

# Pitfalls in Retirement

WEALTH MANAGEMENT INSTITUTE WHITEPAPER

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The current market turmoil has left many to wonder whether they should adjust their portfolio allocations to protect their retirement nest eggs. In weighing this decision, clients should be aware of several basic principles of retirement investing that apply whether markets are up or down, tranquil or stormy.

**N**ewspaper and magazine articles, Internet posts, bestselling books and academic studies bombard us with reminders to save for retirement. But another pressing issue receives less attention: How shall a client invest and spend wisely upon reaching retirement age? As baby boomers reach this age, a growing number seek clarity from Financial Advisors on this question. This paper looks at some of the key risks that retirees face and how to address them.

## BEWARE THE PITFALLS

Many clients fear outliving their portfolios. Indeed, a key concern for 57% of those surveyed is ensuring that their assets will last a lifetime.<sup>1</sup> Their apprehension reflects an erosion of the “three-legged stool” of retirement: Social Security, employer pensions and private savings.

- Social Security faces growing stress as the ratio of workers paying into the system to retirees collecting benefits continues to decline. Government will likely contain costs by reducing benefits, raising the retirement age or further taxing benefits.
- Recent accounting rule changes make traditional defined benefit plans more expensive for employers, hastening their disappearance.
- The two devastating market sell-offs of the past 12 years have sharply reduced the life savings of many retirees.

## KEY IMPLICATIONS

In preparing for retirement, investors should be alert to several common pitfalls:

- **Overspending**  
New retirees can typically afford to spend about 3% to 5% per year of their life savings.
- **Excessive conservatism**  
Allocating a portfolio entirely to bonds and cash might increase a retiree's risk of outliving her wealth.
- **Longevity and inflation risks**  
Investors should consider allocating some of their retirement portfolios to investments that can outpace inflation over time.
- **Abandoning the plan**  
Investors should work with their financial advisors to craft a plan that helps them pursue their retirement goals

<sup>1</sup> Merrill Lynch Affluent Insights Quarterly, March 2011.

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Faced with these challenges, baby boomers must manage their savings to last a lifetime and, ideally, to leave something for the next generation. Doing so requires care because:

- **Retirement investing is challenging and not well understood.** Wealth managers have devised efficient approaches to asset accumulation, but have given far less thought to ensuring that retirees don't outlive their savings.
- **The margin for error is slimmer now than in the past.** Yesterday's retirees could count on more generous pension and Social Security benefits. The fraying of these financial safety nets necessitates greater care in retirement investing.

Clients nearing retirement can benefit from avoiding these common pitfalls:

1. Overspending
2. "Playing it safe"
3. Failing to address longevity and inflation risk
4. Not adhering to a retirement plan

### PITFALL 1: OVERSPENDING

Think of your life savings as a personal financial garden whose produce you can harvest to help pay for retirement. You can improve your chances of harvesting a lifetime income that grows with inflation by spending in moderation, diversifying broadly and following a disciplined asset allocation strategy.<sup>2</sup> Those who draw down their wealth too rapidly risk depleting their savings.

How much may retirees safely spend? Many lack a clear sense. A survey asked investors at least 41 years of age how much of their retirement savings they can safely spend each year without running the risk of exhausting their assets. Forty percent had no idea; an additional 29% said they could safely spend 10% or more of their savings each year.<sup>3</sup>

But, as explained below, the respondents most on target were the one in 10 who estimated sustainable spending rates to be 5% or less. A 5% spending rate would mean that someone with \$500,000 of savings spends \$25,000 the first year of retirement and increases this amount with inflation in subsequent years. This rate may suit some retirees, but no single rate works for everyone. The sustainable rate of retirement spending depends on numerous factors, including:

- The age of the retiree(s)
- Their risk tolerance
- Their asset allocation
- Their desire to leave a sizable bequest

History shows that the sustainability of retirement spending also depends on how markets fare, particularly in the early years of retirement. Consider the hypothetical example of Bobbie, who is approaching 90. Bobbie retired at the end of 1972 at age 50 with \$250,000 invested in a 50-50 stock/bond portfolio. If she had spent 3% of her portfolio the next year and then increased this spending in line with inflation, Bobbie's spending would have grown from \$7,500 in 1973 to \$35,600 in 2010. Her portfolio would have lasted until today, 38 years later, growing in value from \$250,000 to \$1,200,000 (Table 1).

