

AMERICA'S RETIREMENT CRISIS

FACING THREATS TO RETIREMENT PROSPERITY

America is facing a serious retirement crisis: Many Americans are not confident that they will be able to enjoy a comfortable retirement, and many retirees face longevity risk, or the danger of outliving their life savings. The 2008-2009 economic downturn drastically changed the financial landscape and caused profound shifts in the way that many Americans view their retirement. Despite being the largest, wealthiest, and most influential generation of Americans, baby boomers are facing one of the most serious retirement challenges in history. A combination of declining income, increased longevity, and high costs means that an increasing number of Americans may face the possibility of outliving their assets.

One economic study estimates that approximately 46 percent of Americans die with less than \$10,000 in assets, many of them lacking even home equity and relying largely on Social Security benefits to meet their expenses.¹ Most shockingly, many of the households surveyed in the study entered retirement in good financial health; factors such as unexpected health expenses, market losses, and increased lifestyle expenses combined to erode their financial security.

The purpose of this report is to explore a critical issue facing American retirees today and highlight some strategies that may help you avoid outliving your assets.

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UNDERSTANDING THE PROBLEM

THE EFFECTS OF THE FINANCIAL CRISIS

The economic downturn drastically changed the financial circumstances of many. According to a study presented at the 2013 Financial Security Summit, **Americans aged 75 and older lost one-third of their financial assets and one-sixth of their total net worth during the period of 2007-2010.**² While household balance sheets have somewhat recovered in the years since, retirees and pre-retirees have much less time to make up lost ground. Evidence in the study also suggested that older retirees are struggling to make ends meet.

Although most Americans have been able to sharply pay down credit card debt since 2007, credit card debt among elderly retirees has actually risen. From 2007 to 2010, an AARP study found that the percentage of Americans 75 and older with credit card debt rose from 18.8 percent to 21.7 percent, while the rate fell in every other age group.³ This means that more than one-fifth of elderly Americans may be relying on credit cards to cover everyday expenses. Living so close to the financial edge can have devastating consequences; seniors who find themselves in this position may not be able to withstand financial shocks such as expensive medical treatments not covered by Medicare or Medicaid, or other unexpected events such as the need to replace a car or a household appliance.

UNDERESTIMATING RETIREMENT LIVING EXPENSES

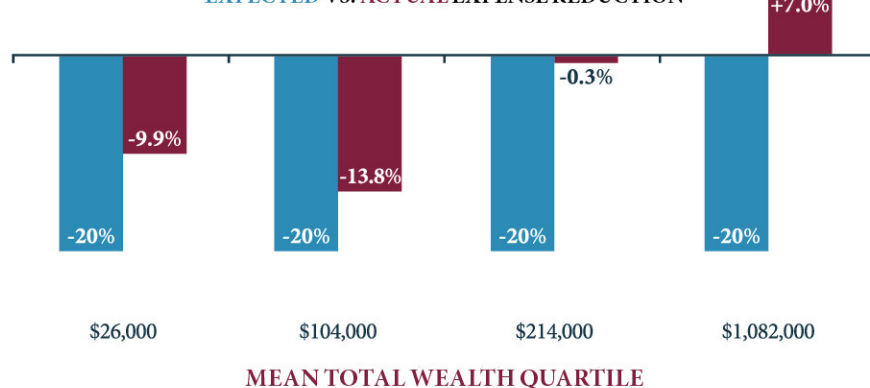
An accurate estimate of your post-retirement living expenses is critical to credibly projecting how large your



nest egg needs to be to ensure a comfortable retirement. Unfortunately, accurately estimating these expenses can be challenging, and retirees who depend too much on optimistic estimates of their future expenses may find themselves facing a shortfall. Many retirement expense calculators confidently predict that retirees will spend as much as 20 percent less in retirement than they do currently. However, changes in spending do not always happen the way people expect.

A 2008 study found that, on average, most retirees did not significantly reduce their expenses after retirement. Retirees having a median total net worth of \$104,000 were able to reduce their expenses by the greatest amount, 13.8 percent; however, those in the wealthiest quartile (having a median net worth of approx. \$1 million) actually increased their post-retirement spending by 7 percent.⁴ While it's possible to reduce retirement expenses by adapting your lifestyle to your circumstances, it's always best when those changes come by choice, not by lack of options.

EXPECTED VS. ACTUAL EXPENSE REDUCTION



Source: Michael Hurd and Susann Rohwedder. "The Retirement Consumption Puzzle." Rand labor and population working paper, April 2008. Survey of 385 retirees, ages 50 to 70. Mean total wealth, including housing.

