

The Five Biggest Threats to a Secure Retirement

THE HIGH COST OF LOW INTEREST RATES



Low Interest Rates: A Double-Edged Sword

Brought to you by
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Low Interest Rates: A Double-Edged Sword

Picture this... for 40 years, David and Sarah have diligently saved for their retirement with the goal of enjoying their golden years together. They dreamed of spending their retirement in the sand, surf and sun, vacationing with grandkids, and volunteering with their favorite charities. In 2007, they invested their retirement savings in a 5-year Certificate of Deposit. They bought the CD for the low-risk growth and interest it provided, which they planned to use to supplement their living expenses.

Flash forward to 2012: Interest rates are at their lowest point in history. While David and Sarah started out strong and on track with their retirement plans, a big problem has now arisen. In 2007 when they purchased the CD the rate of return was 5.25 percent. In 2012, the rate of return is now a meager 1.5 percent! Their money not only didn't grow as much as they had planned over the past five years but, they now aren't getting enough of a return to meet their income needs either– not even close. How should David and Sarah proceed?

“There will be exceptionally low levels for the federal funds rate at least through late 2014.”

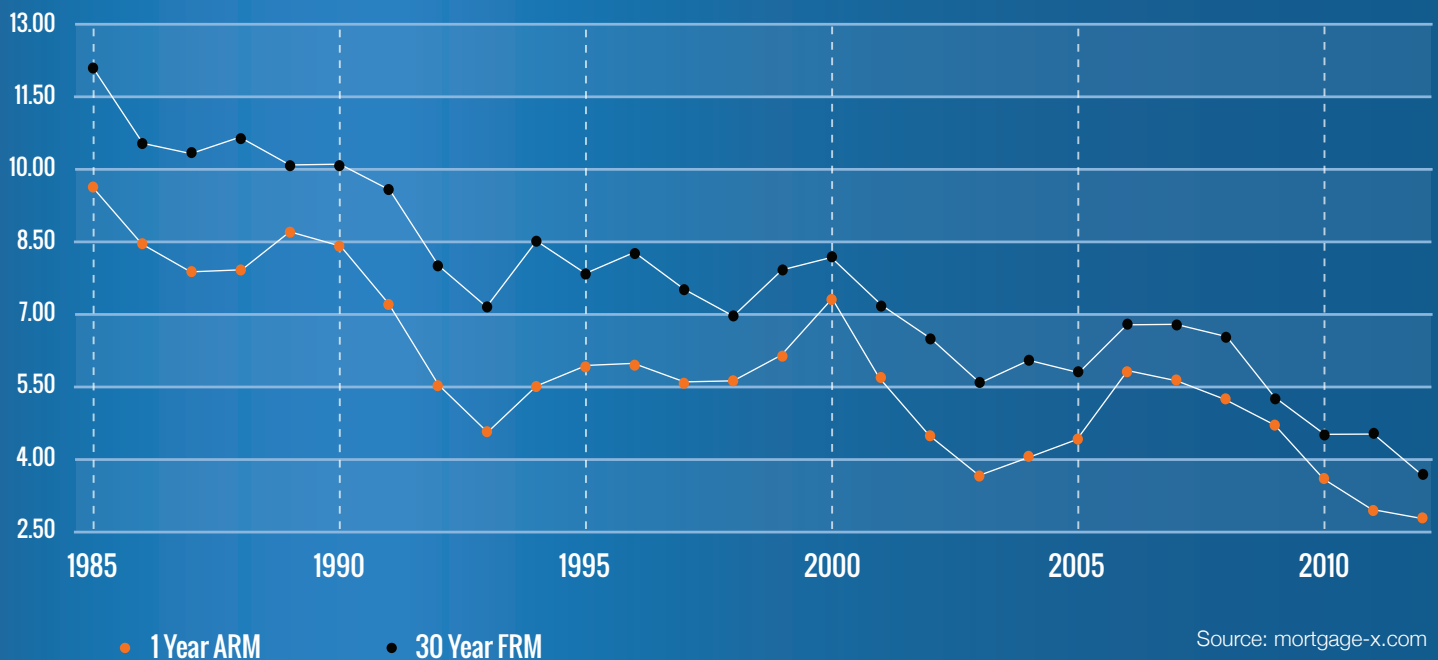
Federal Reserve Bank of the U.S.