**Table 1: Final Wealth at Various Spending Rates**

Start Date Year-End		Initial Spending Rate										
		0%	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1972	Final Portfolio Value	\$4,700,000	\$3,600,000	\$2,400,000	\$1,200,000	\$17,000	\$0	\$0	\$0	\$0	\$0	\$0
	Years of Spending	38+	38+	38+	38+	38+	23	17	14	12	11	10
1974	Final Portfolio Value	\$5,700,000	\$4,800,000	\$4,000,000	\$3,100,000	\$2,200,000	\$1,300,000	\$400,000	\$0	\$0	\$0	\$0
	Years of Spending	36+	36+	36+	36+	36+	36+	36+	31	22	18	15

Notes: For details on underlying assumptions, see Notes to Figure 1. These hypothetical results are for illustrative purposes only and are not meant to represent the past or future performance of any specific investment vehicle. Investment return and principal value will fluctuate, and, when redeemed, the investments may be worth more or less than their original cost.

Source: Merrill Lynch Wealth Management, IMG Investment Analytics.

<sup>2</sup> Diversification and asset allocation can neither guarantee a profit nor ensure against losses.

<sup>3</sup> New York Life survey, "Americans Lack Knowledge About How to Turn Retirement Savings Into Sustainable Income," May 15, 2006. Women were far more likely than men to report not knowing the answer (51% vs. 29%).

The value of Bobbie’s portfolio would have evolved differently at other spending rates. At lower rates, it would have appreciated more rapidly (Figure 1). But at a spending rate of 5%, it would have been exhausted after 23 years. The higher the spending, the less time the portfolio would have lasted.

These results reflect the fact that 1972 was a challenging time to retire. Stocks fell 37% over the following two years. To add insult to injury, inflation over those two years was a cumulative 23%.<sup>4</sup>

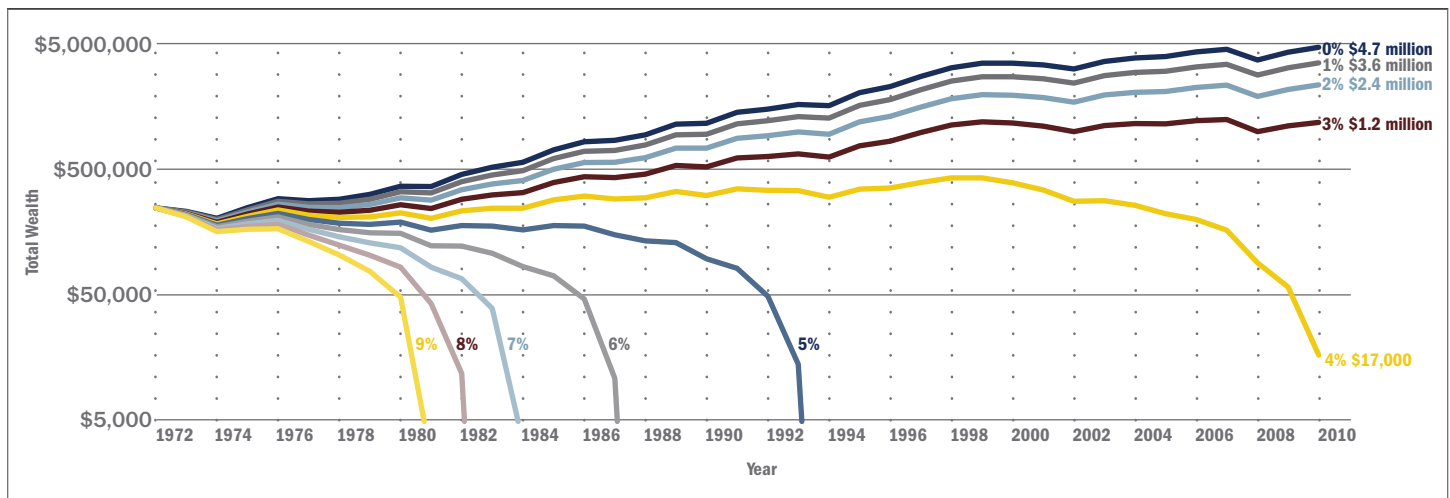
Now suppose that Bobbie’s cousin Billy had retired two years later, at year-end 1974, with the same size nest egg (\$250,000), also divided 50-50 between stocks and bonds. Billy was far more fortunate than Bobbie. Billy missed the 1973–74 market debacle and earned solid returns at the start of his retirement. For Billy, like Bobbie, low spending rates were sustainable and high spending rates were not (Figure 2). But the specific levels of wealth attained by the portfolios were quite different. If Billy had spent at the same initial 3% rate as Bobbie, his wealth at year-end 2010 would be \$3.1 million, as opposed to Bobbie’s \$1.2 million

(Table 1). Bobbie’s retirement portfolio could sustain initial spending rates up to 4%, while Billy’s could sustain 6%.

