

April 15, 2024

Executive Summary

What is my retirement number?

This is a question I get asked frequently. There are no easy answers. Your number is unique and different from everyone else’s.

There is a close relationship between your current spending and your retirement number.

The 4% rule—and its inverse—demonstrate this relationship.

But the 4% rule fails to account for many critical factors and is no substitute for a retirement plan prepared by an experienced professional with state-of-the-art planning tools.

If you do not have a retirement plan, time is not on your side. Decide to make a plan today, and start executing it.

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true because your current lifestyle will not change very much during retirement (unless financial problems and a lack of planning force drastic changes—which is not desirable).

I find the following to be true:

1. Your current spending levels and retirement savings are closely related. The more you spend, the more you need to save for retirement. The less you spend, the less you need to save.

Market Data as of March 31, 2024

		YTD 2024
US Equities	S&P 500 ETF	10.52%
International Equities	MSCI EAFE ETF	5.77%
Emerging Markets Equities	MSCI Emerging Mkts ETF	6.09%
US Bond Market	iShares US Core Bond ETF	-0.75%
Commodities	S&P GSCI Comm ETF	10.06%
Real Estate	iShares US Real Estate ETF	-1.23%

The Critical Relationship Between Your Current Spending and Saving for Retirement

Many people ask me how much they should save for retirement. \$1 million? \$2 million? \$3 million? \$4 million? Maybe more?

People consult the internet and read articles. A recent *Wall Street Journal* article suggested the current “magic number” is \$1.46 million.¹

Anxiety mounts as our retirement date approaches. Have we saved enough?

People want easy answers. But after preparing hundreds of retirement plans, I can confidently tell you that “your number” is unique and different from everyone else’s. Why? Because your lifestyle and the cost of maintaining it are unique to you.

When you tell me how much you are currently spending, I can start the process of telling you how much you need for retirement. This is

¹ Tergesen, Anne. “The New Magic Number for Retirement Is \$1.46 Million. Here’s What It Tells Us.” *The Wall Street Journal*, April 2, 2024.

2. The people who spend too much money now don't save enough for retirement, and the people who don't spend a lot of money now often save more than enough.
3. If you want to know how much to save for your retirement, begin with an accurate assessment of your current spending and how it will—or won't—change in retirement.
4. It is unrealistic to think you will live one way now and a radically different way in retirement. If your current lifestyle cannot be sustained in retirement, it is better to adjust now rather than later.
5. Plan to pay off your mortgage upon retirement. If that's not possible, consider downsizing your home when you do retire. While downsizing is not everyone's first choice, it is not as painful as the following.
6. Running out of money in retirement is not an option and should be avoided at all costs. Having zero savings when you are in your 80s should scare the hell out of you. It's not pretty to see that happen (which I have). Don't burden your loved ones with your lack of planning. That is not fair to them, even assuming they are willing and able to help.
7. Retirement planning is a very complex math problem that you cannot solve on your own. You need to work with a competent, objective expert who employs state-of-the-art tools and experience to craft a plan that works for your unique situation. Reading articles (including this newsletter) online is not a substitute for professional planning.
8. Time is not on your side. Procrastination and denial are not your friends. Stop counting on a miracle. You will not win the lottery or strike it rich by clever stock picking, options trading, cryptocurrency, or speculative business deals. No mysterious wealthy uncle will suddenly show up and bail you out. Saving for retirement takes consistent effort over a long period of time. Discipline is key, but a lack of discipline up to this point is not an excuse to keep procrastinating or to give up.
9. Stop worrying or catastrophizing about working until you die at your desk, living out of a shopping cart, or being a Walmart greeter. Even though that sounds crazy, I hear it all the time. Do something now. Decide to make a plan, and start executing it. You will feel better.
10. For the fortunate among us, there is a precious window of time during which to enjoy a robust and active retirement. Use planning to seize this time and take full advantage of it. Good health is a blessing, but it rarely stays that way the older we get. The window eventually closes.

The 4% Rule

So how do you determine your retirement number?

