THE Wealth REPORT

Planning for retirement can be a tall order when you're still juggling a mortgage, tuition and family vacations. But to get this right, you need to start now.

STRATEGIES FOR RETIRING IN 10 TO 20 YEARS

Overview

Between the beginning of February and the end of March of this year, investors in their 50s saw an average 11.7% drop in their retirement accounts.[1] While the second quarter experienced a substantial recovery from the earlier shock, the average year-to-date 401(k) return for midcareer employees is up by only 1.4%.[2] That can be pretty disheartening if you're looking for high accumulations in the years before retirement.

On average, older investors saw less damage to their retirement portfolios because many followed the sage advice of transitioning risky investments to safer vehicles as they aged. We have recently witnessed why this is a smart strategy. When some unexpected event such as a pandemic comes into play, the older you are, the less time you have to recover from market losses. Generally, the best plan is to avoid substantial losses the closer you get to retirement.

As an investor, it's important to expect the unexpected — and have a plan for it. Presently, workers in their 30s and 40s have time to invest for long-term growth. But what about people who would like to retire in 10 years? How aggressive should they be? After all, this next decade is their last chance to bolster their retirement nest egg before they have to start withdrawing from it. For many people, it's time to take retirement saving and investing very seriously.

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Retirement Phases

As you structure your assets for future retirement income, it helps to understand the three primary phases of retirement. In the first phase, retirees tend to be the most active. They tackle high-expense items on their bucket list, such as travel, country club living and an active social life. This means your monthly expenses may be the same or even higher than when you were working, but also peppered with additional hikes a few times a year when you book airline tickets or host a large family reunion.

The second phase of retirement is when you start to slow down. Many retirees reach a point when they're not as active, so they don't spend as much money. During this phase, your household budget may decrease somewhat and remain fairly steady.

You may be surprised to find that in the third and final stage of retirement, your expenses could increase exponentially. More people are living longer, well into their 90s, but they tend to have higher medical and long-term care expenses. Consider that if you want to age at home, the median cost of a home health aide is more than $52,000 a year, assuming the national median of $23 an hour.[3] Note that Medicare does not cover this expense, and long-term care insurance may defray only a portion of it.

Clearly, not all retirees progress through all three stages of retirement and experience these types of expenses. However, it's important to understand the potential costs associated with living a very long time, and what to expect if you need to hire caregivers. Not only should you be properly motivated to save and invest wisely, but you also should consider adapting your lifestyle now to what your nest egg can afford. If you're looking to retire in the next 10 to 20 years, now is your time to plan.

Eliminate Debt

As you approach your retirement date — even if it's a decade or two away — make it a priority to pay off debt, particularly high-interest debt. If you own a home, you ideally want to pay off your mortgage before you retire. Aggressively tackling credit card and other forms of debt first can give you additional income to allocate toward paying down your mortgage and contributing to your retirement nest egg.

Reduce Expenses, Now
If you find this goal difficult because your finances are tight, it's a good idea to carefully assess your current lifestyle to see whether there are expenses you can reduce or eliminate. There are two sides to this coin, but both are worth considering. First and most obvious, there's your discretionary spending. This represents how you decide to spend money once you've paid all of your fixed living costs, such as your mortgage, utilities, transportation and food costs. This means cutting back on luxuries, such as designer labels and excessive entertainment.

If you feel you've cut back on discretionary spending as much you can stomach, take a look at your necessary spending. For example, if your regular mortgage (and second mortgage) payments are high, you may want to consider selling your home while residential real estate prices are at their peak. Downsizing to a less expensive home can yield many long-term financial advantages. If you think you'll want to age in place, consider a practical home for an aging senior, such as a one-story house located near family members, with a spare bedroom for a live-in caregiver. You may want to consider a condominium that offers maintenance-free options. There are many variables to consider, but taking a hard look at your fixed costs now can yield a tremendous amount of savings over the next 10 to 20 years.

Robust Cash Reserves

We often talk about having an emergency cash account. When you're still working, a good rule of thumb is to have enough cash to cover six months' to a year's worth of expenses. That cash can help tide you over if you unexpectedly lose your job and have a lengthy employment search.

Once retired, you may need a cash buffer to cover one to three years' worth of expenses. Why so much? First of all, recognize that you're not likely to replenish that account; you'll simply drain it over time. Second, your cash reserves can be used to supplement your income during months (or possibly years) when the markets have declined. There are times when it may be better to give your investments time to recover temporary losses, rather than withdraw from your principal to cover your monthly income needs.

Portfolio Diversification

Remember that 10 to 20 years is still a sufficient timeframe to invest for growth. However, once you're in your 50s, it may be prudent to place some of your assets in conservative vehicles. While diversifying your portfolio is always a good strategy to help manage risk, it may be even more important at this stage of your life.