These illustrations give some feel for the spending that a diversified retirement portfolio can sustain. Spending rates of 3% or less are likely sustainable, while those much above 5% may not be. Careful research confirms these observations.<sup>5</sup> The sustainability of spending rates within the range of 3–5% depends on the period in question as well as the other factors noted above.

These examples help dispel the misconception that one can “spend” average returns, an example of the “Flaw of Averages.”<sup>6</sup> Thus, although a 50-50 stock/bond portfolio earned 8.6% average annual returns net of fees from 1973 to 2010, its sustainable spending rate was far lower. To be sustainable, spending must be low enough to allow a portfolio the potential to grow with inflation. Even if the portfolio earned 8.6% each year without fail, had Bobbie spent this return, the portfolio’s value would have stagnated. From 1973 to 2010, the inflation-adjusted value of the portfolio and the constant income stream it generates would have eroded by 79%.

**Figure 1. Bobbie’s Portfolio: The Evolution of the Value of a Diversified Retirement Portfolio at Various Spending Rates, 1973–2010**



Notes: Assumes a \$250,000 investment that at year-end 1972 was allocated half to U.S. stocks (proxied by the S&P 500 Index) and half to U.S. bonds (1976–2010: Merrill Lynch U.S. Broad Market Index; 1973–1975: Ibbotson U.S. Intermediate Government Bond Index) and rebalanced annually. It is not possible to invest directly in these unmanaged indexes. Returns are net of annual fees of 1.3%. Annual spending as a percentage of the portfolio for the first year is as indicated in the figure and rises in subsequent years with inflation (CPI-U). Withdrawals are taken at the end of each year.

These hypothetical results are for illustrative purposes only and are not meant to represent the past or future performance of any specific investment vehicle. Investment return and principal value will fluctuate, and, when redeemed, the investments may be worth more or less than their original cost.

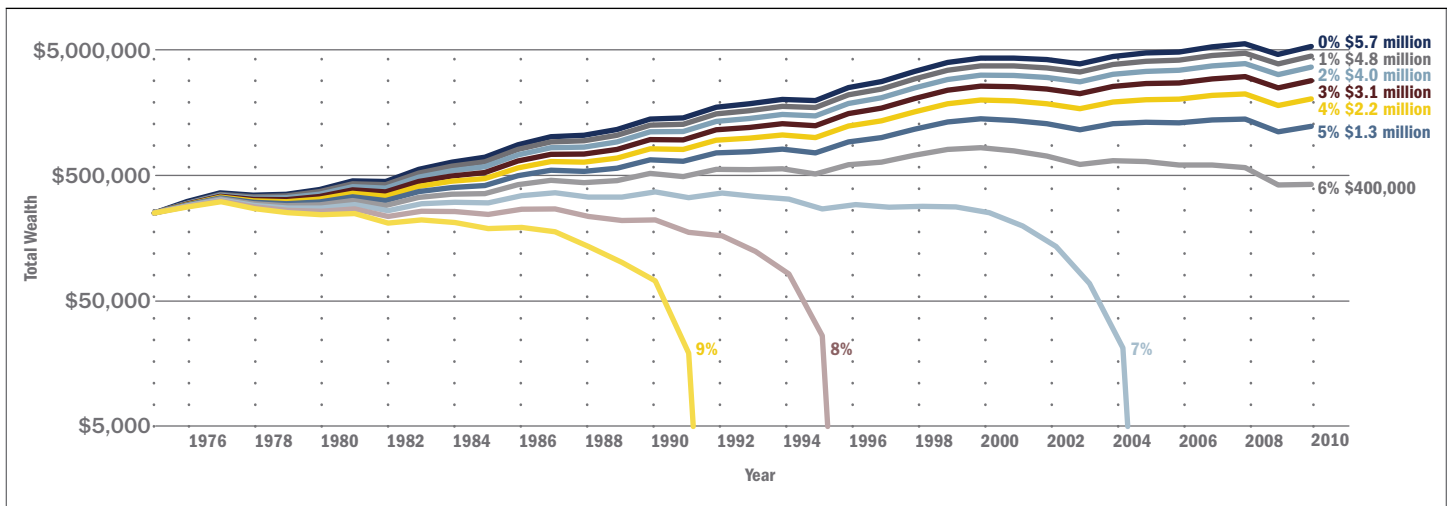
Source: Merrill Lynch Wealth Management, IMG Investment Analytics.

<sup>4</sup> Each increase in prices forces retirees to spend more just to maintain their lifestyles. In fact, from the perspective of sustainability, each 1% increase in prices has the same impact as a 1% decline in the portfolio’s value.