Healthcare costs are one of the major contributors to increased living expenses after retirement. The rapid increase in medical costs over recent years have caused considerable angst to retirees since, as people age, their healthcare expenses tend to rise. More than one-half (54 percent) of respondents to a 2012 Health Confidence survey reported that access to health insurance was extremely important to making a decision to retire and 53 percent of respondents planned to work longer than they would like to continue receiving health insurance through work.⁵

*Source: "Cumulative increases in health insurance premiums, workers' contributions to premiums, inflation, and workers' earnings, 1999-2012." Kaiser Family and Health Research and Educational Trust (HRET), March 2013.

American retirees have good reason to worry about rising healthcare costs during retirement. According to data collected by the Kaiser Family Foundation in the chart below, inflation increased by approximately 3 percent each year during the period of 1999 to 2012, eroding purchasing power by 39 percent, cumulatively. During the same period, wages increased by nearly 50 percent. However, healthcare insurance premiums increased by a staggering 172 percent, far outstripping wage increases over time, meaning that retirees lacking in healthcare coverage may struggle to cover the rising costs of their medical care.⁶

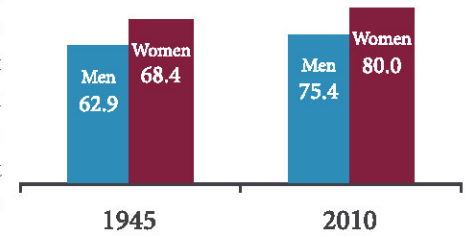
LIVING LONGER IN RETIREMENT

Life expectancies for both men and women have steadily increased over time. In 1945, American men lived an average of 62.9 years, while American women lived an average of 68.4 years. By 2010, average life expectancies had increased to 75.4 and 80.0 years, respectively.⁷

Since Americans are living considerably longer than before, most can expect to spend longer in retirement. Actuarial studies suggest that a 65-year-old American woman has a 50 percent probability of living until age 86, meaning that, if she retires at age 65, she will likely spend 21 years in retirement. A 65-year-old American man has about a 50 percent probability of living to age 82, meaning he will spend approximately 17 years in retirement.

According to the Social Security Administration, one out of every four 65-year-olds will live past the age of 90 and one out of 10 will live past the age of 95.⁸ Many retirement plans were not designed with the possibility of living more than two decades in retirement in mind, and may not last the investor's lifetime.

