Generation R: A Retirement Nation at Risk

How You Can Escape the Coming Retirement Crisis

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Contents

Acknowledgements ix

Introduction xi

Section I

1 Setting the Stage 3

2 A Tale of Three Retirements 20

Section II

3 The Five Key Risks You'll Face in Retirement 29

4 Risk #1: Outliving Your Assets 31

5 Risk #2: Inflation 35

6 Risk #3: Low Returns and Poor Withdrawal Planning. 41

7 Risk #4: The Tax Man Cometh … Again and Again 47

8 Risk #5: Healthcare Costs. 51

9 Taking Responsibility 55

Section III

10 Transforming Yourself into a Great Investor 61

11 Great Investors Don't Follow the Herd 67

12 Great Investors Know Themselves 78

13 Mastering your own risk ignorance 85

14 Great Investors Define Their Long-Term Objectives and Invest Accordingly. 97

15 Great Investors Ignore Short-Term Noise 105

400 North Ponce de Leon Boulevard
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Phone: (904) 824-4349
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16 Great Investors Understand and Embrace the 5 Immutable Laws of Investing 111

Section IV

17 Developing a RICHER™ Retirement Strategy 129

18 R: Reserve Strategy 131

19 I: Insured Income Strategy 135

20 C: Capital Growth and Income Strategy 145

21 H: Healthcare Strategy 149

22 E: Estate and Legacy Planning Strategy 153

23 R: Review and Revise Annually 158

24 The Smartest Investment You Can Make 161

Financial Advisor Interview Questionnaire 167

Epilogue 169

End Notes 171

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Introduction

As I write this, hundreds of people in this nation are waking up and exclaiming, "I'm retiring today!" Tomorrow, hundreds more will do the same. And so on. These exclamations will have a profound effect on individual's lives and on our country as a whole, and it is my belief that most of these people aren't prepared for what awaits them. When it comes to retirement, we are about to experience a confluence of events of historic proportions.

Somewhere along the way, we became a nation of perceived entitlement. We developed a belief that our employers, the government, and society owed us a comfortable living in retirement. Perhaps this belief evolved from our parents' and grandparents' experience, when things were less complicated. Times have changed.

If you are of the mind that a long, comfortable, worry-free retirement is a birthright, you should return this book immediately and get your money back. And best of luck to you. This book is about taking personal responsibility for your future. The government is not responsible for your personal happiness and financial security in retirement. Neither is your employer. Nor your relatives. It's all on you. After reading this book, the choices you make and the actions you take—or don't take—will be magnified over the rest of your life and the lives of your family. If that sounds harsh to you, good. It means you're paying attention.

Nadine Gordimer, the Nobel laureate, once said, "A good scare is worth more to a man than good advice." I didn't set out to pen a book which would cause sleepless nights, but as I researched this retirement revolution further, it became apparent to me that perhaps the only way to save an entire generation from themselves was to present the facts as they are and hope those facts will positively influence readers to think hard about their futures. I believe most people are rational. I also believe that, presented with irrefutable facts, most people have the ability to change their behavior in their own personal self interest.

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I am reminded of an old parable. A traveler is walking through the countryside when he comes upon an old country store. A farmer sits by the pot-bellied stove smoking his pipe. At his feet lies an old hound dog, moaning and groaning. The traveler asks, "Why is that dog moaning?" The farmer glances down at the dog and says, "Cause he's layin' on a nail." The traveler asks, "Why doesn't he just get up and move?" The farmer considers the question for a moment, removes the pipe from his mouth, and says, "I guess it don't hurt bad enough."

If after reading the first section of this book you find out the nail hurts badly enough, you will find all the information you need to take personal responsibility for getting up and moving somewhere more comfortable. The end game for us all, of course, is a long, healthy, rewarding, enriching, and fulfilling life. The strategies, solutions, and tools in this book can help you get there if you choose to use them. Assuming you do take action and improve your circumstances using the strategies herein, there are only two possible outcomes. First, let's assume my research proves correct and things do indeed become difficult for many Americans in the future. You'll have prepared well by immunizing yourself against those challenges and can live out your days in comfort. If I am wrong and none of my predictions come to pass, you'll have more money and can curse me from the deck of your luxurious beach house as you enjoy the sun setting over the horizon. Either way, you win.