<sup>5</sup> See, for example, William Bengen, “Determining Withdrawal Rates Using Historical Data,” *Journal of Financial Planning*, October 1994; Philip Cooley, Carl Hubbard and Daniel Walz, “Retirement Savings: Choosing a Withdrawal Rate That Is Sustainable,” *AAIL Journal*, February 1998; and Moshe Milevsky and Chris Robinson, “A Sustainable Spending Rate Without Simulation,” *Financial Analysts Journal*, November–December 2005.

<sup>6</sup> In *The Flaw of Averages* (p. 11), Sam Savage observes: “Plans based on average assumptions are wrong on average.” Nobel laureate William Sharpe has dubbed planning based on averages “financial planning in fantasyland.”

**Figure 2. Billy's Portfolio: The Evolution of the Value of a Diversified Retirement Portfolio at Various Spending Rates, 1975–2010**



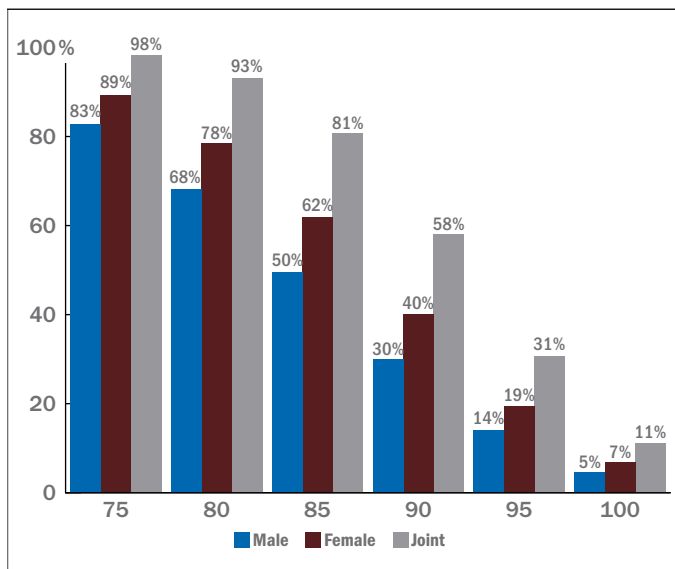
Notes: For details on underlying assumptions, see Notes to Figure 1. This example differs from that of Figure 1 in that the investment begins at the year-end 1974, not 1972. These hypothetical results are for illustrative purposes only and are not meant to represent the past or future performance of any specific investment vehicle. Investment return and principal value will fluctuate, and, when redeemed, the investments may be worth more or less than their original cost.

Source: Merrill Lynch Wealth Management, IMG Investment Analytics.

**PITFALL 2: “PLAYING IT SAFE”**

A natural reaction to market turbulence is to “play it safe” by investing all or nearly all of a retirement portfolio in investment-grade bonds or highly liquid, lower-risk investments like CDs, money market funds<sup>7</sup> or Treasury bills. But this seemingly conservative approach could actually prove riskier for retirees than holding a more broadly diversified portfolio that includes equities.

**Figure 3: Probability of 65-Year-Olds Living to Various Ages**



Source: Society of Actuaries, Annuity 2000 Mortality Table.

New retirees should view themselves as long-term investors. A 65-year-old woman has a 62% chance of living past 85; for a 65-year-old couple, the chance of at least one spouse living past 95 is 31% (Figure 3).<sup>8</sup> Funding a retirement that might last 30 years or more generally requires the higher long-run returns that equities have historically earned. We expect stocks to continue to earn higher long-run returns than bonds (Table 2).

**Table 2: Merrill Lynch Current Asset Class Assumptions**

	U.S. Stocks	U.S. Bonds	Cash (U.S.)
Expected Return	8%	5.0%	3.0%
Expected Volatility	18.0%	7.5%	0.9%

Notes: The proxy for U.S. stocks is the S&P 500 Index; for U.S. bonds, it is a weighted average: 60% Ibbotson U.S. Long-Term Government Bond Index and 40% Ibbotson U.S. Long-Term Corporate Bond Index; for cash it is 1-month Treasury bills. These assumptions are provided for informational purposes only. They do not reflect actual investments, and there is no guarantee that these assumptions will be realized. See the back page for additional information on how these assumptions are derived. Results are illustrative and assume reinvestment of income and no transaction costs or taxes. You cannot invest directly in an index.

Source: Merrill Lynch Wealth Management, IMG Investment Analytics, “Preparing for Your Future,” July 2011. Available at [http://pwmui.services.us.ml.com/publish/wm/wmoverview/pdf/2011\\_Preparing%20for%20Your%20Future%20\(AR81UOMO.06DUCD\).pdf](http://pwmui.services.us.ml.com/publish/wm/wmoverview/pdf/2011_Preparing%20for%20Your%20Future%20(AR81UOMO.06DUCD).pdf).

