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# Can You Afford to Retire?

After watching their savings evaporate and their net worth plunge, many are giving up on retirement planning. But there are ways out of this mess without winning the lottery

By [Peter Coy](#)

The expensive approach to retirement is to pile up so much money that you'll be safe no matter how long you live or what goes wrong with your health or the markets. But for many families, the amount required seems ridiculously out of reach, especially after the twin crashes of Wall Street and Main Street. "There's a big sense of futility and hopelessness," says Liz Davidson, founder and chief executive of Financial Finesse, a Manhattan Beach (Calif.) educational firm.

Take courage. There are more efficient and affordable approaches. As this Special Report will explain, you can have a secure retirement even if you don't have the biggest nest egg since the extinction of the Great Elephant Bird of Madagascar. In these seemingly out-of-control times, you can actually control many of the factors that will affect your retirement. "The news for most households is not as bad as they think," says Boston University economist Laurence J. Kotlikoff.

That's an important message to get across at a time when people are feeling fatalistic. Assets in IRAs and defined-contribution plans such as 401(k)s fell more than \$2 trillion last year, according to the Investment Company Institute. "One of my daughters in her 20s said, 'If I put it in the market I'm going to lose it, and if I put it in the bank I won't make any money, so I might as well spend it,' " says Olivia S. Mitchell, a professor of insurance and risk management at the University of Pennsylvania's Wharton School. As someone who has made a career out of getting people to focus on such issues, says Mitchell, "That was just a terrible shock to me."

A good way to sort out all the conflicting advice you hear about retirement is to use a concept from economics: "life-cycle consumption smoothing." The big idea is that you should arrange your borrowing and saving so as to achieve the highest possible standard of living that you can maintain reliably and steadily over a lifetime. You don't want to subsist on macaroni and cheese in your youth in order to live in luxury when you're old and can't enjoy it. But neither do you want to subsist in poverty in your final years because you blew all the money earlier. The happiness you get from extravagance at any age will never compensate for the unhappiness of penury at a different age.

How do you squeeze the most spending power out of limited resources and still keep that spending steady over a lifetime? By focusing on two core principles: safety and efficiency. Safety means not gambling on high-risk investments to rescue your portfolio. Efficiency means being smart about how you deploy the money you do have, for example by protecting against the risks that you will die either too young to support your spouse and children or too old, having outlived your savings. Bottom line: You never want to get into a situation where your golden years are hostage to the whims of the market.

To begin with, stop making a fetish of The Number—that fearsome string of digits some online calculator or investment adviser said you need to retire comfortably. Retirement is not an all-or-nothing contest like a basketball game, where losing by one is just as bad as losing by 40. You can do pretty well with low-risk strategies to eke out more of the savings you do have, such as postponing retirement; tapping equity in a home; delaying when you start taking Social Security; moving to a lower-tax state or into a smaller house; or simply cutting daily living expenses.

## INSURING EARNINGS

You can smooth consumption safely and efficiently by pooling risks with others. When you're young, most of your retirement "wealth" is in the form of future earnings power. If you die young, that's all erased. So, to safeguard a spouse's retirement, buy a lot of life insurance when you are starting your career. Term policies for healthy young people are cheap because relatively few people die young. As you age you can let coverage dwindle because you'll have more assets, as well as fewer years of future earnings power to cover. Studies show that most young people carry too little life insurance.

When you retire, your risk becomes the opposite: outlasting your assets. Again, the solution is to pool risks, this time by buying annuities that will keep paying as long as you live. Insurers can keep annuity prices reasonably low because profits from those who die young offset losses from those who die old. Some advisers say you should put a quarter or even half of your savings into annuities. The downside is that you lose control of the assets that you annuitize. But the peace of mind is irreplaceable. Says Anna M. Rappaport, chairwoman of the Society of Actuaries committee on post-retirement needs and risks and president of Anna Rappaport Consulting in Chicago: "There's a bigger chance that you'll live to 100 than that you'll have a major fire."

A good supplement to annuities is long-term-care insurance, which could save you from dreary years in a substandard, Medicaid-supported nursing home if you suffer a stroke or Alzheimer's disease. For both forms of protection, look for products that are indexed to inflation. Shop for low fees. Limit default risk by splitting the policies among multiple providers, all highly rated. For annuities, shave the cost by buying ones that don't kick in until, say, 85.