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What gets us into trouble is not what we don't know.
It's what we know for sure ain't so.

—Mark Twain

1

Setting the Stage

I want you to imagine that you work at a lunch counter. This is a special lunch counter, in that everyone who shows up must be served a lunch. You cannot refuse service to anyone. On a typical day at lunchtime, there are a few dozen people milling about outside waiting for you to open the doors. Suppose you show up for work one day, and there are 12,000 people in line waiting for their lunch. You scramble to feed them all. The next day, those same 12,000 people arrive, but another 12,000 arrive with them. The third day, all 24,000 show up again, and another 12,000 are behind them. Imagine this pattern continues *every day for 18 straight years.* Welcome to the retirement revolution.

In the eighteen years between 1946 and 1964, roughly 79 million Americans were born. This is what we refer to as the Baby Boom generation, or, as I like to refer to them, Generation R. That means, on average, about 12,000 people were born each day for those eighteen consecutive years. How will you feed them all?

A few years ago, Sebastian Junger wrote a book titled, "The Perfect Storm". In it, he provided a detailed explanation of how a series of independent meteorological events came together to create the storm of the century—a storm so fierce, its power and devastation were beyond anything experienced

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before it. Each of these weather events, on its own, didn't pose a particular threat. But, when these elements combined, the resulting storm was virtually unsurvivable by anyone in its path.

In order to frame an understanding of what awaits you in retirement, you need to understand a series of factual events that are occurring. Taken alone, these independent events may be mildly worrisome, and I doubt you're losing any sleep over them. But, it's the way these events will *interact* with each other that will dramatically impact the future, much like Junger's perfect storm. Some of these facts aren't pretty, but stay with me, because facts generally yield conclusions. The conclusions you draw from this combination of factual events could very well determine how well you fare when it comes to your retirement years.

The events we'll explore that will affect each and every retiree are:

- The Boomers Big Bang
- The Longevity Revolution
- The Healthcare Conundrum
- Social (In)Security
- The Pension Ice Age
- The Saving and Investment Vacuum
- The Financially Illiterate Masses
- The Rear View Mirror Approach to Retirement

Remember, it's the convergence of these events that will shape our future in retirement, so pay close attention as we explore each one.

The Boomers Big Bang

The Baby Boom generation has had a profound and challenging impact on virtually every facet of our society. Their arrival led to a migration from cities to the suburbs in the postwar years and prompted a building boom in housing and schools. From 1934 to 1947, prepared baby food sales jumped from 400,000 cases to 15 million. As Boomers reached young adulthood, their tastes in music,

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fashion, and politics altered the fabric of our national culture. In the 1950s, more than 100 million Hula Hoops were sold. College enrollment tripled between 1965 and 1975. As they entered the workforce, boomers created enormous demand for new products including the Ford Mustang and (sadly for many dads) the minivan. The shopping mall was born. The economic ripple effect led to the largest and most sustained economic boom in our history. As Boomers approach retirement, much is being written about the growth of active adult communities, the swelling volunteer ranks in society, and the mass-migration to Arizona, Florida, and other retiree-friendly areas of the country. More than 1,000 people per day move to the state of Florida. In my county alone, more than 80,000 homes are scheduled to be built in the next few years. So, what are the implications? The Boomers big bang refers to the way this mass of humanity will change their consumption and investment habits as they retire. Where they live, what they buy (and don't buy), how they travel, and how they vote will continue to change our national fabric. Just as the end of the industrial revolution resulted in migration from cities to the suburbs and left urban areas blighted, the migration of Boomers as they retire will create similar opportunities and challenges. But, a more ominous effect will be felt from the support systems upon which they plan to depend. History is a great teacher if we are willing to listen. We have had sixty years to anticipate the ripple effect of this wave of humanity on our government, on social services and on society in general as this generation reaches retirement, yet little has been done to prepare for it or abate the effects, as you will soon see.

