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How to Have a Successful Retirement

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Abstract
What is retirement? Retirement is the years that an individual is able to enjoy after spending a majority of their life devoted to their career. A successful retirement is not a birthright; it is something that an individual must earn through hard work and proper planning. This paper identifies ten important commandments that are both necessary and helpful in achieving a successful retirement.

Keywords
Retirement, Retirement Planning, Retirment Savings

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What is retirement? Retirement is the years that an individual is able to enjoy after spending a majority of their life devoted to their career. A successful retirement is not a birthright; it is something that an individual must earn through hard work and proper planning. This paper identifies ten important commandments that are both necessary and helpful in achieving a successful retirement.

I. Do Not Invest Too Little, Too Late, Too Conservatively

Investing for Retirement

For good reasons, the financial element of retirement is by far the most talked about and planned for piece of the retirement equation. Retirees need an income stream to sustain a comfortable lifestyle. Income from work prior to retirement needs to be replaced. Social Security benefits should provide a source of income, along with any pension plans or annuities that individual might have. However, these income streams will most likely not be enough to provide the necessary income needed during retirement. A retiree will need to supplement these income streams with withdrawals from their investments.

This leads us to the first commandment: Thou Shalt Not Invest Too Little, Too Late, and Too Conservatively. By investing too little, a retiree will not have sufficient funds. By investing too late, a retiree forfeits the advantages of time value of money and compounding interest. By investing too conservatively, a retiree limits the potential growth of their investments, while also subjecting them to inflationary risk.

Investing "Too Little"

As previously stated, it is common for retirees to depend on their investments to provide a substantial portion of their income during retirement. It is important to the success of their retirement that they avoid investing "too little." The best way to avoid this is by automatically contributing 10-15% of every paycheck towards retirement investment funds. A 401(k) or 403(b) plan can be designed to take automatic payments right out of an individual's paycheck. Automatic payments have several advantages, the primary advantage being that the individual does not touch the money before it is automatically contributed. Without physically having the money in their bank accounts, they are unable to spend the funds on other things. By contributing 10-15% of every paycheck, most individuals will be on the right track to build their investments to meet their retirement goals.

Investing "Too Late"

Time is also another important factor when investing for retirement. Arguably the most important financial principle is the time value of money, and the power of compounding interest. It is imperative that an individual understand these principles at an early age, so that they are able to make the better financial decisions throughout their lifetime. The more time an individual has until retirement, the longer they can put their money to work.

The best way to truly explain the benefits provided by time value of money and compounding interest is through an example. David Chilton shares a powerful example of compounding interest in his book *The Wealthy Barber*. In his example he uses a pair of twins, both age twenty-two and saving for retirement. The one twin starts immediately, investing two thousand dollars for six years and then stops. The other invests the same two thousand dollars, but he starts after seven years and continues to invest this amount until he turns sixty-five. Both investments achieve a twelve percent rate of return. Surprisingly, at age sixty-five they both have accumulated about $1,200,000. It is important to start investing for retirement at an early age. You work hard for your money, so it makes sense to give your money the time to work hard for you.

Investing "Too Conservatively"

Risk allocation is another important factor when investing for retirement. An investor needs to select an appropriate asset allocation to achieve their investment goals and objectives. A younger investor has the opportunity to take on higher levels of risk, because they have a longer period of time for their investments to recover from economic downturns. Different investors may choose to take on different asset allocations and risk levels, to achieve their investment goals. Most retirement investors depend on their investments to grow over time to cover lost income from work. In order to achieve this goal, it is necessary to take on an appropriate level of risk.

An investor that is "too conservative" fails to provide their investments the opportunity to grow at larger rates of return. They also subject their investments to the risks of inflation. Conservative investments may grow at or below the inflation rate. When this happens, the purchasing power of the money invested does not increase. Most retirement investors need their investments to grow at a rate higher than inflation to provide income during retirement.

II. Have a Plan

Retirement is a major stage in an individual's life. It provides individuals the opportunity to enjoy life free from the burden of hard work. This is supposed to be a relatively stress free period in one's life. Through proper planning, it should be something that a person can look forward to in their future. Unfortunately, many Americans are not confident about their future retirement.