AVERAGE LIFE EXPECTANCY IS INCREASING*

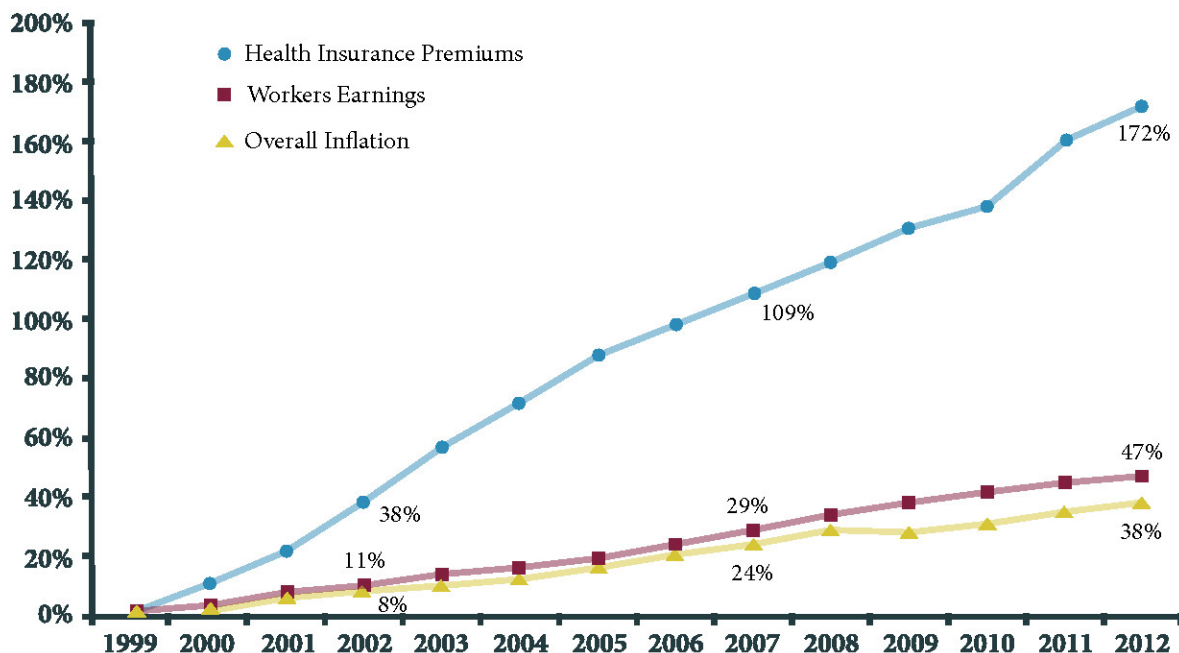


Longer lifespans may also increase the effect that healthcare costs may have on living expenses, and many retirees face the issue of paying for assisted living facilities or retirement communities when independent living is no longer possible.

STRATEGIES TO MITIGATE LONGEVITY RISK

There's no doubt that Americans are facing a retirement crisis; now that we've covered some of the factors that are contributing to this nationwide issue, let's discuss some strategies that can help protect your retirement lifestyle and may help ensure that your assets last as long as you need them to.

HEALTHCARE EXPENSES INCREASE FASTER THAN INFLATION & EARNINGS



*Source: Life Tables For the U.S. Security Administration 1900-2010 - Actuarial Study No. 120

A painting of a family of four in a wooden frame. The father is in a suit holding a basketball, the mother is in a striped shirt, and two children are on either side. Their heads are replaced by portraits of Benjamin Franklin, George Washington, and Thomas Jefferson. The background is a warm, textured orange-brown.

CLARIFY YOUR RETIREMENT NEEDS:

1. *Do you know how much income you will need each month during retirement?*
2. *What sources of guaranteed income do you already have?*
3. *How much do you already have saved for retirement?*
4. *How long could you afford to live in retirement if your investments grow 4 percent annually? 5 percent? 6 percent?*
5. *Have you discussed your concerns with a financial professional?*

CONSIDER DELAYING RETIREMENT OR STARTING A SECOND CAREER

An increasing number of Americans are postponing retirement. Many choose to extend their working lives for a number of reasons, including allowing their investments to recover value, increasing their retirement savings, taking advantage of health insurance coverage, or waiting for a spouse to retire. Some simply aren't ready to give up a fulfilling career. A 2011 Allianz survey found that an increasing number of Americans were shifting their expected retirement age as compared with a year earlier.⁹

Some Americans who are ready to retire from their primary profession choose to take on part time work or begin a second career. While financial considerations can make part time work look attractive, many retirees enjoy the camaraderie or want to stay active and productive while still having plenty of time for family, hobbies, or travel.

According to a recent survey by the MetLife Foundation, as many as 8.4 million Americans between the ages of 44 and 70 have already launched "encore careers," or jobs that combine income with passion or social impact. Among those surveyed that were not already working a second career, nearly half are interested in finding meaningful work. On the whole, those in encore careers find their work fulfilling and worth doing. More than 80 percent of respondents say that they get either a "tremendous amount" or "quite a bit" of satisfaction from their careers.¹⁰

An increasing body of research suggests that Americans are reinventing retirement and viewing it more as a phase of rejuvenation and recreation than as a period of complete rest.

DELAY TAKING SOCIAL SECURITY BENEFITS

One of the most important decisions facing a retiring worker is when to start taking Social Security benefits. While the dependable income can relieve the anxiety of losing a steady paycheck, there are some valuable arguments in favor of delaying benefits. Normal Retirement Age (also known as full retirement age or NRA) is when you're eligible to receive your full Social Security benefits. It used to be 65 for everyone, but current laws mean that for those born after 1938, normal retirement age is some point between 65 and 67.

While the right age to start taking benefits depends on a retiree's individual circumstances, in general, delaying benefits is usually a better choice for most people for the following reasons:

- **Delaying Social Security means you get increased benefits each year, reducing your risk of running out of money later in life.** If you start taking benefits after your NRA at age 70, you will typically get a credit. For example, if you were born in 1944 your NRA is 66. However, if you decide to take your benefits at age 68, waiting the extra two years you could get a credit of 8 percent per year. That would mean your monthly



benefit check will be 16 percent higher than what you would have received at age 66. This will give you more stable income even if you spend through other retirement savings. Although it is important to keep in mind there is no guarantee that social security income will be available in the future. This is just a basic example, and it's important to work with a professional who understands your personal financial circumstances before making decisions about when to take Social Security.