The Longevity Revolution

If you were alive in the year 1000, you could expect to live—on average—to about age 25. Disease, war, plague, famine, and pestilence were rampant, and you had very little defense against them. But, as we evolved, the advances in medicine, healthcare, and technology dramatically expanded your lifespan. By 1900, you were expected to make it to age 47. Today, average life expectancy is around 89 and it grows each year.[1]

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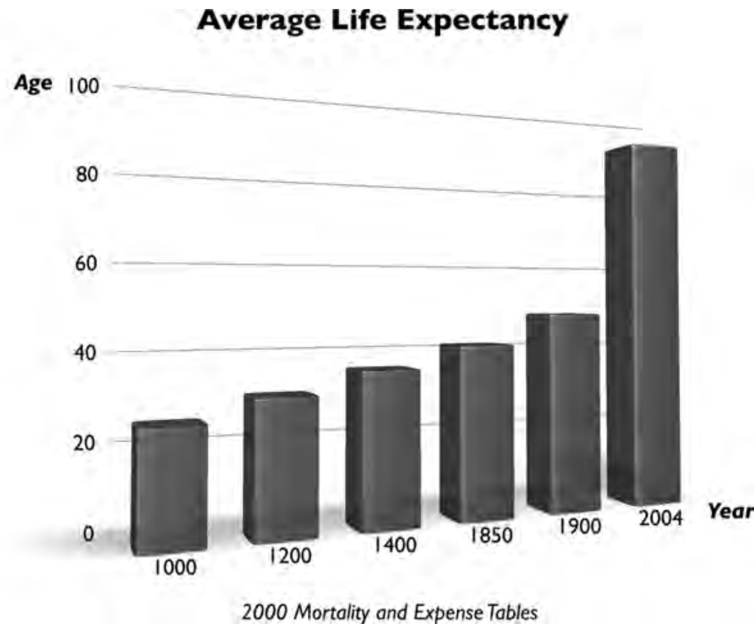

What all this means, of course, is that Americans are living longer today than any time in history, and many of us will likely live well beyond our own anticipated life expectancy. We'll be active, healthy, and vital for much longer than we may think. I recently saw a bumper sticker on a golf cart that proclaimed, "70—The New 40" and I began to think about that. Because we're taking better care of ourselves, 70 is indeed much like what our parents probably felt like at age 40. We're living better, healthier, and longer.

A few years ago, a delightful woman named Jean Calment passed away. At 122, she was the oldest documented human being. Kelly Ferrin, a noted gerontologist, had the opportunity to interview her at age 117 to discern why she had recently given up smoking and drinking. Her reply? She felt that after 117 years, she had been living on the edge long enough. This is more than an amusing anecdote. It is a metaphor for how we will view a much longer life than the generations before us.

Today, there are more than 55,000 centenarians in the US. By 2050, "the number of US centenarians is expected to reach 834,000 and maybe even 1 million," according to Dr. Robert Butler, President of the International

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Longevity Center in New York City. Hallmark, the maker of greeting cards, currently sells 85,000 100th birthday cards each year.

Now, hopefully a fact not lost on you is that the 79 million people in the Baby Boom generation will be living longer. Add to this the estimated 41 million retirees currently between the ages of 62–82, many of whom will also live longer. This will have a meaningful impact on us all as you will see later in the book. To quote Ken Dychtwald, the well-known author of the book, *Age Wave*, "The longevity revolution will have a greater impact on our lives than either the industrial revolution or the technology revolution of the last two centuries."