Sectors
In the near-term, you may want to consider sectors that are faring well during this period of pandemic turmoil, such as technology, consumer staples and pharmaceuticals. It may not be the best time to invest in airlines, cruises, hotels and restaurants, but monitor these industries for a turnaround once the virus is near containment.[4]

Active Investment Management
While investors are generally advised to buy and hold long term, the next year or two could offer growth opportunities in various sectors and countries that recover at different times. Securities that offer short-term gains may plateau after the short run, whereas other areas of the market that recover more slowly could offer higher return opportunities further down the road. It may be helpful to think of the equity portion of your portfolio as more fluid than usual in order to take advantage of potential gains. However, your portfolio should maintain a long-term asset allocation strategy that is appropriate for your risk tolerance and retirement timeline.

IRA Conversion
A timely strategy you may want to consider is converting traditional IRA funds to a Roth IRA, thanks to today's low tax rates. Moving forward, future gains will grow tax-free, and you'll be able to withdraw that tax-free income during retirement. Note that you'll have to pay income taxes on those assets in the tax year they are converted. It may be wise to gradually transition these funds over multiple years so as not to tip your income into a higher tax bracket.[5]

Guaranteed Income

In planning retirement income for 10 to 20 years down the road, it's important to build multiple income streams, particularly reliable ones to supplement Social Security. The more reliable your retirement income, the less you'll have to tap your cash reserves just to cover basic household expenses. For this reason, many advisors recommend annuities, which provide issuer-guaranteed payouts over a period of your choosing, including for your lifetime and even that of your spouse.

To combine guaranteed income with the opportunity for growth, consider a fixed indexed annuity (FIA). An FIA earns interest credits on your principal, up to a certain amount, based on an external market index such as the S&P 500. When you buy an FIA, you do not own any shares of stock or participate directly in the stock market or index. Instead, FIAs credit interest to your annuity based on a formula that decides how additional interest credits based on the performance of the index are calculated and credited to your contract value. The formula is determined by the insurance company and outlined in your annuity contract.

Be aware that FIA guarantees are based on the financial strength of the issuing company. It is important to read the fine print carefully, as not adhering to policy restrictions may result in early withdrawal charges and/or a tax penalty. Be sure to work with an experienced financial advisor to determine whether a fixed indexed annuity is appropriate for your portfolio.

Housing and Long-Term Care

We talk about preparing for assisted living later in life, but as noted earlier, the longer you live, the more overwhelming the cost for private care. No matter how well you plan, you never know if you might suffer from a debilitating condition, such as a stroke or Alzheimer's disease. It may be worth considering contingency options because both spouses should be able to continue a high quality of life no matter their individual circumstances.

One plan may be to explore a "lifecare" continuing care retirement community (CCRC), in which you start out living independently in your own cottage or apartment, and can advance to different levels of assisted living to skilled nursing care, as needed.[6] There are three reasons this prospect is worth considering from a financial perspective:

1. Once you pay an upfront buy-in fee, your monthly rate is locked in at a predetermined level no matter what type of care you need in the future.[7]
2. After you determine your fixed costs in the future and arrange for guaranteed lifetime sources of income to pay for them, you have the latitude to invest in higher-risk, higher-reward opportunities over the next 10 to 20 years.
3. Once you know your fixed costs for stage three of retirement, you can use any surplus assets for splurges during the phase one retirement years with confidence that you won't run out of money later on.

Whether you're thinking of relocating, downsizing or moving into a CCRC, consider doing it early on in retirement — ideally late in phase one or during phase two. This enables retirees to become used to their new lifestyle and able to take full advantage of amenities and nurture new friendships. Be aware that isolation is a big issue later in life, and moving is a much more difficult adjustment the older you get.

Final Thoughts

Retirement planning can be overwhelming. When you're only 10 to 20 years out, you know it's looming, and you know you need to be aggressive. That's why it's important to work with a trusted advisor who can help you wade through the what-ifs and what-to-dos so that you don't have to tackle this all on your own.

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[3] Genworth. March 30, 2020. "Cost of Care Survey." https://www.genworth.com/aging-and-you/finances/cost-of-care.html. Accessed July 30, 2020.
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[5] Ashby Daniels. MarketWatch. March 30, 2020. "5 actions you can take during a bear market." https://www.marketwatch.com/story/5-actions-you-can-take-during-a-bear-market-2020-03-30?mod=home-page. Accessed July 20, 2020.
[6] Elaine K. Howley. US News & World Report. Sept. 16, 2019. "What's the Best Age to Move Into a CCRC?" https://health.usnews.com/wellness/articles/whats-the-best-age-to-move-into-a-ccrc. Accessed July 20, 2020.
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