



How to Build an Adequate Nest Egg

**Chapter****Six**

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The reason that I am writing this book has a lot to do with my faith, which is a major part of my life. I start each day, other than Sunday, with a 45-minute devotional time. This is the most important part of my day because I frequently receive specific direction during this time I spend alone with God. I was directed during my devotional time on the day I started this chapter to share some of my personal plans for retirement, so that is what I am doing.

My goal in this chapter is to personalize the retirement planning process and show that there are five relatively painless steps that can get you on your way toward retirement security. Too often people are led to believe that all they have to do is to plug their retirement dreams into one of the many retirement calculators. This mechanical calculation will supposedly tell you everything you need to know to hit your savings goals. I know that retirement planning is a very personal issue, and the people who are most successful in reaching their goals don't rely on quick, magical numbers. It's a long process, and the more you think about what will be important to you and your family throughout your retirement years, the better planner you will be.

To help you personalize your retirement planning process, I'm going to tell you a little bit about my own background. I grew up on a dairy farm in Bedford County, part of South, Central Pennsylvania, with a daily view of the Allegheny Mountains. When I was six years old I started milking cows in the morning before leaving for school and in the evening before dinner.

My family worked hard, particularly during the summer months. I was blessed with three older brothers, an older and younger sister. The three stronger older brothers were truly a blessing because they got the tougher jobs. Perhaps even more importantly, my dad ran out of farms before he got to me, so I wasn't raised with the expectation that I would stay in the family business. I was the only male member of the family who didn't study agriculture in high school. As a result, I left the farm to attend college.

I got my first full-time job at age 18 by responding to an ad for a math clerk. This was of interest because math was my major. The position was in the pension department of Provident Mutual Life Insurance Company. I spent over five years there learning the basics of the retirement business and attending college at night.

While I was still in college, I joined Ed and Dave Johnson in the northern Philadelphia suburbs. We spent 25 years together building an employee benefit consulting company from scratch. The Johnson Companies eventually grew to a \$25 million firm with approximately 350 employees. We sold the company in 1990, and I was contractually committed to the buyer for three years.

During my time at The Johnson Companies, I had various management and consulting responsibilities, and I became one of the top retirement planning consultants in the country. One evening as I was driving on the Pennsylvania Turnpike, I realized that I had been so focused on wrapping up my assignments that I hadn't given very much thought to the fact that I was soon leaving the firm.

My future was undecided—and as I rode along, I was suddenly made aware that I was being given a clean slate to plan the rest of my life. I was fortunate that the amount of money I received for my stock when we sold the company removed an immediate need to replace my paycheck. But at age 51 I wasn't ready to retire.

The following morning I wrote down the things that I would value most in a future career. It was readily apparent that joining some large organization wouldn't match my goals. That quickly led me to the conclusion that I would be doing something on my own. But the big question was: what? For three years I was prohibited from soliciting any of my former clients or business associates. That plus my general dislike for management activity made me realize that I would have to do something very different.

In 1993 my career took a completely new turn and I established the 401(k) Association. At that time, there was a constant battle to preserve the private retirement system. Many policymakers viewed all private retirement plans as the big black hole that sucked up tax revenue. As I mentioned in Chapter 1, the Reagan team tried to eliminate 401(k) plans in 1985—and the threat to the private retirement system was still very real in 1993. My original objective for the Association was to give participants a vehicle for joining in the fight to save 401(k) plans. Today, because retirement savings plans enjoy a wide level of political and private support, my association now focuses on how 401(k) plans can better serve participants.

Now that you know how I got to where I am today, I can tell you about my personal retirement plans. I am now 59 years old and I've been working since I was 6 years old. Despite my long working career, I've never looked forward to a time when I don't work. I am not consumed by my work, but I've always been thankful to have been given the opportunity to do things that I enjoy.