The Healthcare Conundrum

Medical science, better healthcare, and technology have cured a lot of things that kill us, thereby extending our lifespan, but they have not cured all the things that make us sick. Witness:

- A couple aged 65 today will need approximately $225,000 to fund their healthcare need in retirement.[2]
- In 2004, the increase in employer health insurance premiums was 11.2%.
- Between 2001 and 2003, national prescription medication spending rose 14%.[3]
- In 2003, Americans spent nearly $1.7 trillion on health care; by 2013, those costs are projected to double.[4]
- The Federal government estimated that, in 2004, there were 46 million Americans without health insurance.[5] This represents 15.7% of the population.

Perhaps the single greatest challenge we will face over the next three decades is maintaining the quality of health care provided to an aging population. Unlike prior generations, we can no longer turn to employers for retiree healthcare solutions, as this chart indicates.

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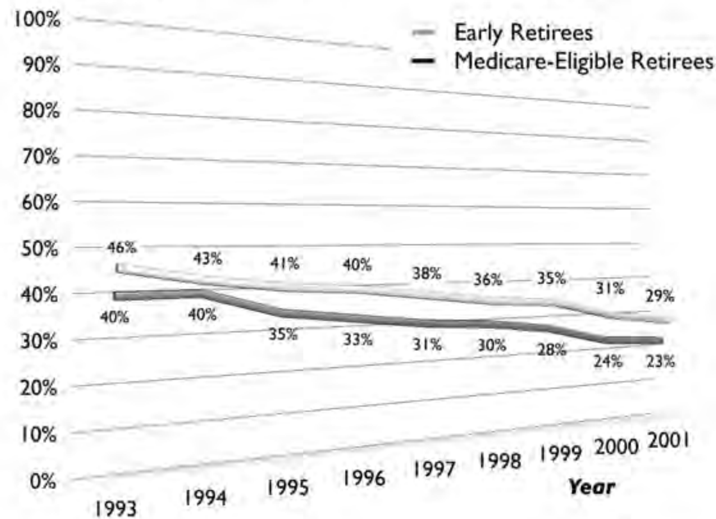

Source: Employee Benefit Research Institute Issue Brief 254

This challenge is not reserved for the private sector. State and local governments have recently begun to take aggressive steps to reduce the cost of providing healthcare benefits to retired teachers, police, firefighters, and other public workers. In December of 2006, the state of North Carolina reported $23.8 billion in unfunded liabilities for retiree healthcare, more than three times what the state owes in ordinary debt.[6] States are routinely either cutting benefits, extending current vesting requirements, or shifting the burden to Medicare for retiree healthcare expenses.

According to the governments audited financial statement released in December of 2006, Medicare's unfunded liability rose $2.6 trillion in 2006 to $32.3 trillion dollars. USA Today reported in May of 2006 that federal, state, and local governments owe at least $58.7 trillion—$510,677 per household—for Medicare, Social Security, civil servant health care, and other obligations.[7]

Unlike pension benefits, medical benefits are usually not protected by law and can be discontinued by state legislatures. All these events will force more retirees to depend exclusively on their own savings and Medicare to provide for their healthcare needs. It is difficult to imagine a solution that does not require

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citizens to take more personal financial responsibility for their own healthcare expenses in the coming decades.

Social (In)Security

In 1934, the nation was deep in the throes of the Depression. The traditional sources of economic security—assets, labor, family, and charity—had all failed to one degree or another. President Franklin Roosevelt would choose the social insurance approach as the "cornerstone" of his attempts to deal with the problem of economic security.

In 1935 he signed into law the Economic Security Act which created the Social Security Administration. The significance of this new social insurance program was that it sought to address the long-range problem of economic security for the aged through a contributory system in which the workers themselves contributed to their own future retirement benefit by making regular payments into a joint fund.

> *"We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age."*
>
> —President Roosevelt, upon signing the Social Security Act

While Social Security provided welcome assistance to a nation in need, the flaws of the program were first witnessed early on. Ida Mae Fuller was the first recipient of a monthly Social Security check. Mrs. Fuller paid a total of $27.00 into the system. Her first check was $22.54. Ida Mae lived to the ripe old age of 100 and collected more than $22,000 in benefits.[8] You don't need a PhD in Finance to discern this is an unsustainable gravy train.