A major factor in this lack of confidence can be attributed to the absence of a retirement plan. The core of a retirement plan is built around the goals and objectives that an individual would like to achieve for their retirement. Once the goals and objectives are determined, a retirement plan maps out the course that needs to be taken to accomplish these goals and objectives. By sticking to a retirement plan, and making appropriate adjustments along the way, an individual should be able to successfully achieve their goals. At the very least, a retirement plan provides some form of structure and commitment to achieving a comfortable and enjoyable retirement.

A major component to almost any retirement plan is the ownership of an IRA, defined contribution plan, or a defined benefit plan. According to the Employee Benefit Research Institute's 2016 Retirement Confidence Survey, respondents or their spouses, who owned an IRA, defined contribution, or defined benefit plan were far more confident about their retirement than respondents without a retirement plan. 74% of those with a retirement plan were either very confident or somewhat confident about their retirement, while only 39% of those without a retirement plan were either very confident or somewhat confident about their retirement. The lack of a retirement plan made a significant difference in the respondent's level of confidence.

Having an IRA, defined contribution, or defined benefit plan is the basis of almost any retirement plan. An overall retirement plan includes: long-term care insurance, health insurance, life insurance, and Social Security benefits. There are many different elements that need to be accounted for and planned for during the retirement process. Without proper planning, retirement becomes a grey area. It looms off in the future. A person may know what they want out of retirement, but they have no plan to get there. This will most likely result in an unsuccessful retirement.

There are many advisors and financial planners that can help a person develop a retirement plan. There is also plenty of information available to help get started on creating a plan. Any company that offers a qualified retirement program most likely has a person to talk to or other information available. With all of the resources available, there is no reason to stay in the grey when it comes to retirement. Create goals and objectives for retirement and implement a plan to achieve those goals and have a successful retirement.

III. Take Advantage of Tax Incentives Provided Through Retirement Savings Plans

Investing for retirement is not only important for an individual, but it is also necessary for the growth of the economy as a whole. When individuals invest for retirement, their investments are being used to grow and finance a wide range of private and public entities. This benefits the economy in multiple ways. Not only is an individual investing, but they are increasing their wealth and ability to sustain their life throughout retirement without the assistance of welfare programs. The money acquired from these investments is then pumped back into the economy as the retiree covers their expenses throughout retirement. The government and the Internal Revenue Service recognizes the benefits of individuals investing for retirement. To encourage this behavior, they have created a variety of programs that provide tax incentives to encourage individuals to invest in their own retirements. To have a successful retirement, it is important to take advantage of these tax incentives as much as possible.

It is impossible to talk about retirement without mentioning a 401k or 403b retirement savings plan. For a majority of American workers, these plans provide the best platform to invest for retirement. A 401k plan is a retirement savings plan that is sponsored by an employer. A 403b plan is similar to a 401k plan; the primary difference is that a 403b plan is designed for nonprofit companies, religious groups, school districts, and governmental organizations. Both plans allow an individual to contribute a portion of their income, up to a certain limit, into an investment program without having to pay income taxes on these contributions. The money then grows tax deferred.

These programs provide the employees with multiple investment options to choose from, based on their risk tolerance and other factors. This allows the employee freedom when managing their investments. The plans are also designed to allow employees to set a withdrawal rate and automatically have money deducted from their paychecks. If an employee does not adjust their withdrawal rate significantly over time, they will benefit from dollar-cost averaging. Dollar-cost averaging is when a consistent rate of investment is sustained regardless of market fluctuations. During market downturns more shares are purchased, and during market upswings fewer shares are purchased. This reduces the risk of market timing.

There are other retirement saving programs that provide similar tax incentives. Keogh plans are designed for self-employed individuals. IRAs are individual retirement accounts that provide different tax incentives, depending on the type of plan.

It is important that an individual researches the different retirement savings plans and selects the best plan or a combination of plans to maximize their tax savings. Contributions to plans that are income tax deductible can provide an individual with significant tax savings depending on their tax bracket. Tax deferred growth is common among varying retirement savings plans. Tax deferred growth maximizes the power of compounding interest. This allows investments to grow tax free, until the funds are withdrawn from the account. To have a successful retirement, it is important to take advantage of plans that provide the best tax incentives.