You may have heard the general rule that you can spend about 4% of your retirement savings each year and not run out of money in your lifetime. I find this rule to be a useful tool for “back of the envelope” calculations. That said, it is no substitute for a proper retirement plan. It can, however, be a conceptual starting point.

The inverse of this rule can also be useful. That rule is that you must save 25 times your average annual spending in retirement. For example, if you spend about \$10,000 per month (or \$120,000 per year), you will need retirement savings of \$3 million to support that level of spending. If you spend about \$15,000

per month (or \$180,000 per year), you will need retirement savings of \$4.5 million. If you spend about \$5,000 per month (or \$60,000 per year), you will need retirement savings of \$1.5 million.

Working the other way around, \$1 million in retirement savings will support \$40,000 per year of spending (or 4% of \$1 million). \$2 million in retirement savings will support \$80,000 per year of spending (or 4% of \$2 million), and so on.

Now you can begin to see the relationship between spending and retirement savings using the 4% rule or its inverse.

Don't Forget About Post-Retirement Income

But it is important to remember to factor in any post-retirement income you may receive. For most of us, the primary source of post-retirement income is Social Security. Let's go back to the first example. Say you check your Social Security record and see your estimated benefit upon retirement will be \$4,000 per month (or \$36,000 per year). So, \$4,000 of your \$10,000 monthly retirement plan will come from Social Security. Now you only have to fund the other \$6,000, not the whole \$10,000.

Fortunately, the amount you need to save for retirement has just come down significantly. If you need to fund \$6,000 per month (or \$72,000 per year), you will need retirement savings of \$1.8 million (or \$72,000 per year times 25). This is significantly less than the \$3 million number we first calculated.

If You Believe That Social Security Will Not Survive, You Have More Saving to Do

Social Security is vitally important for most of us. Some say that the program will not survive. If you believe that, in our first example your retirement savings goal just went up by \$1.2 million, or you need to reduce your retirement spending by \$4,000 per month. That is not an option for many people approaching retirement. That is why we must fix Social Security. For many seniors, it is their only source of income. For the rest of us, it is a critically important source of post-retirement income that we cannot outlive.

Limitations of the 4% Rule

The 4% rule assumes your long-term investment return is in the 6%–7% range. If you have your retirement savings stuffed in your mattress, you will not earn any return, and you will run out of money in retirement using the 4% rule. Conversely, if you are taking too much risk in your portfolio or it is not properly diversified, you may sustain significant losses in any down market that leave you vulnerable to running out of money by following the 4% rule. You must be invested correctly.

Some planners and economists even wonder if the 4% rule works at all. Some believe a more flexible withdrawal strategy, like withdrawing a certain amount when markets are up and somewhat less when they are down, is more prudent. I advise clients to curtail spending on big-ticket items during down market years to give their portfolio a rest.

Another important factor is long-term inflation. The 4% rule assumes long-term inflation of around 2.5%. If inflation is higher than that, the 4% rule may not work to help you keep up with the higher cost of living in retirement, which has been an issue recently.

Other Factors Must Be Considered

Other important factors that must be considered in any retirement plan include but are not limited to:

1. Taxes
2. Social Security withdrawal timing and strategy
3. Investment returns, risks, and portfolio design
4. Withdrawal strategies, Roth conversions, and required minimum distributions
5. Inflation and cost-of-living adjustments
6. Whether to include the eventual sale of your home
7. And many, many more

Professional Help Is Critically Important

Retirement planning is really a giant, complex math problem. That is why you need a competent professional, like a CFP® professional, with access to state-of-the-art software tools and real-world experience.

In my practice, I use a professional financial planning program called MoneyGuidePro, which is used by some of the largest and most prestigious financial firms in the world.

Sorry, I don't care if you are an engineer who knows how to use Excel. I've seen scores of spreadsheets, and they are always wrong, often dangerously so. Don't rely on this approach.

In any event, I guide the client through the process of gathering detailed information about their finances and putting them into the program. It generates a year-by-year cash flow projection that shows the clients their portfolio balance at the beginning of the year, their post-retirement income (e.g., Social Security), their portfolio return (given their custom asset allocation and historical or projected investment returns), their federal and state taxes and required minimum distributions, their inflation-adjusted retirement spending, and then, finally, their end-of-year balance.