How can our government's old age support system be so flawed? Well, it was developed upon the then accurate assumption that many more people were paying in than receiving benefits. At the inception of the Social Security Administration in 1935, the ratio of people paying into the system versus those taking out was 16:1. But things changed. In 1990, the ratio was 4.5:1. By 2030, it will be 2:1.[9] Unless reforms are undertaken, it is estimated that the Social Security system will be insolvent in 2042.[10]

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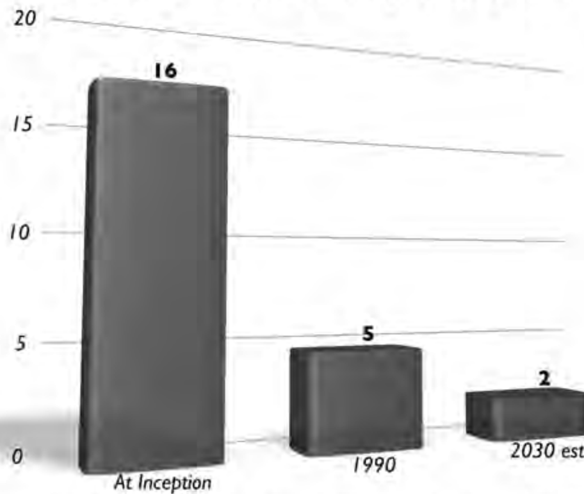

It is important to note that the Social Security program was originally designed to provide *supplemental* income to a *minority* of Americans. Instead, it has become the *primary* source of income for the *majority* of Americans. It is estimated that more than 68% of Americans aged 65 and older rely on Social Security for 50% or more of their income and 39% rely on it for more than 90% of their income.[11] And the "lunch counter" hasn't really even opened yet for Generation R. This shift will have a profound impact on the system's ability to meet the needs of future retiring Americans.

It is somewhat interesting and ironic to note that the basis for our Social Security system was derived from Germany, which enacted the first old age pension under Chancellor Otto Von Bismarck in the late 1800s. As of November 2006, Germany's Cabinet had approved raising the official retirement age from 65 to 67 in order to cut state spending and pension costs.[12] You can be sure that politicians in the US will be closely watching this development overseas as a possible solution to some of our challenges. It is indeed difficult to imagine a remedy for our domestic program that does not contain the same elements.

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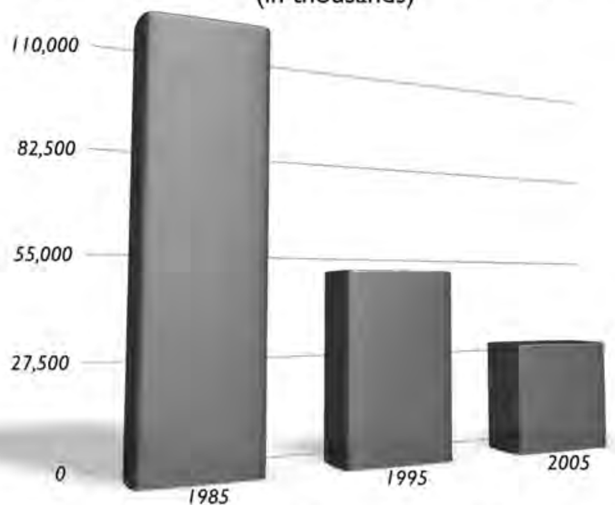
The Pension Ice Age

For decades, a substantial number of Americans depended upon employer-funded pensions to provide a source of guaranteed income in their golden years. Coupled with Social Security, pensions provided assurance that regardless of how long you lived, you and your family could receive a monthly check as a reward for your years of contribution.