IV. Be Aware of Retirement Challenges and Issues

There are few things in life that are planned out as far in advance as an individual's retirement. There are many future challenges that a retiree may face forty years from now that do not exist today. Retirement in the 21st century has changed significantly from retirement in the 20th century. It is imperative that an individual stays aware of situations and trends as they evolve by adjusting their plan accordingly.

A primary example of one of these issues is the future of Social Security. At its current rate, the Social Security system is not sustainable. The Baby Boomer generation will put a significant strain on the system, as the ratio of contributing workers to benefitting retirees is decreasing. It is difficult to predict how or when the system will be adjusted. There is no reason to panic or expect the Social Security program to fail. However, it is reasonable to expect a change that may reduce future benefit payments or increase the retirement age. Depending on a retiree's age, these changes may have an effect during their retirement. It is important to realize that this may happen and plan accordingly. Most retirees that prepared well for retirement should be able to still live comfortably even with a reduction in their Social Security benefits.

Another changing trend is the expected longevity of retirees. As healthcare improvements are made and environmental and technological changes reduce our exposure to pollution and toxins, life expectancies continue to rise. As people live longer, they need their money in retirement to last longer. This may require an individual to retire at a later age, or possibly work a part-time job during retirement. Other adjustments can also be made to better prepare for a longer retirement.

The responsibility of investing for retirement is also shifting from employers to employees. There has been a significant shift from defined benefit plans to defined contribution plans. Defined benefit plans are becoming too costly; they are creating large liabilities for companies to maintain. As the Baby Boomer generation approaches retirement, companies are realizing that the pension plans they promised are going to be a burden for the company to pay out, especially since the Great Recession significantly reduced many defined benefit plans' investments. The companies are still required to pay out the promised benefits regardless of how much the investments suffered during the economic downturn. As a result, many companies are freezing their defined benefit programs and/or switching to offering defined contribution programs.

Defined contribution programs shift the responsibility of the investments' success onto the employees. The employees are responsible for contributing to the plan and deciding how the funds are invested. This makes individuals more responsible for the success of their retirement investments and requires more participation in the process.

In addition, many retirees are adding a post-retirement job as an additional source of income. This was not previously common amongst retirees. There are several factors that are causing this trend. Some retirees need to work to make up for losses that the downturn in the economy caused to their retirement investments. Some work to stay active and social. Whatever the reason, it is important to understand this trend and how it may affect an individual's decisions as they approach and enter into retirement.

Another issue many retirees face as they approach their retirement is their ability to work as long as they would like to. According to the Employee Benefit Research Institute's 2016 Retirement Confidence Survey, 69% of respondents in 2016 expected to retire at or beyond the age of sixty-five. In actuality, only 31% of individuals in 2016 retired beyond the age of sixty-five. This illustrates that the general population overestimates their ability to work beyond the age of sixty-five. This has obvious implications for their retirement. If an individual expects to be able to work to a certain age, and they are unable to, their retirement outlook will most likely be worse than they expected. An individual that plans for this uncertainty can position themselves in a better situation for their retirement.

There are many challenges and changing trends that retirees will face. It is not possible to accurately predict exactly what will happen, but it is still possible to plan and prepare for different scenarios. A successful retirement depends on a plan that accounts for both expected and unexpected changes that may occur through time.

V. Be Prepared to Make the Right Decisions during the "Retirement Red Zone"

When it comes to retirement planning, it is truly not over until it is over. A life-time of good financial decisions could be completely reversed if a few poor decisions are made at the wrong time. There is no time period more important to the financial success of a retirement than the five years leading up to and the five years after an individual's retirement date. During this time period there are several decisions that need to be made that will have a major impact on the financial success or failure of a plan.

The primary decision is asset allocation. After years of savings and investment growth, asset allocation becomes crucial to achieving the goals and objectives of a retirement plan. As a retirement investor approaches their retirement age, they may shift their asset allocation to a more defensive position. In the years prior to the "retirement red zone," an investor should have focused their asset allocation towards growth-oriented equities. While entering the "retirement red zone," an investor should shift their allocation towards more income-oriented investments. This will protect their investments in the event of an economic downturn during this period. The investor should also consider allocating more towards cash. When they retire they will need the cash to cover their expenses, but the cash also serves as a safety net in the event of an economic downturn.