A Sharp Reality

David and Sarah are not alone. For today's pre-retirees and retirees alike, low interest rates represent a double-edged sword that sharply impacts finances and retirement planning decisions.

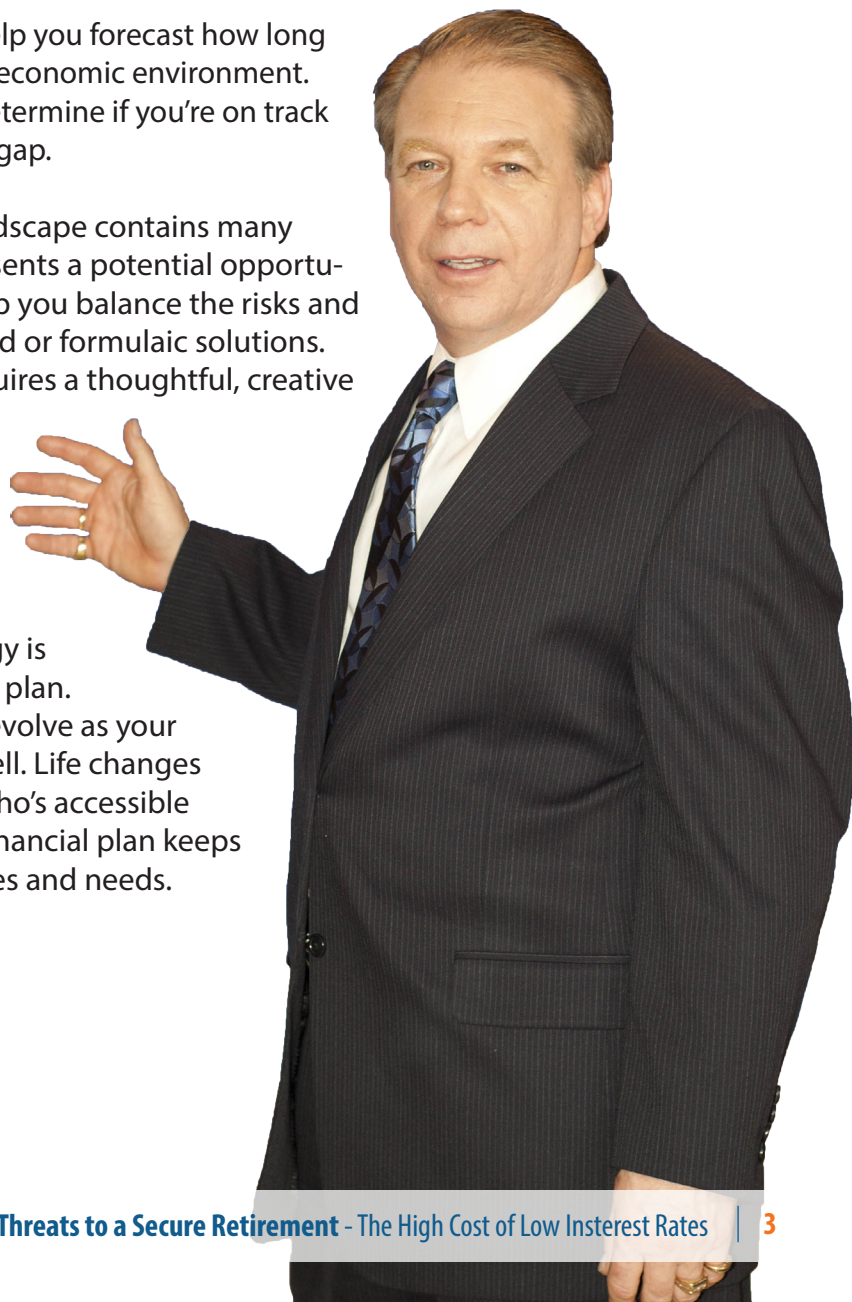
On one edge, money is cheap. Consumers can purchase homes, vehicles and other items for less than they could have in the past few decades. The chart below shows the decline in mortgage rates since 1985. Specifically, it shows the 1-year adjustable rate and 30-year fixed rate mortgages. These numbers are great news for those looking to buy or sell a home.



However, in spite of the good news, disaster lurks on the other edge of the sword. Low interest rates mean the money earned on “safe” investments (CDs, fixed annuities, and bonds) is also low – very low. This means retirees and those nearing retirement, who are in or transitioning into the preservation phase of their investment lives, are suffering great financial strain. It’s a new kind of challenge. How can one preserve assets and earn enough return to achieve their financial goals?