## A SCIENTIFIC APPROACH

Annuities and long-term-care insurance aren't cheap, but the only alternative, apart from good luck, is counting on a big pile of assets to get you through. Trouble is, a pile that's big enough is both extremely hard to accumulate and probably a waste of money, because the chance that you will use it all is slim.

This stuff gets complicated quickly. Planning for your retirement using rough rules of thumb is better than not planning at all. But if you want to be more scientific, you can use free software that implements consumption-smoothing principles. Economic Security Planner, whose president is Kotlikoff, sells ESPlannerPLUS (\$199) and makes a stripped-down version, ESPlannerBASIC, free online.

For victims of post-crash stress disorder, the good news is that you don't need to cut your spending by anywhere near as much as the stock market has fallen in percentage terms. Kotlikoff used ESPlannerPLUS to examine how the retirement plans of a dual-income couple, "Jack and Jill Crash," would be affected by a stock market drop that cut their net worth by just over 30%. If Jack and Jill are 60, they must cut annual consumption from now until their (presumed) death at age 100 by 20%, assuming they both still plan to retire at age 65. If the couple are 45, they need to cut by only 6%. And if they are 30, they need to cut by only about 1% (chart). Kotlikoff's calculations were based on Jack and Jill saving according to the assumptions in the ESPlanner formula before the crash. He also figured stock prices would grow at 3% annually after inflation following the crash.

Other calculation methods reach similar conclusions. "The bottom line is that many people even within five years of retirement can recover from the losses of 2008," says Wei-Yin Hu, director of investment analysis and research for Financial Engines, a math-oriented advisory firm.

Smoothing your consumption over a lifetime does require discipline. When you find yourself behind on saving, it's tempting to change assumptions about the future—say, plug in a higher expected rate of return on assets. That's less painful than trimming back your lifestyle. Face it, though: The stock market is beyond your control.

It's also tempting to plug in a later retirement age, as doing so can make a huge difference. A survey in February by benefits consultant Watson Wyatt Worldwide ([WW](#)) found that fully half of workers 50 and over planned to work past age 65, and one-third of workers had upped their planned retirement age over the past year—many of them, presumably, to try to compensate for losses on retirement portfolios.

Delaying retirement, though, is more easily said than done. A Prudential Financial ([PRU](#)) survey in 2004 (not a recession year) found that 40% of workers who retired early were forced to do so by factors such as layoffs, injury, and health limitations.

## SAVING YOURSELF

People who blithely assume they will work until age 70 may change their minds when the time actually comes. It ain't easy. Robert M. Gill Sr. retired as a pharmacist four years ago at the age of 63 only to go back to work this year after his 401(k) lost half of its value. Now he is working an average of 24 hours a week at a CVS pharmacy 45 minutes from his home in St. George Island, Fla. He says the work has sharpened his mind but does make his feet sore some days, and he is looking forward to re-retiring. Says Gill: "This is just a holdover until the market comes back."

When it comes right down to it, the retirement dial that's most obviously under your control is the one marked "saving." Try to set money aside for retirement before you even think about the rest of your budget. People who contribute to 401(k) and 403(b) plans through automatic deductions do exactly that. Fidelity Investments says that the average contribution actually rose slightly in 2008 vs. 2007 among the 11 million participants in corporate 401(k) plans that it manages.

For some people, simply staying the course on retirement saving isn't enough. Scott Ackerman, 38, of Lansdowne, Va., is downsizing to a smaller house because the recession has hurt business at the two health clubs he operates, and he has big medical expenses for his 1-year-old son, who has special needs. "It's a tough struggle," he says. "But we're going to make sure we have breathing room to continue to save."

The bust has hurt, all right. But if you are willing to make some sacrifices, as Ackerman has, and use smart planning methods like consumption smoothing, your retirement should turn out just fine.

For the best places to retire, how people are adjusting their plans, seniors who won't retire, and tips for the sandwich generation, view our slide shows and video at [businessweek.com/go/09/retirement](http://businessweek.com/go/09/retirement)

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