<sup>7</sup> An investment in money market mutual funds is not a bank deposit, and is not insured or guaranteed by Bank of America Corporation or any of its affiliates or by the Federal Deposit Insurance Corporation or any other government agency. Although money market mutual funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in money market mutual funds. Please see the prospectuses for a complete discussion of the risks of investing in money market mutual funds.

<sup>8</sup> Calculations based on Society of Actuaries, Annuity 2000 Mortality Table.

There are solid reasons to expect stocks to outperform bonds and cash over time:

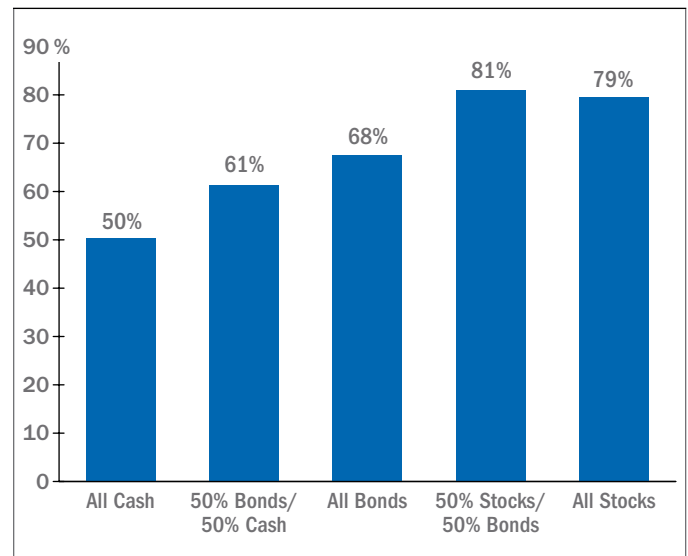
- From 1926 through 2010, U.S. stocks, as represented by the S&P 500 Index, earned an average annual compound return of 9.9%, compared with 5.7% for U.S. bonds.<sup>9</sup>
- Stocks have exhibited superior long-term performance in many other countries as well.<sup>10</sup>
- Because stocks are riskier than bonds, investors require higher long-term returns from stocks. Absent this “risk premium,” investors would shun stocks.

How can retirees harness this uncertain long-run risk premium given that, as Keynes observed, “In the long run we are all dead”? Investing patiently and diversifying prudently can help. For example, a portfolio split evenly between stocks and bonds (as presented in Figure 1) realized negative returns in just four of the 25 years through 2010 (1994, 2001, 2002 and 2008) and lost more than 10% in just one year (2008, down 16.2%). Moreover, in each of these four instances, the portfolio recovered from its losses within two years. Of course, past performance is no guarantee of future results.

Many retirees wish to play it safe by avoiding stocks. But a portfolio of bonds and cash, despite producing stable returns year-to-year, may not be the best answer for many retirees. A balanced portfolio that holds both stocks and bonds may offer retirees a far better chance of not outliving their wealth.

Consider the hypothetical example of a 65-year-old woman with \$500,000 to invest who wishes to draw 4% income, or \$20,000, next year and amounts that increase in line with inflation in subsequent years. If she invests the portfolio entirely in cash, she will have year-to-year return certainty but, according to our analysis, only a 50% chance of not outliving her wealth. If she instead invests entirely in bonds, this likelihood rises to 68% (Figure 4). But if she allocates half the portfolio to bonds and half to stocks and rebalances the portfolio annually, her chances of not outliving her wealth rise to 81%.

**Figure 4: Probability of a 65-Year-Old Woman Not Outliving Her Wealth for Various Asset Allocations**



Notes: Assumes that a 65-year-old female spends 4% of her wealth the first year of retirement and increases this spending in line with inflation in subsequent years. These withdrawals are taken at the end of each year, at which time the portfolio is rebalanced. The analysis reflects uncertainty with respect to the lifespan of a 65-year-old woman, as reported in the Society of Actuaries Annuity 2000 Mortality Table. Risk and expected returns assumptions for stocks, bonds and cash are as given in Table 2.

These hypothetical results are for illustrative purposes only and are not meant to represent the past or future performance of any specific investment vehicle. Investment return and principal value will fluctuate, and, when redeemed, the investments may be worth more or less than their original cost.

Source: Merrill Lynch Wealth Management, IMG Investment Analytics.

Stocks are riskier than bonds with respect to daily or annual portfolio fluctuations. But if you are a retiree, there is another risk to consider: the risk of outliving your wealth. A broadly diversified portfolio that includes both stocks and bonds may reduce this risk.