A Six-Step Success Strategy

1. If you find yourself in this situation keep your head and don't be tempted by short term potential gains. If you're in the preservation stage of your investment life, it's not a good idea to take too much additional risk.
2. Don't assume that your investments (or life insurance policies) will grow according to initial projections. Get the facts. Make a list of each of your accounts and their current rates of return. Open online accounts so you can easily monitor your money.
3. Get clear about your financial goals and timelines. It's hard to create an accurate roadmap until you know exactly where you're going. Answer these questions:
 - a. How much do you have accumulated in retirement savings?
 - b. How much income do you need to harvest from these assets?
 - c. At what rate will this mean you are spending your assets down, and are you earning enough to replace that money each year? Or are you spending down principal?
4. Ask a financial professional to help you forecast how long your money will last in the current economic environment. Can you accomplish your goals? Determine if you're on track or if you will need to fill an income gap.
5. Recognize that the financial landscape contains many variables, and each variable represents a potential opportunity. Find a financial expert to help you balance the risks and rewards. Beware of generic, canned or formulaic solutions. The solution to this challenge requires a thoughtful, creative and customized approach.
6. Meet with your financial advisor once every six months to review your financial progress and adjust your plans as needed. A real retirement strategy is not a "set it and forget it" type of plan. It must constantly change and evolve as your life is constantly changing as well. Life changes fast and you need an advisor who's accessible and who will make sure your financial plan keeps pace with your goals, objectives and needs.



Again, let's look at the numbers. The table below compares CD rates from 2002 to 2011. As you can see, growth is sluggish. The sharp edge of the low interest rate sword slashes the amount of retirement income generated.

Certificates of Deposit Index

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Jan	3.363%	1.688%	1.132%	1.693%	3.674%	5.217%	5.145%	2.730%	0.488%	0.319%
Feb	3.077%	1.643%	1.113%	1.836%	3.837%	5.266%	4.958%	2.572%	0.407%	0.327%
Mar	2.828%	1.586%	1.098%	1.996%	3.996%	5.301%	4.748%	2.428%	0.337%	0.331%
Apr	2.607%	1.533%	1.085%	2.163%	4.158%	5.324%	4.543%	2.265%	0.288%	0.325%
May	2.423%	1.483%	1.083%	2.332%	4.318%	5.338%	4.323%	2.091%	0.278%	0.305%
Jun	2.263%	1.419%	1.118%	2.492%	4.483%	5.336%	4.108%	1.893%	0.288%	0.280%
Jul	2.107%	1.358%	1.162%	2.658%	4.640%	5.324%	3.898%	1.690%	0.293%	0.266%
Aug	1.961%	1.303%	1.212%	2.833%	4.774%	5.333%	3.673%	1.483%	0.295%	0.263%
Sep	1.868%	1.247%	1.277%	3.000%	4.897%	5.343%	3.517%	1.204%	0.298%	0.268%
Oct	1.820%	1.194%	1.355%	3.174%	4.997%	5.323%	3.453%	0.864%	0.300%	0.276%
Nov	1.767%	1.171%	1.451%	3.345%	5.081%	5.293%	3.236%	0.685%	0.305%	0.288%
Dec	1.726%	1.151%	1.563%	3.512%	5.153%	5.268%	2.965%	0.556%	0.312%	0.304%

Source: Derivation of Rates Reported by Federal Reserve Board

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Decisions, Decisions ...

Retirees need to keep investments safe, outpace inflation and generate enough income to cover living expenses and achieve their financial goals. This can be challenging in a low interest rate environment. When CDs and other fixed investments are yielding such low returns, it can be tempting to move money into investments that carry greater risk with the allure of potentially higher returns. However, this can be a dangerous move that places retirees in precarious situations.

How long will this low interest rate environment last? The Federal Reserve Bank of the United States said in January, "There will be exceptionally low levels for the federal funds rate at least through late 2014."

With this information in mind, how should David and Sarah proceed? Unfortunately, there is no clear answer. Ideally, they should leave their money alone and give it a chance to continue to grow. However they are already retired, no longer have earned incomes and need the money. Sarah and David must review their complete financial picture, and all of their investments with their advisor to uncover a creative way to meet their living expenses. Unfortunately this may mean either cutting back on the vacations with grandkids, or worse yet, picking up some part-time work to cover the shortage.



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