Retirement blues for baby boomers

Coping with a bleak landscape

Postponing retirement beyond age 70 is not appealing to most people. But it's a realistic possibility for many in the so-called baby boom generation, according to a recent article by Robert D. Arnott and Anne Casscells. A review of their article was recently published by *Morningstar*©, the Chicago firm that evaluates mutual funds, stocks and other financial instruments. The following is adapted from Morningstar's review.

Arnott and Casscells explore how to deal with the coming crisis of too many people retiring at once without the work force in place to support them. Titled, "Demographics and Capital Market Returns," their article appeared in the March/April 2003 issue of *Financial Analysts Journal*. It qualifies as a "must-read" for anyone planning to retire in the next 10 to 20 years.

Facing demographic facts

Arnott and Casscells argue that demographics will play an important role in how we plan our retirements and how we approach our investments. According to one model in the article, the normal retirement age will swing upward from 66 today to 68 in 2010 and then level out at 72 in 2030.

One of the primary problems we're facing is that the proportion of people over age 65 will increase from 12% of the population today to 20% of the population by 2030. In part that's because so many people were born between 1946 and 1958 (the so-called "baby boom") and in part because fewer people were born between 1965 and 1990.

Another important demographic fact is that we're living longer. In 1940, men dominated the work force, and many people did not live past age 65. Today, the average person lives to just under age 77. With medical advances, future retirees may be able to plan on even more years in retirement.

The combination of fewer workers contributing to Social Security and more retirees collecting Social Security for a longer period of time will no doubt stress the current system. Since 1950, Social Security tax rates have more than doubled. The prospect of Social Security taxes doubling yet again creates an intergenerational nightmare. But according to Arnott and Casscells, even if the government did raise Social Security taxes, it wouldn't be enough to solve the problem.

A whole new wrinkle

In addition to the strain an aging population will place on the Social Security system, retirees will have to contend with another major issue: Just when the boomers need to begin structuring their portfolios for less risk and more income, there won't be enough buyers for the securities they will be trying to sell. Demographics probably played a larger role than we originally thought in driving up the stock market in the 1980's and 1990's; unfortunately, we may see the negative effects of that same cycle going forward.

Aggravating the fact that we might not get as much of a premium for our stocks in the future, is the unfortunate reality that with so many retirees bidding up the cost of health care, leisure and other services, those goods and services will increase in price. Retirement for baby boomers will cost more.

As financial planners have been calculating retirement projections for people in their 50's and 60's, estimates for retirement expenses have changed dramatically. In years past, those expenses were thought to be 10% to 15% less than during working years – because retirees would no longer incur the many costs associated with working.

In recent years, however, many financial planners have begun assuming that expenses during retirement would stay roughly the same as during working years, due to the rapid rise in health-care costs. Now it appears that retirement-expense projections need to be moved even higher, to account for the glut of workers trying to retire at the same time – and inadvertently increasing the demand for (and price of) retirement-related goods and services.

Possible "solutions"

Given the changing retirement landscape, let's talk about some potential "solutions" to these problems.

You can always consider retiring outside the United States, where there is a younger work force and the costs of living may not be as high. But it's not clear how many people would be comfortable in doing that. And according to Arnott and Casscells, 120,000 retirees would need to leave the U.S. every month for the next 30 years for this solution to work.

Retiring later is another possibility – a not so palatable solution for many people. It may be that most pre-retirees have their sights set on retiring as early as age 62 (when Social Security is available); and if that isn't possible, then by age 65 to 66. But if Arnott and Casscells are right, the baby boom generation may need to start adjusting to the fact that retirement may be more of a reality at age 72.

Practical considerations

More modest adjustments can be made to brace for a changing retirement landscape. Here are a few considerations to keep in mind in planning for your retirement:

1. How will your retirement plans be affected if there aren't enough younger workers to support the current eligibility ages for Social Security? For example, say you've been planning to start drawing Social Security at age 62, but you find out later that it won't be available until age 67. Would you postpone retirement, reallocate your cash flows, or save more? Putting a "Plan B" in place is a good idea.

2. If you're already retired, you may want to factor in a greater rate of growth for your expenses from the year 2010 and beyond. That may mean spending less now to be able to afford the increasing prices in the future.

3. If you are 5 to 15 years away from retirement, you should probably run an updated projection that increases your expenses in retirement and possibly delays the age you will be eligible for Social Security. If you are eligible for a pension, you may also want to consider taking it at a later age and working a little longer.

4. Give some thought to how you would change your portfolio in case stocks have lower valuations in the future. Go through a scenario where you change how you're investing today to allow for a less-hospitable market for stocks in the years ahead. Making more conservative assumptions about stock returns and valuations may mean that you have to save more now in order to reach your goals.

5. If retiring abroad appeals to you, visit those areas you are considering. Learn more about their tax policies and demographic profiles.

6. If you think you may have to work longer than you originally expected – and that's the case with many people who lost money in the stock market over the years 2000, 2001 and 2002 – give some thought to "phasing into" retirement, particularly if you work in a career you love.

7. Investigate working remotely. Living near urban centers, as many people do, tends to cost more than living in rural locations. Explore the possibility of working from a location of your choosing that may offer a lower cost of living while allowing you to continue a job you like. It may take some time to accomplish this, so it pays to lay the groundwork for such a plan early on.