

How much is **ENOUGH?**

COVER | Buck up, America. You may be better prepared for retirement than you think. *By Mary Beth Franklin*

BEFORE YOU WAX NOSTALGIC for the good old days when you could count on pensions and social security to support you in your golden years, remember that those days were relatively brief—not so much an era as an aberration.

The whole concept of retirement is fairly recent, an experiment that began with the creation of social security in 1935, observes Ken Dychtwald, a gerontologist and authority on aging in the U.S. With the country facing massive unemployment during the Great Depression, social security was a way of providing older workers with guaranteed income so that they could leave their jobs, freeing up slots for younger workers. “No one considered whether a life without work would be satisfying or sustainable,” says Dychtwald. Even when traditional pension plans were at their peak in 1985, fewer than half of Americans working for private companies were covered.

As the leading edge of the baby-boom generation turns 60 this year, “it’s time to retire retirement,” declares Dychtwald, author of *The Power Years: A User’s Guide to the Rest of Your Life*. And he doesn’t think that’s necessarily a bad thing: “Like a great dessert, too much leisure can make you sick after a while. Boomers don’t want to fade into obscurity. They want to trade success for satisfaction.”

Much of that satisfaction will come from continuing to work, either by downshifting to a part-time schedule or cycling periodically between employment and leisure. It’s all about remaining connected, vibrant and useful. Not incidentally, it’s also about continuing to earn money, now that only 17% of those employed outside government entities can expect to receive traditional pension checks in retirement. And the new retirement is about saving more.

This modern model rests on a solid foundation. Nearly 80% of employees

participate in their work-based retirement plans; 401(k) plans alone have more than 42 million active members. All told, more than \$13 trillion has been stashed in a variety of public and private retirement plans, more than double the amount invested ten years ago (and despite a brutal bear market).

That's the big picture. How much will you personally need in order to finance your life in retirement? Depending on your age and economic circumstances, your "number" could be 15%—the percentage of earnings young workers should be socking away. Or 80%—the amount of preretirement income you should aim to replace when you leave your job. Or \$1 million (or more)—the size of the nest egg needed to generate that income.

OFF AND RUNNING

ALISON DUNBAR, 32, knows exactly what her number is. She wants to save about \$2 million by retirement age, and she's on track to do it. A physical therapist who works in Palm Springs, Cal., Dunbar contributes the maximum amount to her 401(k) plan—\$15,000 this year—and \$4,000 to a Roth IRA. She also saves about \$10,000 a year outside her retirement accounts.

How does a single woman, who bought her own house when she was 29, manage to squeeze enough out of her paycheck to fund her long-term goals? Dunbar credits her parents with

setting her on the path to saving. They paid for her college education, allowing her to graduate debt-free, and taught her never to carry a credit-card balance.

And she's a creative cost-cutter. In return for a \$16,000 increase in salary, she opted out of her employer's health, life and disability insurance plans. Instead, she pays \$100 a month for a high-deductible health-insurance policy she purchased on her own. She has a roommate who splits the cost of her \$1,000 monthly mortgage payment on a house that has nearly doubled in value over the past three years.

Dunbar calculates that if she continues to save at her current pace and earns 7% a year on her investments, she'll meet her \$2-million retirement goal. But she hopes to work at least part-time into her seventies—just like one of her colleagues at the hospital. "I see people working into their late sixties and seventies and they seem very happy," says Dunbar.

THE 15% SOLUTION

YOUNG WORKERS don't need to get hung up on a specific target for their retirement nest egg. Save as much as you can as early as you can and you'll be off to a great start. Although there is no hard-and-fast rule, Christine Fahlund, senior financial planner with T. Rowe Price, recommends that young workers try to save 15% of their gross salary (including employer matching contributions)

in order to replace 50% or more of their salary in retirement (the later you start, the more you'll need to save).

Most retirees will also receive social security benefits that could replace another 20% or 30% of preretirement income. For the average wage earner—with an income of \$37,000 in 2005—social security replaces about 42% of preretirement income; the figure is less for those with higher earnings. That would boost total income close to the 75%-to-85% range of preretirement earnings generally recommended.

Don't see how you could possibly save 15% of your income? It doesn't all have to come out of your pocket, so it isn't as painful as you might think.