With an office at home (which was a major adjustment), I save a lot of commuting time. This arrangement gives me room to reward myself with a hike into the mountains (which I can see out my office window), walks to the library, a bike ride, running and most importantly visits with our children, their spouses and our grandchildren. I plan to continue working as long as I

am healthy, enjoy what I am doing and I can find something productive to do. I'll reassess my career plans again at age 64. This will take me to the 25th anniversary of 401(k), which may be the ideal time to hang it up—unless there are new challenges that give me a reason to continue.

There are both financial and physical reasons why I'm not anxious to retire. I believe that our Creator did not intend for us to spend 20 years or more in retirement. Of course, I realize that many of you are in situations where you are counting the days until you can leave your job and never look back. Many of you work in jobs that probably entitle you to a 20-year golf game. But most people have a built-in need to be productive and useful. This is not just my opinion—there are endless numbers of studies that show that productivity in the traditional “retirement” years leads to longer and healthier lives.

In my case, I'm not only predisposed to be productive, my family genetics suggest that I may be retired for a long time. At any income level, it takes a lot of savings to live in financial security for 30 years or more without a paycheck. I'm also not confident that Social Security and Medicare will give me the financial help I need 30 years from now.

The best way to avoid outliving your retirement nest egg is to delay using it as long as possible. I plan to do just that. On the 50th anniversary of 401(k), I don't want my grandchildren to find that I've outlived my retirement nest egg and set up camp in the woods!

STEP 1: ESTABLISH... **...a Realistic Retirement Target Date**

The most difficult part of planning for retirement is knowing how much you will need. First you need to establish a realistic retirement date target. Most workers want to retire at an age that is considerably younger than what is considered their Social Security normal retirement age. This is the age when you're eligible to receive full

Social Security benefits. The age is 65 for those born prior to 1938 and 67 for those born during 1960 or later. The normal retirement age is between 65 and 67 for the rest of you.

While we're on the subject of Social Security, you need to know that the earliest age that you can receive benefits is 62. If you retire at age 62, you will get 80% of the full benefit if 65 is your normal retirement age and 70% if 67 is your normal retirement age. Although the future of Social Security is uncertain, you need to factor these benefits into your retirement planning.

There is no “right” age to retire—it's a very personal issue. Virtually everyone I talk to who is over age 30 has some general ideas about retiring some day. These may be dreams that include travel or nothing but sitting around. In most instances, people have a target retirement age. At one extreme are those who plan to retire by age 45, but they have saved very little. These people are generally clueless about what it will take to retire. At the other end of the spectrum are 35-year-olds who have very detailed and disciplined plans to retire early.

I doubt that Social Security benefits will disappear during the next 20 to 30 years, but they may be reduced. There's also the possibility that a “means test” will be enacted, whereby only those with incomes below a certain threshold will receive Social Security benefits. Here are some of the more likely Social Security changes that will occur in the next 10 years:

- All earned income will be subject to the full FICA (Social Security) tax
- The normal retirement age will continue to increase
- All Social Security benefits will be taxed if your income exceeds a certain level.

The most important piece of advice I can give you about Social Security is to reduce your expectations.

STEP 2: CALCULATE... **...How Much You Need to Save**

Once you have decided on a retirement age, assume that your retirement begins tomorrow. What will your life be like? This is the retirement planning prerequisite question that retirement calculators don't ask. Most importantly, what will you do six months from now after the novelty of retirement wears off and you're tired of golfing, shopping, traveling and other leisure activities? Many people find it difficult to go straight from full-time work to full retirement—particularly when they haven't developed interests outside of work.

As you continue down this imaginary path, consider how you will feel if you no longer have a paycheck of any size. How much income will you need to maintain your current standard of living? Probably close to 100% of your current income.

How much savings will it take to provide this level of income? The answer is a lot. I generally recommend saving ten times the final income you expect to earn when you retire. This formula is a good starting point if you plan to retire at your Social Security normal retirement age. If you retire earlier, you will of course need to save more. If you have a company pension or other sources of income, you may be able to get away with saving a bit less.