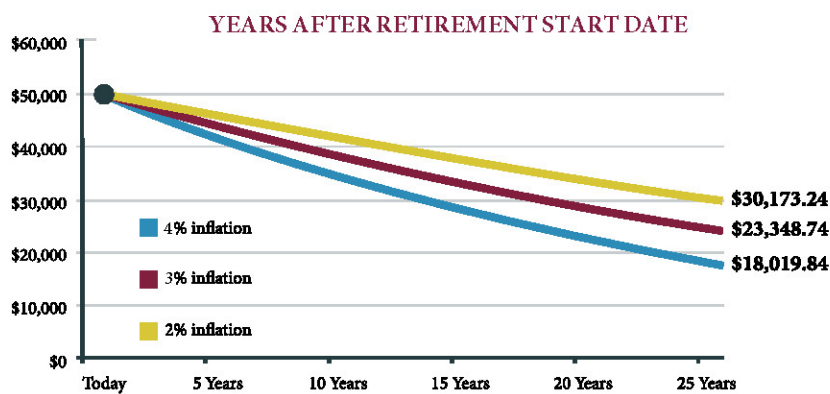
- **Each future cost of living adjustment (COLA) may be bigger.** Social Security benefits increase each year to keep up with inflation. Your COLA typically could increase by a percentage of the current payout each year, meaning that delaying your benefits may give each adjustment a higher dollar value.

Social Security benefit strategies can get complex. Before making any decisions, be sure to consult with a tax planner or other financial professional who can help you make the right decision for your needs. Please feel free to contact us if you would like assistance with determining what is best for your situation.

FIGHT THE EFFECTS OF INFLATION

Inflation is insidious and can eat away at the purchasing power of your money over time. Retirees are disproportionately affected by the effects of rising prices because they are paying higher prices for food, housing, and other expenses while often living on a fixed income. Medical bills are also typically higher in retirement due to increased health needs and higher insurance premiums. Even relatively low inflation can significantly impact a retiree's purchasing power over time.

The hypothetical example below shows that \$50,000 would be worth just over \$30,000 in 25 years, even assuming



This is a hypothetical example calculated using assumed rates of inflation of 2%, 3%, and 4% to illustrate the effects of inflation on purchasing power over time. The U.S. long-term average annual inflation rate is 3.22% according to the U.S. Bureau of Labor Statistics. Actual inflation may be more or less and will vary. This example does not include the effects of taxes, fees, or potential portfolio growth and should only be used for illustrative purposes.

a very low inflation rate of 2 percent. Historically, the average annual inflation rate in the U.S. has been 3.22 percent, though it jumped as high as 18 percent in 1918 and fell into negative digits during several periods in the last century.¹¹

Having a portfolio that's positioned to help fight inflation is critical. Traditionally, as workers have neared retirement age, they have gradually reduced their exposure to risk and favored more conservative investments that prioritize income and wealth preservation over growth. However, a too-conservative investment strategy can be as dangerous as a too-aggressive one since it exposes your portfolio to the corrosive effects of inflation and may limit your retirement assets' ability to grow over time, thus increasing the risk that you'll outlive your assets. A well-diversified portfolio that includes an appropriate mix of stocks, bonds, and other investment types according to your personal needs and goals may help you seek the growth you need in a way that lets you sleep better at night.¹² Diversification helps you spread risk throughout your portfolio, so investments that do poorly may be balanced by others that do relatively better. However, please note that diversification cannot ensure a profit or protect against a loss.

Before making any investment decisions, it's important to understand how factors such as your own personal financial circumstances, risk tolerance, and time horizon affect your choices. A financial professional can work with you to develop an investing strategy that's right for your needs, goals, and financial situation.

PLAN FOR RISING HEALTHCARE COSTS

Longer life spans, rising medical costs, declining medical coverage, and funding shortfalls for Medicare and Medicaid mean retirees face a serious challenge in managing their healthcare costs in retirement. According to a Fidelity report, a 65-year-old couple retiring in 2013 will need an estimated \$220,000 in savings just to cover healthcare costs during their retirement. Some estimates put healthcare inflation at 6 percent a year, and if future trends continue, healthcare will be retirees' second-largest expense after housing.¹³

In order to understand and plan for your healthcare expenses in retirement, consider the following strategies:

- **Earmark a portion of your retirement savings specifically for healthcare expenses.** Take advantage of tax-favored vehicles such as Health Savings Accounts.
- **Understand your health insurance options after retirement.** While most retiring workers will lose their employer-sponsored coverage, some firms still offer retirement health care coverage.
- **Understand how Medicare fits into your health coverage.**
- **Be a smart healthcare shopper.** When visiting a healthcare provider, be prepared with information about existing conditions and any symptoms you are experiencing; ask questions about a diagnosis and prescribed medications to be sure you understand all alternatives and outcomes; know what you're paying for so that you fully understand your out-of-pocket costs for any treatment plans.