Beginning in the 1980s, however, many companies began to strain under the weight of retirees who were living longer and their growing pension liabilities. Something had to be done. In 1985, more than 110,000 employers offered a defined benefit (aka "pension") plan. By 2005, the number had shrunk to 30,000 employers as the following graph indicates.[13]



"The Incredible Shrinking Benefits," *Business Week*, July 25, 2005

Gradually, the burden for retirement planning has shifted to employees through the advent of defined contribution ("DC") plans. You know these plans by a series of confusing numerical and alphabetical codes such as 401(k)s, 403(b)s, 457 plans, etc. These plans differ from pension plans, in that their contributions are funded by the employee (and sometimes the employer) to determine potential future retirement benefits. It is worth noting here that this

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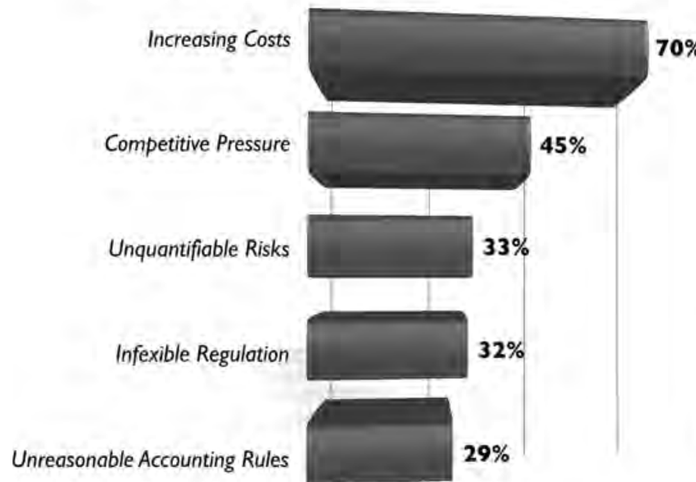
represents a transfer of risk from the employer to the employee. In pension plans, the employer or issuer of the pension benefits absorbs mistakes in funding requirements. In effect, they make good on it for the employees. In the future, the employee will absorb mistakes in their funding requirements. It is unsettling to note that even state and local pensions, long protected by either union contracts or constitutional guarantees, are being quietly challenged. Some have already reduced workers' pensions on the grounds that their pensions cannot sustain the weight.[14] According to Dereck Guyton with Mercer's Human Resources Consulting, the nation's cities and states have promised a total of about $1.4 trillion in commitments. Funding for these obligations is typically derived from your taxes. Take a look at the main reasons both public pension and private pension plans are being discontinued.

DB plan sponsors are closing or freezing their plans primarily because of the following:



Source: Pensions & Investments, 2007

So, if employers have shifted the responsibility for funding retirement to employees, how are we doing at it? Unfortunately, this shift from involuntary retirement savings in pensions to voluntary savings in defined contribution plans has not been accompanied by the training and education necessary for most people to succeed, as you will see.

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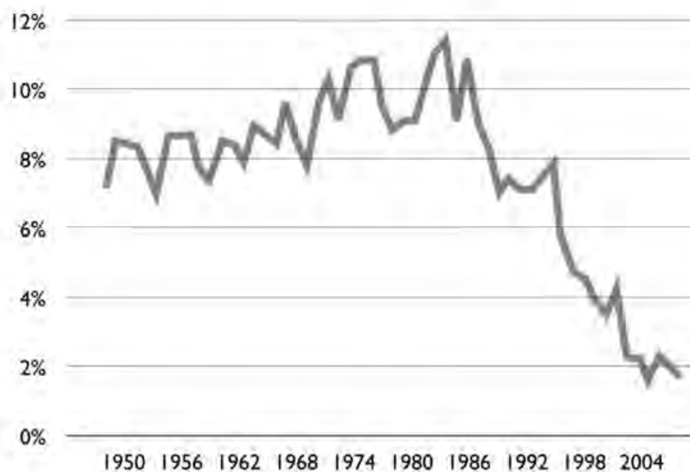
The Savings and Investment Vacuum

As if the foregoing facts aren't disturbing enough, the personal savings rate in the U.S. has steadily declined over the past few decades to about 2%. In fact, only two industrialized nations have lower savings rates than the United States. By contrast, Germany's personal savings rate is 11% and France's is 10.2%.[15]