### **PITFALL 3: FAILURE TO ADAPT TO UNCERTAINTY**

Retirees can be blindsided by unanticipated risks. Many people need to retire sooner than expected or live longer than they imagined. Moreover, inflation can wreak havoc on a retirement plan, especially for those enjoying a long retirement.

#### *Timing of retirement*

You may have in mind a retirement date and a plan to save enough by then. But there’s a good chance you might retire sooner than intended due to circumstances beyond your control. Less than a quarter (23%) of workers plan to retire before age 65, yet two-thirds (68%) of current retirees end up doing so. What explains this disconnect?

<sup>9</sup> U.S. bonds are represented by a weighted average: 60% Ibbotson U.S. Long-Term Government Bond Index and 40% Ibbotson U.S. Long-Term Corporate Bond Index.

<sup>10</sup> The U.S. returns data are from Ibbotson Associates. For global returns, see Elroy Dimson, Paul Marsh and Mike Staunton, *Triumph of the Optimists*; and Credit Suisse, *Global Investment Returns Yearbook 2011*.

Nearly two-thirds of those who retire sooner than expected do so because of a health problem or disability; for nearly a quarter, the cause is a business downsizing or closure.<sup>11</sup>

The strong possibility of retiring earlier than expected heightens your need to be well prepared, or even overprepared. In planning for retirement, save early—and save often. If you find yourself among the many who retire sooner than expected and your wealth must last longer than originally anticipated, you may need to revisit your work options and spending plans.

#### *Length of retirement*

Many financial plans assume a fixed time horizon, such as 30 years. This approach has two basic shortcomings. First, in most cases the planning horizon takes no account of a client's actual life expectancy. Second, even if the planning process does take the client's life expectancy into account, it may do so incorrectly. How, for example, should you plan for a remaining lifespan that may be 20 years, but may also be 40 years?<sup>12</sup> Being overly conservative may lead you to continue working longer than necessary in your current position or keep you from enjoying your retirement. But following an overly aggressive approach may cause you to retire too early or spend too freely, placing you at risk of exhausting your wealth.

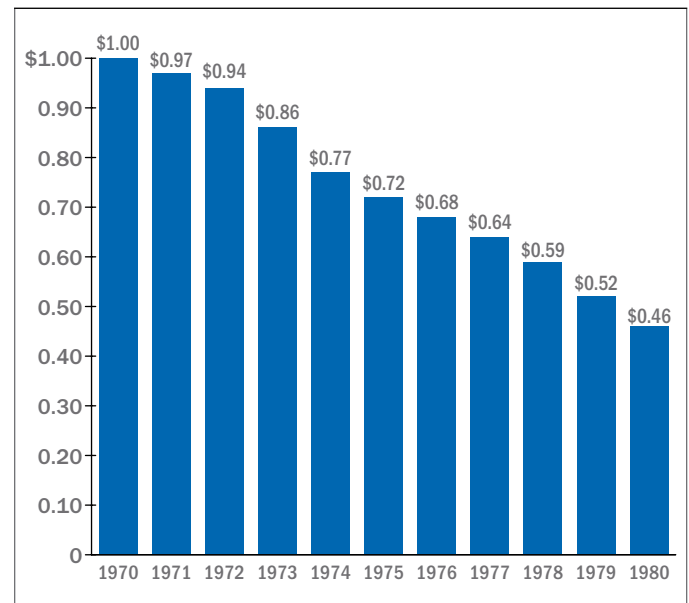
Complicating matters is the difficulty many encounter in estimating their life expectancy. Two-thirds of retirees surveyed underestimated their life expectancy. Just one in five provided an estimate of life expectancy that was on target or higher.<sup>13</sup> One reason for these underestimates is a failure to recognize that life expectancy increases with age. Another is that many people estimate their life expectancy based on how long their parents or other close relatives lived. Because life expectancies have grown markedly from one generation to the next, using relatives as a benchmark can lead people to underestimate their life expectancy.

#### *Inflation*

When planning for retirement, many do not adequately consider the corrosive long-term impact of inflation. For example, some baby boomers might recall that the price of a first-class postage stamp was 4 cents in 1958. Today it costs 44 cents, a cumulative inflation rate of 1,000%. More generally, according to the Consumer Price Index (CPI-U), a typical basket of goods and services that cost \$10 in 1958 cost \$76 in 2010, an 87% erosion in the purchasing power of the dollar. Uncertainty regarding the ongoing rise of prices is known as inflation risk, another key risk confronting retirees. It is related to longevity risk because the longer a retiree lives, the more acute inflation risk becomes.

Inflation can spike suddenly. In the 1970s, the purchasing power of the dollar eroded by 54%, imposing a serious burden on anyone trying to live on a fixed income (Figure 5).