Let's say you are single and earn \$50,000 a year. Let's also say you contribute to a 401(k) plan, and the company matches your contribution 50 cents on the dollar up to 6% of your salary—the most common matching formula. You'd need to contribute \$3,000 to your 401(k), or \$250 per month, to get the largest possible matching amount, \$1,500.

But 401(k) contributions are made in pretax dollars. So in the 25% federal tax bracket, saving \$250 a month would reduce your take-home pay by just \$187.50, or \$2,250 per year. With your employer deducting the money off the top of your salary, you wouldn't miss the cash. And taking that single step would get you more than half way *(continued on page 73)*

to your annual savings goal.

To close the gap, you could contribute an additional \$3,000 to a Roth IRA. In retirement, you'd have to pay tax on funds withdrawn from your 401(k), but withdrawals from your Roth would be tax-free. In 2006, you can contribute up to \$4,000 of earnings to a Roth, plus an additional \$1,000 in catch-up contributions if you're 50 or older. To qualify for a Roth, your income can't exceed \$110,000 if you're single or \$160,000 if you're filing a joint return.

In the end, adding 15% of your \$50,000 earnings, or \$7,500, to your retirement kitty would cost you only \$5,250 out of pocket.

HARNESSING INERTIA

WHEN YOU BEGIN saving for retirement, the amount you contribute has a larger impact on your account balance than investment performance. A study by Putnam Investments found that bumping up contributions by just 2% would have doubled retirement wealth after 15 years compared with relying solely on investment performance. As your balance increases over time, however, investment performance becomes increasingly important (see the model portfolios on page 75).

Call it an exceptionally long learning curve, but after 20 years of trying to educate workers about taking control of the investment decisions in their retirement plans, plan sponsors and providers have finally figured it out: Many people simply don't want to do it. So their newest strategy is to "harness that inertia," says Jeff Maggioncalda, president of Financial Engines, one of the earliest providers of online investment advice for retirement savings.

Do-it-yourself 401(k) plans are giving way to do-it-for-me options, collectively called automatic 401(k) plans. Employers automatically enroll workers as soon as they're eligible to participate (workers can always choose to opt out). As a painless way to increase con-

THE BOOMER PLAYLIST

RIFFS on retirement

Members of the Woodstock generation searching for a new anthem as they retire won't have far to look for inspiration. Many of their rock icons are still touring to sellout crowds, even though many people in the audience could qualify for an AARP discount.

Paul McCartney turns 64 this year, 40 years after he recorded "When I'm 64" with the Beatles. Paul Simon and Art Garfunkel put aside their differences to cash in on their "Old Friends" tour in 2003. And the Rolling Stones, with a collective age of 245, are finding out what a drag it is getting old. The good news is that their prescription for "mother's little helpers" may soon qualify for Medicare coverage.

Plenty of other selections gathering dust in your eight-track tape library can be downloaded to your iPod to avoid the sounds of silence in retirement. You might follow the Eagles' advice and "Take It Easy," or pass the time with Otis Redding "Sittin' on the Dock of the Bay." Maybe you're more of a "Wanderer" like Dion and the Belmonts, or, like Chuck Berry, you have "No Particular Place to Go." Or maybe you plan to travel to all your dream destinations, because, as Elvis reminded us, "There Is So Much World to See."

Worried about growing bored or running out of cash, some of us may decide, with the Silhouettes, to "Get a Job." After all, we'll be "Stayin' Alive," according to the Bee Gees, for a very long time. In the end, our greatest satisfaction will come from knowing that, like Old Blue Eyes, we did it our way.

tributions, some plans allow employees to elect automatic increases in their salary deferral tied to annual pay hikes. And about 40% of companies offer life-cycle retirement investments that provide a balanced portfolio of mutual funds targeted to a specific retirement date; the portfolio becomes more conservative as the target date nears (see "The One-Stop Solution," on page 80).

Now companies even allow workers to choose someone else to manage their portfolios for them—something that 45% of employees say they prefer, according to a 2005 survey by Principal Financial Group, the largest provider of 401(k) plans.