CONCLUSIONS & NEXT STEPS

The average 65 year old can expect to live 20 years or more in retirement, so it is critical to prepare so you can maintain a comfortable retirement lifestyle. Living a long life has its considerable benefits, but it can create uncertainty and stress around how much money retirees will need to live comfortably for the rest of their lives. Out of fear of financial ruin, many retirees unnecessarily adopt frugal lifestyles that cause them to miss out on the best parts of retirement. Others miscalculate the true cost of retirement and overspend, depleting their savings too soon.

Many retirees have been taught the rule of thumb that retirement assets can be made to last 30 years if investors withdraw 4 to 4.5 percent of the original value each year. Unfortunately, this old adage was developed in the 1990s, and that withdrawal rate may not work when inflation-adjusted interest rates are close to zero for long periods of time. So, if you can't safely withdraw at least 4 percent a year from your portfolio, what can you do? There are a number of alternative approaches that a retirement specialist can explore with you that may help ensure that your money lasts as long as you do.

The issues we've presented in this report are complex, and it's critical to make the right decisions before and during retirement. While every investor's circumstances are different and there are no guarantees of success, we aim to help our clients take some of the uncertainty out of retirement planning and work with them to develop a suitable financial strategy for their unique retirement circumstances.

Footnotes, disclosures, and sources:

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¹ "Reclaiming the Future. Allianz Survey. 2010-2011. Accessed August 7, 2013. https://www.allianzlife.com/about/news_and_events/news_releases.aspx?articleID=56

² Allianz Life Insurance Company of America (Allianz) conducted a nationwide survey of 3,257 American adults, aged 44-75. The online survey was conducted in May 2010. A 2011 smaller-scale survey revisited key survey questions to determine how respondents surveyed in 2010 feel about key retirement issues one year later

³ "A crisis for the very old: They're outliving their assets." Accessed August 11, 2013. <http://www.jsonline.com/news/opinion/a-crisis-for-the-very-old-theyre-outliving-their-assets-b9957225z1-216189001.html>

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⁴ "A crisis for the very old: They're outliving their assets." Accessed August 11, 2013. <http://www.jsonline.com/news/opinion/a-crisis-for-the-very-old-theyre-outliving-their-assets-b9957225z1-216189001.html>

⁵ "The Retirement Re-Set Study. SunAmerica/Harris Interactive Poll 2011-2012. Accessed August 10, 2013. https://www.sunamerica.com/TridionData.do?Page_ID=355474

⁶ "The Retirement Consumption Puzzle." Rand Labor and Population working paper, April 2008. Accessed August 12, 2013. http://www.nber.org/papers/w13929.pdf?new_window=1

⁷ "Views on Health Coverage and Retirement: Findings from the 2012 Health Confidence Survey." Employee Benefit Research Institute. Accessed August 11, 2013. http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5157

⁸ "Cumulative Increases in Health Insurance Premiums, Workers' Contributions to Premiums, Inflation, and Workers' Earnings, 1999-2011." Kaiser Family and Health Research and Educational Trust (HRET), September 2011. Accessed August 11, 2013. <http://kff.org/health-costs/slide/cumulative-increases-in-health-insurance-premiums-workers-contributions-to-premiums-inflation-and-workers-earnings-1999-2012/>

⁹ "Reclaiming the Future Study: One Year Later." Allianz Life Insurance Company of North America. 2011

¹⁰ Life Tables for the U.S. Social Security Administration 1900-2010 - Actuarial Study no. 120. Accessed August 13, 2013. http://www.socialsecurity.gov/oact/NOTES/pdf_studies/study120.pdf

¹¹ Social Security Administration Life Expectancy Calculator. Accessed August 12, 2013. <http://www.ssa.gov/planners/lifeexpectancy.htm>

¹² "Encore Career Survey." MetLife Foundation/Civic Ventures. Accessed August 12, 2013. https://www.metlife.com/assets/cao/foundation/Encore_Survey.pdf

¹³ Historical Inflation Rates. Accessed August 13, 2013. <http://www.usinflationcalculator.com/inflation/historical-inflation-rates/>



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