As an example, assume you are retiring today and you earn \$50,000 per year. This means that you should save a total of \$500,000 to hit this ten times goal. This nest egg would be sufficient to provide approximately \$30,000 per year of inflation-adjusted income, assuming:

- the rate of inflation is 3%,
- you will need this income for 25 years,
- only a small cushion will be left at the end of 25 years,
- you invest 50% of your nest egg in stocks and 50% in bonds during this period.

Remember that \$50,000 represents your gross earnings—you are not actually living on

\$50,000 because you have to pay taxes. Your taxes will be less when you retire and you will no longer need to save for your retirement. Your income will also be subsidized by your savings and Social Security—the other reasons why you actually need a smaller amount—roughly \$30,000—for each retirement year.

STEP 3: ADJUST... **...Your Savings Target for Inflation**

Your first reaction is likely to be that you can generate a lot more than \$30,000 per year or 6% from a \$500,000 nest egg. But the amount that you withdraw for each year of retirement needs to be increased annually to offset the impact of inflation. You will need \$60,984 (3 x 20,328 from the inflation chart below) in the 25th year of your retirement to buy what \$30,000 will buy in the first year. This is why you need \$500,000 to provide \$30,000 of inflation-adjusted income for 25 years.

Inflation Chart

This chart uses \$10,000 as an example of the income amount you need during the first year after you retire. The amount you need will increase 3% each year after you retire. The sole purpose of this chart is to show how inflation erodes buying power—even at a modest 3% annual inflation rate.

Number of Yrs. After You Retire	Annual Income Needed	Number of Yrs. After You Retire	Annual Income Needed
1	\$10,000	13	14,258
2	10,300	14	14,685
3	10,609	15	15,126
4	10,927	16	15,580
5	11,255	17	16,047
6	11,593	18	16,528
7	11,941	19	17,024
8	12,299	20	17,535
9	12,668	21	18,061
10	13,048	22	18,603
11	13,439	23	19,161
12	13,842	24	19,736
		25	20,328

Those who have never done any retirement planning may have trouble believing that you should withdraw only \$30,000 per year from a \$500,000 nest egg. The following chart shows why you must be realistic about how much you should withdraw.

Managing Your Nest Egg During Your Retirement Years

No. of Yrs.	Beginning of Year Balance	Annual Withdrawal*	Investment Return**	End of Year Balance
1	500,000	30,000	33,950	503,950
2	503,950	30,900	34,195	507,245
3	507,245	31,827	34,393	509,811
4	509,811	32,782	34,539	511,568
5	511,568	33,765	34,628	512,431
6	512,431	34,778	34,653	512,306
7	512,306	35,822	34,610	511,094
8	511,094	36,896	34,485	508,683
9	508,683	38,003	34,278	504,958
10	504,958	39,143	33,977	499,792
11	499,792	40,317	33,574	493,049
12	493,049	41,527	33,060	484,582
13	484,582	42,773	32,424	474,233
14	474,233	44,056	31,654	461,831
15	461,831	45,378	30,740	447,183
16	447,183	46,739	29,667	430,111
17	430,111	48,141	28,423	410,393
18	410,393	49,585	26,992	387,800
19	387,800	51,073	25,358	362,085
20	362,085	52,605	23,505	332,985
21	332,985	54,183	21,413	300,215
22	300,215	55,809	19,062	263,468
23	263,468	57,483	16,431	222,416
24	222,416	59,208	13,497	176,705
25	176,705	60,984	10,445	129,166

* Equal to \$30,000 adjusted annually for inflation, assuming a 3.0% inflation rate
 ** 7% return

You will have enough left after 25 years for only another two years. That isn't a very big cushion.

