Are You Underprepared for Retirement?

A university study serves as a wake-up call.

Financially speaking, how many Americans are truly on track to retire? A recently published white paper suggests that about half of us are approaching our "third acts" with faulty assumptions.

Perception differs from reality. Researchers from the University of Alabama and Ohio State University looked at the Federal Reserve's Survey of Consumer Finances and assessed the retirement readiness of its 2,300-odd respondents. They determined that 58% of these workers (age 35-60) were saving too little for the future, with a near-majority of that 58% failing to recognize the gravity of their situation. Only 42% of households were sufficiently prepared for retirement, but 46% of households believed they were.

The researchers discovered two other interesting disconnects. One, a slight majority of those who *were* saving adequately for retirement believed they were not saving enough. Two, the insufficiently prepared workers who were in line to receive old-school pensions were more likely to have flawed assumptions about their retirement readiness than workers without future pensions.

Just how much money do you really need for retirement? The answer to that question varies per household, but many households could stand to save more. One old rule of thumb says you should save the equivalent of 12 times your end salary for a comfortable retirement. If you retire earning $150,000 a year, that means $1.8 million.

Very few IRAs or workplace retirement plan accounts contain that much – so if your retirement nest egg needs to be that large, other sources of funding for your retirement probably need to emerge.

A household with either or both spouses earning $150,000 may have those resources. A middle class household may need to dedicate 10% or more of its income to retirement savings accounts.

Saving 5% of your salary for retirement probably means saving too little. Take the case of someone who starts saving for retirement at age 30 while earning $40,000. Hypothetically, assume that this person gets a 3.8% raise annually (which may be optimistic) and gets a consistent 6% yield from his or her retirement accounts (this is a hypothetical example). What if this person works until full retirement age (67)? In 2052, 37 years from now, this worker will have, under these conditions, a retirement nest egg of $423,754. Not bad, but not fantastic.

Another old rule of thumb says living comfortably in retirement requires 85% of your end salary. A nest egg of $423,754 is clearly too small to provide that for most of us, even with income withdrawn from it supplemented by Social Security payments.

If you save and invest ably over 30 or 40 years, you might end up a millionaire with the help of strong yields and compounding. You may *need* to be a millionaire to retire.

What if interruptions diminishe your retirement savings effort? They may diminish it, but they should never halt it. Divorce, medical issues, prolonged joblessness – these and other events may impede your progress toward your savings goals, but the effort to save must still be made as you want time on your side.

If you are able to anticipate such an interruption, there are ways to plan to possibly make up the slack. You could explore investing more aggressively during that time period – but you invite greater market risk. You could cut back on household expenses (or inessential expenses) to free up more money to sustain your pace of retirement saving. Or, you could determine potential strategies far ahead of such disruptions by sitting down with a financial professional to run some scenarios (laid off at 60, taking three years out of the workforce at age 35 or 40 to be a stay-at-home mom or dad, and so forth).

You should strive to be financially prepared for your retirement, and for the unexpected life events or financial surprises that may occur before it arrives.

Most on line calculators can provide some assistance with preliminary data entry inputs.
For more customized Retirement Planning, providing more detail, see your Certified Financial Planner. While many brokerage or insurance firms will produce one for no charge, they are either very limited or you're required to open up an account. See your "Fee Only" Financial Advisor for more information.