Staying on a plan is easy. During our semiannual meetings, we compare the balance of their nest egg with the cash flow projection in the plan. Monthly automatic transfers help keep clients on track. If adjustments are necessary, we make them.

“What if” scenarios are also easy to show the clients if they have additional ideas, like retiring early or abroad, purchasing a second home, paying for their grandchildren's education, handling assisted living someday, or knowing how the current market downturn may impact their long-term plans.

Most importantly, they have confidence because they can see years into the future, and for some, they're confident about the legacy they are leaving for their children or charity. They sleep better at night.

I have attached an addendum of two hypothetical case studies that show two couples working through the retirement planning process.

If you have questions about your savings program, your portfolio, or your long-term financial plan, please give me a call.

Thank you.

D. Austin Lewis

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Hypothetical Case Study Addendum

John and Karen

John, 62, is a partner with a busy practice at a large downtown law firm. He makes about \$600,000 per year, and sometimes earns more from annual profit-sharing bonuses. Karen, 60, is a volunteer docent at the local art museum. They have two children currently attending private college. One is a graduating senior, and the other is a sophomore. They are spending \$160,000 per year on college right now. Fortunately, one child is graduating this spring, and the other will graduate in two or three years. John and Karen used savings from two 529 accounts they previously funded, but the accounts were exhausted last year. They are now funding education expenses from current earnings and retirement savings.

They have saved about \$2 million (including John's profit-sharing plan) for retirement. John saves about \$50,000 a year in his 401(k), and the firm contributes another \$50,000 a year to his profit-sharing plan.

Their home is worth about \$3.5 million, and they recently borrowed money to complete an extensive renovation with a new kitchen. Their outstanding mortgage balance is about \$1 million, and their current mortgage payment is \$6,000 per month. They have about \$20,000 in credit card debt.

They are not sure how much they are currently spending, but they are concerned it is too much. After some rough calculations, they believe they are spending, on average, about \$20,000 per month (excluding education expenses).

They are both in good health. They are active members of the local country club, where John plays golf and Karen plays tennis and attends yoga classes.

John and Karen have discussed retiring in three years, when John turns 65, but they are unsure about exactly how that would work. Karen is very concerned about their losing John's paycheck and is nervous about spending their savings. Upon retirement, Karen wants to travel more. John dreams of taking up fly fishing.

In retirement, John and Karen's single-largest expense will be their \$6,000 monthly mortgage payment, which they will have for the foreseeable future. After their youngest graduates from college in two or three years, their education expenses will end, although Karen wants to pay for graduate school if either child desires to go. John would not make any more monthly contributions to his 401(k) plan. Otherwise, they would trade their monthly health insurance premium through work for a Medicare premium with some sort of supplemental plan. Those costs look to be about the same. Karen thinks that their spending level will be about the same in retirement, except that they want to spend more on travel than they do now.

John and Karen are hoping for a \$20,000-per-month retirement spending plan. Annually, that is \$240,000 per year (or \$20,000 times 12). Now let's subtract any sources of income in retirement. John went online to look at his Social Security record and estimates his benefit at age 65 will be about \$4,000 per month (\$48,000 per year). At age 65, Karen will qualify for half his benefit, or \$2,000 per month (\$24,000 per year). Now, if John and Karen want to spend \$20,000 per month in retirement, \$6,000 of that will come from Social Security, leaving a difference of \$14,000 per month they will have to fund themselves. Take \$14,000 per month times 12, and that is \$168,000 per year.

To fund \$168,000 per year in retirement, they will need retirement savings of \$4.2 million (applying our rule of thumb by multiplying \$168,000 per year times 25).

John and Karen need to save \$4.2 million by age 65 (only three years from now) to meet their retirement goals, but they have saved only \$2 million. There is no realistic chance for them to meet this goal.

John and Karen's retirement dreams will have to be modified. Of course, John could try to work into his 70s, but his law firm has already forced out other partners when they reached that age. He has a stressful job. What if his health—or Karen's—deteriorates?