One of those workers is Jeanne Marchak, 50, national sales manager with the wall-decor division of Crescent Cardboard, in Wheeling, Ill. Because Marchak says she's "not a motivated investor" on her own, she was thrilled when her company began offering managed accounts two years ago through ProManage, which offers guid-

ance on 401(k) investments. Now she's satisfied that her portfolio is appropriately diversified, and she doesn't mind paying the management fee, which averages \$350 a year on her six-figure 401(k) account. "I pay someone to cut my lawn," says Marchak. "Now that I can afford it, I also want someone to take care of my investments."

MID-COURSE SHIFT

ONCE YOU'RE IN your fifties, it's time to get serious about crunching the number you'll actually need in retirement. Just taking the time to do that calculation can be a major motivator. Only about 42% of workers have tried to determine their retirement-savings needs, according to the annual Retirement Confidence Survey conducted by the Employee Benefit Research Institute. But of those who did, nearly half took steps to bolster their savings, such as increasing their contributions or shifting investment allocations.

In 2004, the average 401(k) balance was \$57,000, reports EBRI. But accounts for older workers were significantly larger. For those age 60 and over with 30 years on the job, the average balance was nearly \$180,000.

As soon as Marchak turned 50, she began making additional catch-up contributions to her 401(k)—up to an extra \$5,000 in 2006. She plans to continue that strategy as long as possible to reach her personal retirement-

you'll need to draw from personal savings in your first year of retirement and then multiply that by 25. This so-called rule of 25 is essentially the same thing as saying you can afford to withdraw 4% (or one twenty-fifth) of your nest egg initially, and increase that amount each year for inflation.

Assuming you retire at 65 and expect to live up to 30 years in retirement, this conservative formula assures that you won't run out of money.

to ensure steady income for life.

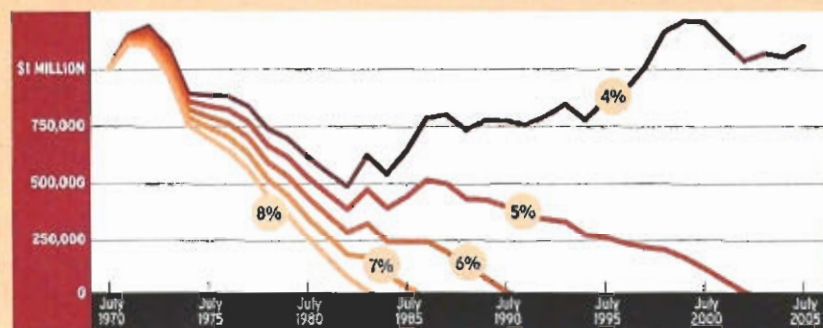
Because each annuity payment represents a return of principal plus interest, you'd enjoy larger withdrawals than you would under the 4% rule. But there **would be nothing left** for your heirs **when you die unless you** buy specific survivor protection, and that would **reduce your monthly payments**.

Another drawback: It doesn't make sense to stash all of your money in an immediate annuity—especially one that does not increase with inflation—because you'd wipe out your savings. Even Wray admits it's preferable to have money in reserve, because "no one can predict all the things that will affect you over a 30-year retirement."

The sweet spot for the optimum retirement-savings number seems to lie between the two extremes. So someone looking to generate \$40,000 a year in retirement strictly from personal savings would need a nest egg somewhere between \$500,000 (12.5 times the initial withdrawal) and \$1 million (25 times the initial withdrawal).

WILL YOUR MONEY LAST? Depends on how fast you spend it

Let's assume you start retirement with \$1 million in assets, invested 40% in stocks, 45% in bonds and 15% in money-market accounts. The chart below shows how long your nest egg might last when withdrawn at different rates. The example is based on historical rates of return since July 1970. At withdrawal rates of 4% to 5%, savings would last 30 years or more.



Note: Withdrawals were made at the beginning of each month for one-twelfth of the annual withdrawal amount. Reprinted with permission from American Century Investments.

savings goal of \$1 million. Marchak figures that she and her husband, Dave Fait, will enjoy a comfortable retirement based on their combined savings and social security benefits, plus the profits they'll make when they sell their home in suburban Chicago and move to someplace warmer and less expensive.

Determining the lump sum you'll need to support a comfortable lifestyle in retirement is the most difficult part of the equation. Marchak's million-dollar estimate is reasonable, but there's no agreement on how much is enough.