Since you will not be retiring tomorrow, but at some point in the future, the following table helps you project how much you are likely to be earning the year you retire. Assume your retirement goal is age 62—or 20 years from now. You

Inflation Adjustment Table

Number of Years	Assumed Annual Rate of Change				
	3%	3.5%	4%	4.5%	5%
1	1.03	1.035	1.04	1.045	1.05
2	1.06	1.07	1.08	1.09	1.10
3	1.09	1.11	1.12	1.14	1.16
4	1.12	1.15	1.17	1.19	1.22
5	1.16	1.19	1.22	1.25	1.28
6	1.19	1.23	1.27	1.30	1.34
7	1.23	1.27	1.32	1.36	1.41
8	1.27	1.32	1.37	1.42	1.48
9	1.31	1.36	1.42	1.49	1.55
10	1.34	1.41	1.48	1.55	1.63
11	1.38	1.46	1.54	1.62	1.71
12	1.42	1.51	1.60	1.70	1.80
13	1.46	1.56	1.67	1.77	1.89
14	1.51	1.62	1.73	1.85	1.98
15	1.56	1.68	1.80	1.93	2.08
16	1.60	1.74	1.87	2.02	2.18
17	1.65	1.80	1.95	2.11	2.29
18	1.70	1.86	2.02	2.21	2.41
19	1.75	1.93	2.10	2.31	2.53
20	1.80	1.99	2.19	2.41	2.65
21	1.86	2.06	2.28	2.52	2.79
22	1.91	2.13	2.37	2.63	2.93
23	1.97	2.21	2.46	2.75	3.08
24	2.03	2.29	2.56	2.87	3.23
25	2.09	2.37	2.66	3.00	3.39
26	2.15	2.45	2.77	3.14	3.56
27	2.22	2.53	2.88	3.28	3.74
28	2.28	2.62	3.00	3.43	3.92
29	2.35	2.72	3.12	3.58	4.12
30	2.42	2.81	3.24	3.74	4.33

need to project your current income to what you think you'll be earning 20 years from now.

Assume you expect your income to increase at an average rate of 3% per year for the next 20 years. The appropriate factor from this table is 1.8. Multiply 1.8 times your current income (\$50,000 in this example), and you'll see that your expected income at retirement is \$90,000. This will increase the size of your targeted nest egg to \$900,000 (10 times \$90,000). This is an easy way to get a rough idea of how big a nest egg you should build—regardless of your current age or income.

STEP 4: DEVELOP... **...a Detailed Savings Plan**

How do you accumulate ten times your annual income—and then some—by the time you retire? The first step is to start early. Then there are many retirement calculators and other tools you can and should use to help you develop a workable retirement plan.

A retirement calculator should be available through the financial organization that handles your 401(k) money. Some other resources are:

www.financialengines.com
www.mpower.com
www.quicken.com/retirement
www.money.com
www.asec.org/int-blpk.htm

Each calculator uses different methods and assumptions. As a result, different calculators will give you widely varying results. Check the assumptions each calculator uses to see if they make sense for your situation.

Tools like retirement calculators will help you decide how much you need to save—and then once you begin to save, you have to keep checking that you're on track. There are certain benchmarks that generally help you gauge where you should be at certain points of your nest egg accumulation. The following savings goals are

designed for 25-year-olds who are just starting their savings program.

Most likely you are over age 25, but these benchmarks can still tell you if you're on target with your retirement planning. Many of you will be significantly behind these benchmarks. Remember that these are ideals, and I don't include them here to make anyone feel defeated. Instead, my intention is to motivate you to sit down and develop a workable plan for catching up. This may mean that you have to work longer than you would like—unless you have enough time to substantially increase your savings rate.

Savings Goal By Age 35: **One Times Your Pre-Retirement Income**

How To Accumulate \$39,000 by Age 35

Age	Your Pay	Your Contribution	Employer's Contribution	Total Return	Year End Value
25	\$25,000	\$1,000	\$500	\$68	\$1,568
26	26,000	1,300	650	229	3,747
27	27,040	1,622	811	446	6,626
28	28,122	1,687	844	710	9,867
29	29,246	1,755	878	1,006	13,506
30	30,416	1,825	912	1,339	17,582
31	31,633	1,898	949	1,710	22,139
32	32,898	1,974	987	2,126	27,226
33	34,214	2,053	1,026	2,588	32,893
34	35,583	2,135	1,067	3,104	39,199

The above example is based upon the following assumptions:

- 4% annual wage increases
- 4% of pay contributed during the first year; 5% the second year and 6% each year thereafter
- an employer matching contribution equal to \$.50 per \$1.00, limited to the first 6% of pay that the employee contributes
- an assumed total investment return of 9%

Your goal should be to accumulate one times your annual income by age 35. The previous

example shows what you need to do to accomplish this goal.