**Figure 5: The Declining Spending Power of the Dollar, December 1970–December 1980**



Source: Calculations by Merrill Lynch Wealth Management, IMG Investment Analytics, based on CPI-U.

<sup>11</sup> Employee Benefit Research Institute, "Retirement Confidence Survey 2011—Changing Expectations About Retirement." Many retire earlier than expected to provide care to a parent or other relative. According to a survey by the National Alliance for Caregiving and the AARP, 49 million Americans care for someone who is ill or aged. Caregivers provide 20 hours per week of care on average.

<sup>12</sup> The uncertainty surrounding an individual's lifespan, called longevity risk, is a key risk facing retirees.

<sup>13</sup> Society of Actuaries, "Longevity: The Underlying Driver of Retirement Risk," July 2006. The remaining 12% of retirees surveyed either did not know their life expectancy or declined to respond.

Over the course of a long retirement, even moderate inflation can have a major impact. Inflation of 2.5% per year will erode purchasing power by 63% over 40 years (Table 3). Three decades of 5% inflation will reduce purchasing power by 77%. Moreover, retirees typically experience higher inflation than the headline CPI-U figure reported in the media. This is because retirees consume a different basket of goods and services than the general populace does. Notably, medical care expenditures have twice the relative importance for a retiree as for a pre-retiree. From 2000 through 2010, medical care inflation averaged 4.1%, as opposed to 2.4% for CPI-U. Aside from inflation, as people grow older, their health care expenses tend to rise.<sup>14</sup>

**Table 3: Erosion in the Purchasing Power of the Dollar at Various Rates of Inflation**

Year	Rate of Inflation			
	1%	2.5%	5%	7%
0	\$1.00	\$1.00	\$1.00	\$1.00
10	91¢	78¢	61¢	51¢
20	82¢	61¢	38¢	26¢
30	74¢	48¢	23¢	13¢
40	67¢	37¢	14¢	07¢

Source: Merrill Lynch Wealth Management, IMG Investment Analytics.

#### **PITFALL 4: NOT ADHERING TO A RETIREMENT PLAN**

People nearing retirement can benefit from sound retirement planning, a process that a Financial Advisor can facilitate. Planning can offer assurance and comfort to those on track to retire, and guidance on how to improve retirement prospects to those who are not. With a sound plan in place, clients can make prudent decisions on such matters as when to retire, how much they can afford to spend and when to start receiving Social Security. Many find that the very process of developing a plan offers a heightened sense of well-being.<sup>15</sup>

#### *The need for a retirement plan*

One of the greatest threats to a secure retirement is the failure to plan. Yet, remarkably, only 42% of workers surveyed report that they or their spouse have tried to calculate how much money they may need to live comfortably in retirement.<sup>16</sup> Most retirees need income from their retirement savings to fund living expenses, making it crucial to have a sound plan. Moreover, some retirees face challenges such as unexpected health care expenses. These concerns distinguish retirement planning from financial planning for other stages of life.

#### *Sticking to a retirement plan*

Dalbar produces an annual study gauging the impact of investor behavior on long-term portfolio returns. The study shows that individual equity fund investors realized a 3.8% average annual return between 1991 and 2010, compared with 9.1% for the S&P 500 Index.<sup>17</sup> It concludes that the benefits of a long-term investment strategy are lost to the average investor, who generally abandons investments at inappropriate times, often in response to bad news.

What gives investors the fortitude to stick with their retirement plans and hold investments despite market turmoil? Confidence that their plan is well thought out and suited to helping them pursue their goals. What investors want most is not to beat some market benchmark or to outperform their peers. Investors want to achieve their personal goals, nothing more and nothing less.

To help its clients work toward achieving their goals, Merrill Lynch is actively developing a Goals-Based Wealth Management approach and a related suite of tools.<sup>18</sup> Goals-based planning offers clients the confidence and courage to stay on course even when markets gyrate.

<sup>14</sup> Data on medical and CPI-U inflation and medical care expenditures are from the U.S. Bureau of Labor Statistics. For systematic guidance on planning for health care costs in retirement, see Merrill Lynch Wealth Management, "Healthcare Costs in Retirement Guide."

<sup>15</sup> In "Annuities and Retirement Well-Being," a chapter in Olivia Mitchell and Stephen Utkus, *Pension Design and Structure: New Lessons From Behavioral Finance*, 2004, Constantijn Panis notes: "Our evidence conclusively shows that satisfaction with retirement was higher among retirees who had engaged in some sort of financial planning activity."

<sup>16</sup> Employee Benefit Research Institute, "2011 Retirement Confidence Survey."