According to the Credit Union National Association, credit union balances as a percentage of average household deposits have declined from 15.1% in 2001 to 2.5% in 2006. Mark Zandi, chief economist at Moodys.com, estimated the national savings rate in the first quarter of 2006 across all households was minus 1%.[16]



National Income and Product Accounts (NIPA's), U.S. Bureau of Economic Analysis, Sept. 2005

When we look at retirement savings alone, the news gets worse. Today, the median balance for all 401(k)s is approximately $35,000. Among those aged 55–64, the median balance is approximately $60,000.[17] Americans are simply not saving enough in personal retirement accounts to offset the changes occurring in government and employer funded programs. The 2004 Survey of Consumer Finances shows that 21% of eligible workers fail to participate in employer based defined contribution plans. Only 11% of workers participating

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contribute the legal maximum. Of those earning $40,000–$60,000, less than 1% contribute the maximum amount. This shift of responsibility to employees has been underway for a couple of decades now and it doesn't appear most Americans have risen to the challenge. The dismal savings habits of Americans, particularly those within a few years of retirement, are not likely to sustain a 30-year retirement.

The Financially Illiterate Masses

One might presume that the thrusting of responsibility onto individuals comes with an assumption that they have the skills to accept it. This doesn't appear to be the case by a long shot. The Retirement Research Center at the University of Michigan has done extensive work on the financial literacy of Americans, and the results aren't encouraging. Witness:

> *Gustman and Steinmeier (2004) show that only half of earlier respondents could identify what type of pension plan they had (defined benefit, defined contribution, or hybrid) and fewer than half could identify when they would be eligible for early or normal retirement benefits. Information about Social Security is also scanty. Only two-fifths of respondents could venture a guess about their expected Social Security benefits and many respondents knew little about program rules … over half of current workers expect to become eligible for full Social Security benefits younger than they actually will (at age 65 or before). Thus, households are overall uninformed about the critical variables that should enter any saving plans.*[18]

In addition, a recent study by John Hancock Financial Services revealed the following insights:

- 38% of respondents said they had little or no financial knowledge.
- 40% of respondents incorrectly believed that a money market fund contained stocks.
- Two-thirds of respondents did not know that it is possible to lose money in government bonds (if you liquidate prior to maturity).

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- Respondents on average believed that employer stock was less risky than a stock mutual fund.

How does this shocking lack of financial literacy translate in real life? A study prepared for the Nebraska Public Employees Retirement System (PERS) found that from 1983–1999 that system's pension plan (which is managed by pension trustees and professional money managers) generated an average of 11% annually, but the system's defined contribution plan participants (managing their own money) experienced returns of 6% over the same time period.[19] This is consistent with many current studies of average investor returns versus market returns in general. Giving people total responsibility for their financial future without the tools to succeed is akin to giving a fourteen-year old the keys to the Porsche. It's just not a good idea.

I suspect that readers with some level of financial acumen will dismiss these poor souls as lost causes. "Thank goodness I have the ability to manage my money," you may say. "Those poor folks will be left by the curb." Well, as you will see in the next chapter, this lack of financial literacy among your fellow citizens will likely end up costing you money in the long run, as government and social programs will be forced to pay the tab for such poor financial management and education. And they will pay for it with your tax dollars and the tax dollars of the generations that follow. No one is immune to the confluence of events I've described here. We will all be impacted in some way. Unless more Americans are prepared to educate themselves and seek professional assistance to help accumulate and manage their financial assets, this lack of literacy will create a tragic legacy for future generations.

The Rear View Mirror Approach to Retirement Planning

The last element I'll share with you isn't demographic. It's psychographic. And, it's the most important and potentially dangerous one in all this analysis. People, by nature, are extrapolators, which means that we think the future will be a logical extension of the past. We relate our past personal experiences to what we think the future will hold for us. (I will show you how this trait destroys your investment returns in a later chapter.) When it comes to retirement, our frame of reference is, of course, our parents and grandparents. In the 1970s, the average age of retirement was 65 and average life expectancy was around

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8–10 years beyond that. Your parents and grandparents probably had very nice pensions, Social Security, and enough savings to live modestly, if not comfortably, for their life expectancy.