One idea would be to downsize their home. If they sold their home, they could take the \$2.5 million in home equity and purchase a smaller home, which would allow them to ditch their monthly \$6,000 mortgage payment. If they did this, they would only need to personally fund \$8,000 per month (or \$96,000 per year) to have \$14,000 per month to live on during retirement. This would reduce the amount they need to retire from \$4.2 million to \$2.4 million (\$96,000 times 25). They would need to save only \$400,000 more on top of the \$2 million they have already saved.

Also, John believes that they should take a long look at their spending and see if there are easy opportunities to save some money. He believes they could easily get by on \$1,000 to \$2,000 less a month if they were simply more attentive and intentional. If he is right, they could probably retire now.

That said, Karen is unhappy to think about leaving the home they just recently renovated. She particularly likes their new, spacious kitchen. John says they can enjoy their current home for a few more years and then downsize. John says they could purchase a new home with an equivalent kitchen, but they would have to move farther away from the city, their current friends, and the country club, or they could live with less space. There are upscale townhomes near their current neighborhood that sell in the \$2.5 million range, and a few of their friends have recently taken this route.

Obviously, they have some time to figure out what is most important to them. But on their current trajectory, they will quickly run out of money during their retirement. Something will have to give. They are committed to making it work. Karen has started to look at Zillow to see what's out there, and she called one of her friends to ask about her townhouse. John appreciates her flexibility.

John and Karen are beginning the process of making the necessary adjustments to create an enjoyable retirement together.

Darrel and Stacy

Darrel, 62, is an engineer at a large firm in town. His salary is \$175,000 per year, with the occasional bonus. Stacy, 60, works as a teacher in the local public school district. She makes about \$40,000 per year. They have two children, both of whom have graduated from college.

They have saved about \$1 million for retirement. Darrel saves about \$24,000 per year in his 401(k). Stacy saves about \$12,000 per year in her 457 plan. They have also been diligent in saving Darrel's annual bonuses and have stashed away some money outside their retirement plans.

Their home is worth about \$1.5 million. Their outstanding mortgage balance is only about \$60,000, and their monthly payment is \$3,000. They are on track to pay off their mortgage upon retirement. They have no other debt.

Stacy pays the bills every month and knows they need about \$11,000 per month to live, which includes a \$2,000-per-month allowance for travel, home maintenance, and other items.

Darrel and Stacy want to retire in three years, when Darrel turns 65. In retirement, Darrel wants to buy an RV and travel to the national parks. Stacy tolerates RV camping but would really like some grandchildren someday. Both Darrel and Stacy are in good health.

They will pay off their mortgage very soon, so they will drop their \$3,000-per-month mortgage payment. They no longer have any education bills to pay. Upon retirement, they will no longer contribute to their retirement accounts. They expect to save a little money with Medicare. Darrel wants to budget \$60,000 for an RV.

Overall, they want to budget \$8,000 per month for retirement. Annually, that is \$96,000 per year (or \$8,000 times 12).

Now let's subtract any sources of income in retirement. Darrel went online to look at his Social Security record and estimates that at age 65, he'll receive about \$3,000 per month (or \$36,000 per year). Stacy has a pension benefit with the school district that will provide a monthly benefit of \$2,000 per month at age 65 (or \$24,000 per year). Now, if Darrel and Stacy want to spend \$8,000 per month in retirement, \$5,000 of that will come from Social Security and Stacy's pension. That means they will have to fund the difference, or \$3,000 per month. Take \$3,000 per month times 12, and that is \$36,000 per year.

To fund \$36,000 per year, they will need retirement savings of \$900,000 (applying our rule of thumb by multiplying \$36,000 per year times 25). Darrel wants \$60,000 for a retirement RV, which would increase this number up to \$960,000.

Although Darrel and Stacy will need to save \$960,000 by age 65, they have already saved \$1 million. They could probably retire today if they really wanted to.

Darrel and Stacy's retirement dreams are on track. Work is quickly becoming optional. Their retirement plan works. No adjustments are necessary.