

Second Phase of Retirement

Phase 2

Approximately six years before retirement, do a reality check as to the amount of money you are likely to need in retirement. First, gather information from your human resources, Social Security and Thrift Savings Plan on the benefits you are entitled to, plus any additional sources of retirement income. Initially, target your retirement income needs at 85 to 90 percent of your current spending level (it is better to be over-prepared). Many retirees find that their spending actually increases in the period immediately following retirement – they have time to do all the things they have been putting off. There are some individuals who, in retirement, can live the lifestyle they want on perhaps 50 to 65 percent of their pre-retirement spending, but that usually requires making major lifestyle changes – selling a primary residence, moving to a lower cost environment, etc.

Once you know what you can expect from your retirement plan, Social Security and Thrift Savings Plan, subtract that figure from the 85 to 90 percent of your current spending level. The difference is the shortfall that you will have to decide how to cover. Work a year or two longer? Convert certain non-liquid assets into liquid assets? Purchase an immediate annuity? Manage your investments better? There is an excellent calculator to estimate the savings you will need to retire and how much you need to save each year to reach that goal at the American Savings Education Council website, www.ASEC.ORG.

One thing that many can do is become actively involved with understanding their investments and particularly how to manage their nest egg.

Understanding Your Investment Goals

Where should you put your money so that it would be there when you need it and have earned a good rate of return. This answer depends on (1) how much time you have to meet your goal, (2) your income (current and realistically projected future), (3) your ability to tolerate risk and (4) what are you planning to use the money for.

There is no perfect investment.

It is best to learn the characteristics of various types of investments and of your goals, and see which matches best.

Purpose of Investment

What are you saving/investing for?

Retirement, college education for children, emergency fund, etc. How you intend to use the money will determine what characteristics you should look for in your investments.

Time Horizon

How long before you need the money? This helps to determine the volatility you can accept in the investment and the rate of return you need to seek. If you have a short time horizon, you need to assure that the value of your money will be there when you need it. On the other hand, if you have a long time horizon you want to assure that inflation has not eroded the value of your money.

Necessary Rate of Return

Once you have done your Net worth (You Are Here), set your goals (where you are trying to get to) and your cash flow (the vehicle) you have an idea of what rate of return you must get in order to meet your goal. Be realistic. If an investment offers an extraordinary rate of return it will likely also carry an unusually high risk.

Your Personal Risk Level

Once you have invested your money, “Can you sleep at night?” If you worry about the return of your money and are ready to move your money at the first sign of a downturn you probably have a low risk tolerance. But remember, every investment has some risk - If you put money in a super safe investment a “risk free” insured account you will have the risk that inflation will erode the purchasing power of your money.

There are four separate types of risk:

1. **Financial risk:** Financial risk arises because the issuers of the investment may experience financial difficulties and not be able to live up to their promises or expectations.
2. **Market Risk:** Market risk arises out of price fluctuations for a whole securities market, for an individual group or for an individual security, regardless of the financial ability of the particular issuers to pay the promised or expected investment returns.
3. **Interest Rate (Money Rate) Risk:** Interest risk is complex and involves the price changes of existing investments because of the changes in the general level of interest rates in the capital markets.
4. **Purchasing Power Risk:** Purchasing power risk involves the uncertainty over the future purchasing power of the income and principal from an investment. The purchasing power of income and principal depends upon changes in the general price level (inflation) in the economy.