If the markets experience a downturn in the five years leading up to the retirement date and the investor did not adjust to a more conservative asset allocation, they could experience some significant losses. At the same time, it is important not to adjust the allocation too conservatively. The investor will need this money to last the entirety of their retirement. Therefore the investor still needs to be able to achieve some growth to combat inflationary risk. As inflation increases, the purchasing power of an investment's value decreases. It is important to pick an asset allocation that is sustainable and will grow enough to offset inflation, while also providing growth to help offset some of the money removed through withdrawals each year.

In the years leading up to retirement it may be beneficial to create a retirement budget and "test drive" the budget. If an individual is able to live comfortably on the budget, then they should be well prepared for retirement. If they find that the budget does not support their desired lifestyle, they may choose to adjust accordingly. This may result in picking up a part-time job in retirement or working a few extra years before retiring.

In some situations, it actually makes more sense to work a couple of extra years. This is especially true during a bear market. By working a few extra years, an individual not only receives more income, but they also allow their funds time to recover. The extra years of pay could also help add higher paying years to Social Security and any pension plan the retiree might have. However, for some this will not be possible, as they may be unable to work for a variety of reasons. For others, they may want to retire regardless.

Deciding when to take Social Security benefits also comes into play during the "retirement red zone." There are benefits to taking early retirement payments, and there are also benefits to waiting. It depends on an individual's situation. If they expect to live a long time, they may choose to wait and take the higher payments.

During the years immediately following retirement, it is important to select an appropriate withdrawal rate, and to tap into different retirement accounts at the right time. A withdrawal rate that is too high may eat up too much too soon. By tapping into investments in the wrong order, an individual may be forfeiting the optimal tax-based decision.

VI. Set Sustainable Withdrawal Rates

Selecting withdrawal rates during retirement is equally important to investing beforehand. Now that an individual has acquired savings and investments over time, they need to make this money last. Selecting withdrawal rates creates a friction of interests. On the one hand, a retiree wants their portfolio to be sustainable, and on the other hand they would like to enjoy retirement to its fullest. Decisions made when choosing withdrawal rates are more critical than decisions made during the accumulation phase, because there is no element of time to correct any mistakes.

Over the years there have been many different opinions on the appropriate withdrawal rate. Most experts recommend a withdrawal rate within the range of 3-7% of the beginning portfolio balance. In an article titled "Determining Withdrawal Rates Using Historical Data," the author William P. Bengen, established a 4% withdrawal rate as a standard in the industry. According to Bengen, "assuming a minimum requirement of 30 years of portfolio longevity, a first-year withdrawal of 4 percent, followed by inflation-adjusted withdrawals in subsequent years, should be safe" (1994). The 4% rule will most likely sustain a portfolio for a person with a longer lifespan.

There are other experts that dispute this withdrawal rate for a variety of reasons. If a person is not expecting to live for thirty years, then they do not need to be as conservative in their withdrawal rates as someone expecting to live a long time. Other retirees want to maximize their "golden years" of retirement. They may choose higher withdrawal rates in earlier years, allowing themselves to enjoy a better lifestyle during their more active and energetic years of retirement. There is no precise formula when determining appropriate withdrawal rates. A successful retirement depends on an appropriate rate being selected to match the goals and objectives of a retiree.

VII. Keep a Cash Reserve

Cash can play a major role in the financial success of a retirement. It can be used as a tool to combat downswings in the market. Having an appropriate amount of cash while entering into retirement years, and also during retirement years, can change the financial outlook of a retiree. However, the benefits of holding cash come at a cost. Cash does not earn investment income, and it is subject to loss of purchasing power due to rises in inflation.

In the years before retirement it is beneficial to keep three to twelve months of expenses in an emergency fund. If anything unexpected occurs along the way, the emergency fund provides a necessary safety net. Most retirement accounts have heavy penalties and tax implications for early withdrawals. It is imperative that an individual avoids withdrawing from their retirement accounts before the maturity dates. The taxes and penalties are costly, and it defeats the purpose of setting the money aside in the first place.

As an individual enters into the retirement phase, it may be wise to set aside more than one year's expenses to account for any economic downturns. Some experts even advise up to seven years of expenses stashed away in cash, to survive the worst economic downturns. During a bear market or an economic downturn, a retiree's investments will lose some of their value. A retiree wants to avoid selling off shares of their investments during these times.