Today, the average age of first retirement is around 58.[20] If average life expectancy is, say, 89 and growing, that means on average you'll spend perhaps thirty years in retirement. So, in the last three decades, we have tripled to quadrupled the amount of time we will spend in retirement compared to our parents or grandparents. This is most certainly not your father's retirement. Yet, many seem to be planning as if it is. According to the 2005 National Survey of Employers and Employees, the average person plans for 19 years of post-retirement living. Only 37% of people surveyed are planning to live more than 21 years upon retirement.[21]

So, let's review what these facts reveal:

- 12,000 people are, on average, reaching retirement age every day.
- This group of people will, on average, live longer than anyone in human history before them.
- They will require quality healthcare during their retired lives, the cost of which increases each year.
- Government and social services for this group are already under significant strain, even before the bulk of them qualify for benefits.
- Corporate employers are shifting the burden for retirement savings onto the worker, and for many of them, it may be too late to comfortably accept the burden.
- The savings and personal investment accounts of most Boomers are woefully under funded if they exist at all and will likely not support a thirty-year retirement.
- People on average may not have the experience, capacity, or interest to successfully manage their own financial futures.
- People generally expect their future to look like their recollection of the past, and many underestimate how long they will live.

At best, this confluence of events is unsettling. Why is it we haven't considered these challenges as a group and addressed them before? Because these facts typically come to us one by one through the media. We read a headline one day

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about Medicare challenges, and the next day about a large company freezing their pension plan. No relation. It's not the media's job to connect the dots. As a result, we generally dismiss these events as noise. But, when one assembles these events into a cause and effect structure, the outcomes are worrisome at best, and more likely the perfect formula for a national crisis. Let me show you what I mean.

First, we learned that the largest segment of the U.S. population—79 million of them—are beginning to retire and will do so over the next 25 years, essentially crossing this threshold together. We also learned that they are living much longer than any generation before them.

Then, the facts teach us that this demographic shift is already stressing our government and social services programs and pension plans to their limits, and we've just gotten started. On January 1st, 2008, the first 12,000 baby boomers turned 62, qualifying for Social Security benefits. And 12,000 more will turn 62—*every single day*—for the next eighteen consecutive years. It also means that beginning in 2011, 12,000 people will qualify every day for Medicare benefits for eighteen straight years. And, they will consume a record amount of healthcare services.*

Regarding the government's ability to support both Social Security and Medicare benefits for future recipients, there is little disagreement on the plausible solutions. The Employee Benefit Research Institute, a highly regarded source of data on public policy and employee benefits, suggests:

> *"Since current tax revenues are projected to be insufficient to support these programs at their existing levels, some type of changes are likely to occur that could result in increased retirement age eligibilities, higher taxes, or in cutbacks of benefits." (October 2004)*

Perhaps the most watched man in politics and fiscal policy is our current Federal Reserve Chairman Ben Bernanke. Care to hear what he has to say on the matter?

> *"… as the population ages, the nation must choose among higher taxes, fewer government programs, cuts in Social Security and*

* You want job security? Apply to be a switchboard operator at the Social Security Administration.

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Medicare, a higher deficit, or some combination of those options." (October 5th, 2006)

Now, were this news not bad enough, we also learned that a diminishing number of people will be able to depend upon pensions to support themselves. And, few members of this generation have adequate personal savings and investments for retirement, which will increase their reliance on the already overburdened government and social service infrastructure. Lastly and most tragically, we learned that by nature, people tend to project their past experience into the future. Most appear to be blissfully unaware that all the elements of the perfect storm are converging in the next few years to disrupt their retirement life. Let all that sink in and marinate for a moment.

What are the consequences? How will all of us live for the next 30 or 40 years? What will our lives be like? Have I gotten your attention? Good. Read on.

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