Van Harlow, president and chief investment officer for Fidelity Asset Management Services, recommends that you figure out how much income

Withdrawing only \$40,000 of a \$1-million portfolio during your first year in retirement would protect your nest egg from gyrations in the stock market, even if the market is in bear country when you start to tap your funds.

But David Wray, president of the Profit Sharing/401(k) Council of America, argues that the 4% rule is too conservative, and that the prospect of amassing assets equal to 25 times their income gap is too lofty a goal for most people. Instead, Wray suggests that a nest egg half that size would suffice to meet basic retirement-income needs. Wray's bare-bones formula, based on research by Aon Consulting, assumes that the entire lump sum would be used to purchase an immediate annuity

THE OTHER NUMBER

COMING UP with that amount requires you to figure out another target number: how much you need to draw out of personal savings in the first place. To maintain your lifestyle, most financial experts recommend that you try to replace 75% to 85% of your preretirement income with a combination of social security, personal savings and a pension, if you're lucky enough to have one. But your personal number depends on how and where you live.

Jack and Sandy Marquette, both in their early sixties, are living an idyllic retirement life in a country-club community in Payson, Ariz., and it's costing only about 25% of their preretirement income. Jack, a former pilot with America West, had no traditional pension from the airline when he was required by law to retire at age 60. But he and Sandy have a combined income of about \$64,000, thanks to their two

social security checks and his military pension. The Marquettes have barely touched their seven-figure nest egg, except to buy a travel trailer for extended trips.

The secret to keeping their expenses relatively low? No mortgage. After selling their home in Phoenix for a big profit, they took the cash and built their dream house in the pine-topped high country of central Arizona.

Ironically, one of the Marquettes' neighbors, a former pilot for Delta Air Lines, has a traditional pension—but not the secure retirement he expected. He's too young to collect social security, and will probably receive only a fraction of his original pension now that Delta has filed for bankruptcy. He plans to sell his house and downshift to a less expensive lifestyle.

A NEW CAREER

WORKING LONGER may be the key to financial security for many future retirees who haven't saved enough during their working lives. Today, a majority of retirees elect to take social security at 62 rather than their normal retirement age (65 and 8 months for those born in 1941 who retire this year). Early retirees accept a permanent reduction in benefits of 20% or more for the rest of their lives.

Every year you work past age 62 boosts your financial well-being in re-

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- Your retirement target
- Social security benefits
- How bigger contributions to retirement accounts add up
- Which IRA option is best

irement (see the box below). Not only do you avoid a reduction in social security benefits and increase your annual income, but you also avoid having to touch your retirement accounts, so they can grow tax-deferred for another year. In addition, you shrink the period during which you have to draw down your savings, trimming the size of the nest egg you need in retirement.

Roger Schueller, 61, could be the poster boy for the new face of retirement. After a career of 30-plus years with a telecommunications company, Schueller accepted an early-buyout package more than two years ago. He took a lump-sum distribution from his pension and, together with the balance in his 401(k), rolled his million-dollar-plus nest egg into an IRA.

Geordie Crossan, president of NBS Financial Services, in Westlake Village,

Cal., recommended that Schueller invest in a diversified portfolio of mutual funds, with about 60% of the assets allocated to stocks. That would allow Schueller's investments to continue growing even as he began taking regular distributions. Crossan recommended the conservative withdrawal rate of 4% to 5% per year.

Too young for social security and limited to withdrawing about \$50,000 a year from his investments, Schueller decided to make up an income shortfall of about \$12,000 a year with a part-time job. What he found instead was a whole new career.

Schueller, who lives in Thousand Oaks, Cal., responded to a newspaper ad looking for Hollywood extras. Initially he worked for free, then for minimum wage. Now, as a member of the Screen Actors Guild, he earns \$122 a day. He generally works three days a week and has appeared in the television dramas *Boston Legal* and *West Wing*, as well as in several movies, including Tom Cruise's latest film, *Mission: Impossible III*.

Best of all, Schueller can work when he wants. He intends to take a break for a long-planned cruise around the Hawaiian Islands with his wife, Marge, 60, who continues to work to bolster her own retirement savings. His advice to retirees in search of employment: "Try something entirely different and have fun doing it." **K**