't have other income will lower the tax bill. It will also lower the balance in these accounts, which becomes important later when required minimum distributions begin at age 73. The lower your account balance, the less you are required to take out. This gives you more control over taxable income.

Avoid Sequence of Returns Risk

Planning when you will withdraw funds from your investment accounts isn't just about minimizing taxes. The amount you have invested is sensitive to down markets, and when you withdraw in a down market, you crystalize the loss. This is true throughout your retirement, but it's particularly important to avoid as much as possible in early retirement.

You need as long as possible for your money to grow to get you through multiple decades of retirement, and studies have shown that withdrawing funds in a bear market in early retirement can permanently reduce your principal and impact the amount your investments grow. Liquidating assets when the portfolio is at a lower asset value due to a negative market means the smaller portfolio then has a more difficult time recovering.

With the current volatile market environment, it's even more important to have a plan to mitigate this risk. Strategies can include diversification, time-bucketing retirement investments, and paying attention to the maturities and duration of your bond investments to reduce interest rate risk. With money markets and savings accounts paying 4-5% interest, holding cash (or cash equivalents) equal to two-year's expenses is a hugely valuable strategy.

Should You Rethink Your Retirement Housing Plan?

If you planned to sell the family home and purchase somewhere else, you might want to rethink for now. Housing prices are still historically very high, and mortgage rates are near the highest they've been in decades. Giving up a low-interest mortgage to buy somewhere else and financing the transaction with a new mortgage at higher rates might outweigh the tax or lifestyle benefits you were counting on.

There may be a compelling reason, like being closer to family and part of grandkids' lives while they are young. Or being able to pursue a warm-weather hobby full-time. The additional expense doesn't make it prohibitive – it's just important to revisit the decision and look at it in the context of your entire plan.

Take a Close Look at Your Risk Profile

The old retirement standard was the 60/40 portfolio. It worked well – until it didn't. Spiking inflation and a restrictive monetary policy from the Federal Reserve erased the negative correlation between the equity and the bond markets – when one is down, the other is usually up. The correlation broke down in 2022 when we saw historically bad performance from both markets. The 60/40 portfolio has recovered but deserves a closer look regularly and certainly isn't a "set-it-and-forget-it" allocation.

Volatility can make investors nervous and result in precipitous decisions to get out of the markets completely. This is usually a mistake. Markets recover over time, and staying invested is key so that you don't miss out on the recovery when it arrives.

Be honest with yourself about your comfort level and take action to ensure your investments mirror your preferred level of risk so you can remain invested through downturns.

Plan to Be Flexible

You may have set up a retirement date and plan that you think will work well. But for many people, retirement comes earlier than they expected. This could be due to layoffs, illness, family needs, or just simply deciding going to work every day is no longer serving your best interest.

Building a retirement plan that gives you options to retire earlier and later than expected is possible. Then test and push those assumptions until you are confident and comfortable with the outcomes. Finally, repeat, repeat, repeat to test new information and new retirement plans – there is nothing static in retirement planning.

The Bottom Line

Retirement planning in our new paradigm is more complicated, but there are tried and true ways to create and maintain a plan that will keep you on track.

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