<sup>17</sup> Dalbar, *Quantitative Analysis of Investor Behavior*, March 2011. The study uses data from the Investment Company Institute and Standard & Poor's to compare mutual fund investor returns with appropriate benchmarks. Covering the period from January 1, 1991, to December 31, 2010, the study uses monthly mutual fund sales, redemptions and exchanges to measure investor behavior. These behaviors reflect the "average investor." Based on this behavior, the analysis calculates the "investor return" for various periods. These results are then compared with the returns of relevant indexes. Past performance is no guarantee of future results.

<sup>18</sup> For some of the technical foundations of this approach and a case study of its application, see Hungjen Wang, Anil Suri, David Laster and Himanshu Almadi, "Portfolio Selection in Goals-Based Wealth Management," *Journal of Wealth Management*, Summer 2011.

## OVERCOMING THE PITFALLS

Having examined four retirement pitfalls to which many are prone, let's briefly recap and discuss some solutions.

- **Overspending.** Most retirees have little idea how much of their savings they can safely afford to spend each year. The answer varies, but is generally on the order of 3–5%. Spending much more than this could put you at risk of reducing your retirement savings to a level that requires scaling back your lifestyle, perhaps substantially. If this amount seems inadequate, you might examine your spending patterns to identify which expenses are essential and which are discretionary. By eliminating or reducing some of the latter, it may be possible to reduce your spending rate to 3–5%.

Another possibility is to delay retirement. This need not mean continuing to work in your current position. It could be a “second act” career that allows you to work in a field or setting more to your liking. Indeed, a majority of older Americans with full-time career jobs move to a different job before exiting the workforce.<sup>19</sup> Delaying retirement can help compensate for a retirement savings shortfall by providing: added income; medical benefits; a shorter retirement to finance out of pocket; more time to save and earn returns; and higher Social Security benefits, which are largely tax-exempt. Your Financial Advisor can help you weigh these options.

- **“Playing it safe”** by shunning equities. A well-diversified portfolio with appropriate allocations to stocks, bonds and cash investments has the potential to keep pace with inflation and grow in value. Investing a retirement portfolio entirely in bonds and cash may be counterproductive. If market fluctuations leave you uncomfortable, it may make sense to limit your equity exposure. But doing so may mean lower long-run returns, necessitating a lower spending rate. Your Financial Advisor has tools to help you determine what strategic asset allocation is most appropriate for your situation.
- **Longevity and inflation risks** are important examples of the subtle factors that can undermine your retirement security. Your Financial Advisor can help you craft a strategy that addresses these risks. This might include allocating some of your retirement portfolio to investments that can outpace inflation over time. Another possibility to consider is allocating some portion of your retirement savings to an immediate annuity, which can provide an income for life, regardless of how long you live.<sup>20</sup>
- **Staying with your plan.** People are much more likely to adhere to a retirement plan if they feel comfortable with it. Your Merrill Lynch Financial Advisor can help you structure your retirement portfolio in a way that helps you pursue your long-term financial goals, providing you the fortitude to stick with your plan even when markets turn stormy.

Just as you will get more out of retirement by staying physically fit, staying financially fit and avoiding these pitfalls can help you get more out of retirement. Your key to a secure retirement is a plan that helps you meet your financial goals.

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<sup>19</sup> Michael Giandrea, Kevin Cahill and Joseph Quinn, “Bridge Jobs: A Comparison Across Cohorts,” *Research on Aging*, September 2009, pp. 549–76.

<sup>20</sup> For more details, see Merrill Lynch Investment Management and Guidance, “How Immediate Annuities Can Help Meet Retirement Goals,” Summer 2011 (available at [http://www.totalmerrill.com/publish/mkt/campaigns/Webcast\\_Retire\\_0611/How-Immediate-Annuities.pdf](http://www.totalmerrill.com/publish/mkt/campaigns/Webcast_Retire_0611/How-Immediate-Annuities.pdf)). Please see the back page for additional disclosure on annuities

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Anil has been with Merrill Lynch since 2004, where he was previously Head of Investment Strategy & Analytics in the Alternative Investments area and a Senior Investment Strategist on the Merrill Lynch Research Investment Committee (RIC). Anil's research has been published in the *Journal of Wealth Management* and discussed in *Barron's* and *The Wall Street Journal*. His prior experience includes roles as a senior AI strategist at Citigroup, trader at Credit Suisse and management consultant at McKinsey. Anil earned an M.B.A. with honors from the Wharton School of the University of Pennsylvania, an M.S.E. (operations research and financial engineering) from Princeton University and a B. Tech. from the Indian Institute of Technology at Delhi.

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Summer 2011	Why Behavioral Finance Matters	Statman
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