A successful retirement depends on the ability of a retiree to fare through economic downturns. From the years 1900 to 2008 the US economy experienced 32 bear markets. This is a rate of approximately one bear market for every three years. By maintaining cash reserves a retiree significantly increases their financial flexibility and the longevity of their investments.

VIII. Stay Healthy and Active

A successful retirement is not solely focused on financial implications. After all the purpose of preparing financially for retirement is to allow a retiree the freedom to live an enjoyable lifestyle without worrying about work or finances. Maintaining a healthy lifestyle into and during retirement has a positive impact on several retirement factors. Even without any retirement savings, a healthy individual puts themselves in a position where they can continue to work to bring in income.

For many retirees, health care costs may be a major expense during retirement. A healthy retiree will most likely have fewer health issues and therefore incur less in health care costs. By exercising and eating healthy, a retiree expands their expected longevity, while most likely reducing their health care expenses. With all of the extra free time a retiree has, they should have no problem finding time to exercise and eat healthy.

A healthy retiree also has the option to pick up a part-time job, or work later into their career. A part-time job will provide a retiree with additional income and keep them active. Working a few extra years before retirement also provides the retiree with more income, more time to invest, a chance to ride out bear markets, additional years of high salary added to Social Security benefit calculations, and a higher salary rate for pension plans to be calculated at. Of course the healthy individual could still choose to retire regardless, but it is nice to have these options available.

There are many advantages to living a healthy and active lifestyle, especially during the retirement years when a person's health starts to deteriorate. An active and healthy retiree has the opportunity to make the most of their retirement, allowing them to truly have a successful retirement.

IX. Prepare Psychologically

Entering into and adjusting to life after retirement can be a difficult transition. The benefits of a career on a person's emotional and mental wellbeing are often an overlooked aspect of the retirement process. An individual's career most likely provided their life with structure, pride, success, a purpose, self-worth, and many other psychological benefits. Without mental and social preparation, a retiree may be significantly impacted by these changes in their lives.

Maslow's hierarchy of needs is a well-known psychological theory describing the stages of growth in humans. The base layer of the hierarchy of needs includes the physiological needs: food, water, shelter, etc. The top two layers are self-actualization and self-esteem. An individual grows throughout their career to fulfill these two layers. Upon retirement an individual may lose some of their sense of self-actualization and self-esteem as they transition from the person they were, to the person they now are as a retiree.

There are many ways that a retiree could still fulfill these needs throughout retirement. They could volunteer for an organization, participate in social activities, or join a wide range of clubs and organizations.

Without addressing these needs in retirement, a retiree may not be able to fully enjoy their remaining years. A successful retirement depends on the psychological wellbeing of the retiree.

X. Live a Well Balanced and Social Life

Retirement brings about significant changes in an individual's life. The many hours once spent at work are now free of responsibilities. To enjoy a successful retirement, a retiree needs to find productive ways to fill their newfound free time. Some retirees may find this challenging, as their career fulfilled a majority of their time and they do not have hobbies or social circles to fall back upon. To avoid this situation, it is important to begin planning for the social changes long before retirement.

The best way to do this is to live a well-balanced life well before retirement. One can achieve this by maintaining social relationships and activities/hobbies outside of work. If an individual's social life consists mainly of the relationships they have with their co-workers, they may have a tough transition into retirement. Many retirees find that they lose connections with a lot of people they had planned on staying in touch with. This includes previous co-workers. Without consistent interactions at work, they may find that sometimes these relationships do not work as well outside of the work setting. To prepare for the social changes, a retiree may want to build a close social circle of people they can maintain relationships with into retirement. It may be wise to find other individuals that are also approaching retirement age and will be facing similar life changes.

Hobbies and other activities may provide a good platform for socialization. Before retirement, an individual should test out some different hobbies that they can continue into retirement. These activities will help a retiree fill their time, stay active, and stay social. Some retirees find that hobbies they have previously enjoyed are not as satisfying when they have more time to commit to them in retirement. An individual may love to golf, but they may not enjoy golfing more than once or twice a week. That is why it is important to test out different hobbies and interest before and during retirement.

Without social stimulation, retirement can be mundane and boring. A successful retirement includes socialization and activities that can fulfill a retiree's free time and keep them active and happy.

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