Understanding the Key Risks in Retirement

*Planning for these risks can improve the odds of a successful retirement*

Rather than thinking of retirement as the end of something, retirement should be viewed as simply beginning the next phase of life. It’s a phase reached through a lifetime of hard work, dedication and achievement to one’s career, family and employer, and themselves. And like the earlier phases of life, retirement carries with it a number of risks. While the risks themselves may be similar to what you have faced leading up to retirement – investment risk, inflation, health care, etc. – their impact may be much greater, and the opportunity to adjust to them much smaller.

The way we prepare for retirement has changed substantially in recent history. Nearly gone, for example, are the days of relying solely on employer-provided pension plans and Social Security to fund retirement. Now more than ever, there is a greater reliance on personal savings and investments to supply the income needed in retirement. As a result, the combination of unpredictable investment markets and longer life expectancies (among other risks) has led many to question whether they have enough money to live comfortably in retirement. Below are some of the risks you are likely to encounter which may significantly impact your retirement goals.

**Investment Risk**

Long-term trends have shown that stock investments will provide the best opportunity for investment return, followed by bonds and then cash. During retirement, one approach to reducing overall portfolio risk may be to reduce or eliminate stock exposure. However, a poor asset allocation strategy can have a devastating effect on your retirement income strategy. Being too conservative may cause you to prematurely run out of money, while being too aggressive increases your exposure to market volatility.

A sub-risk to this is something known as the sequence of returns risk – the idea that poor market performance in the early years of retirement can significantly impact the long-term sustainability of those assets. Proper retirement planning will include a good asset allocation foundation, along with an understanding of how to respond to different market conditions.

**Inflation Risk**

Inflation is sneaky. You may not realize it’s happening over the short term, but over the long term, it can decimate a retirement strategy by eroding the value of assets set aside to meet every-day expenses. Inflation has historically averaged about 3% annually, which may not seem like much, but that can have a dramatic impact on the purchasing power of your income over the course of your retirement. Just consider the changes in the cost of goods such as gas, milk or bread over the past 25 years for further evidence of inflationary impacts. The increasing cost of goods and services has to be accounted for when...
building a retirement income plan, either by investing in a way that provides an increasing level of income, or by adjusting your retirement goals over time.

**Longevity Risk**

It is no secret that people are living longer in retirement today than at any point in history. Advances in medicine and technology have had an impact on aging within our society. However, nobody wants the success of their retirement plan to be contingent on an early death. Many people underestimate how long they will live, increasing the likelihood of outliving their assets. Married couples have unique issues to consider – how will things change when either spouse outlives the other? How will income needs and income sources change for the surviving spouse? Lifetime income strategies, insured solutions and a sound asset allocation approach are ways to protect against this risk.

**Health Care Risk**

Inflation on health care costs coupled with living longer in retirement can spell disaster if not properly managed. Compounding this issue further is the rate of inflation on items such as prescription drugs and preventive care, which have historically exceeded the 3% general rate of inflation mentioned earlier. According to a 2015 Fidelity Investments study, a 65-year-old couple would need $245,000 to pay for medical expenses throughout retirement, not including long-term care expenses. Genworth Financial’s 2016 Cost of Care survey revealed annual long-term care costs ranging from $43,000 for assisted living facilities and home health care, all the way up to $82,000 or more for nursing home care. These are significant expenditures which show no sign of decreasing. Traditional solutions such as Medicare and Medicaid are helpful, but they aren’t always enough to meet an individual’s needs. This is where strategies such as private insurance coverage and appropriate savings strategies come into play.

**Other Risks**

Beyond these four risks, there are other key factors that you must be prepared for in retirement. These include things such as legislative or tax code changes, a change in family status (divorce or remarriage) or unexpected demands on your resources (supporting family members, such as children, grandchildren, parents or others).

**Summary**

A sound retirement income plan may not have solutions for all of these potential issues and risks, but understanding what might stand in your way and taking action to mitigate their effects will be critical to the long-term sustainability of your plan. Your Baird Financial Advisor will help you identify what risk factors might play a more important role in your retirement and will build a plan with you and your family’s long-term success top of mind.