As you can see, a 50% employer matching contribution is a big help. You would have to adjust your contributions if you are in a plan that has a lower employer contribution or none at all.

Savings Goal By Age 45:

Three Times Your Pre-Retirement Income

Assume in the next 10 years you increase your contribution rate to 10%. You continue to receive a 50% match or a 3% of pay contribution from your employer, your annual pay continues to increase by 4% per year, and your investment return is 9% per year. The following are the results:

Age	Your Pay	Your Investment	Employer's Contribution	Total Return	Year End Value
35	37,006	\$3,700	\$1,110	\$3,744	\$47,753
36	38,487	3,849	1,154	4,523	57,279
37	40,026	4,003	1,201	5,389	67,872
38	41,627	4,163	1,249	6,351	79,635
39	43,292	4,329	1,299	7,420	92,683
40	45,024	4,502	1,350	8,604	107,139
41	46,825	4,683	1,405	9,917	123,144
42	48,698	4,870	1,461	11,368	140,843
43	50,646	5,065	1,519	12,973	160,400
44	52,672	5,267	1,580	14,744	181,991

By age 45 you will be ahead of schedule with an accumulation of more than 3.5 times your annual pay! You will be well on your way to accumulating a nest egg equal to 10 times your annual pay at retirement.

Savings Goal by Age 55:

7 Times Your Pre-Retirement Income

Assume that everything stays the same for the next 10 years—except that you increase your contribution rate from 10% to 15% at age 50, your

annual salary increases by 4% per year and your investment return continues at 9% until age 50 and then drops to 8% from 50 to 55 because you reduce your stock holdings.

Age	Your Pay	Your Investment	Employer's Contribution	Total Return	Year End Value
45	\$54,778	\$5,478	\$1,643	\$16,699	\$205,811
46	56,970	5,697	1,709	18,856	232,073
47	59,248	5,925	1,777	21,233	261,008
48	61,618	6,162	1,848	23,851	292,869
49	64,083	6,408	1,922	26,733	327,932
50	66,646	9,997	1,999	26,714	366,642
51	69,312	10,397	2,079	29,828	408,946
52	72,085	10,813	2,162	33,235	455,156
53	74,968	11,245	2,249	36,952	505,602
54	77,967	11,695	2,339	41,571	561,207

At this point you will have accumulated 7.2 times your annual pay. As you near retirement, your goal is within reach.

Savings Goal by Age 60:

Ten Times Your Pre-Retirement Income

Assume that you keep your contribution rate at 15%, receive a 3% employer contribution and your pay continues to increase by 4% per year. Your investment return remains at 8%.

Age	\$ Your Pay	\$ Your Investment	\$ Employer's Contribution	\$ Total Return	\$ Year End Value
55	81,085	12,163	2,432	45,480	621,282
56	84,329	12,649	2,529	50,311	686,771
57	87,702	13,155	2,631	55,573	758,130
58	91,210	13,682	2,736	61,307	835,855
59	94,858	14,229	2,845	67,551	920,480
60	98,652	14,798	2,960	74,348	1,012,586

Now you have topped your goal with an accumulation of just over 10 times your annual income. At this point you should be in a good

position to consider various alternatives—including retirement, working fewer hours at your current job or shifting to some other income-producing activity that is of interest.

Step 5: TRACK... ...Your Savings Progress

The purpose of these examples is to show you how a specific plan gives you a tangible way to measure your progress each year. It's helpful for you to know some assumptions that I've made in the previous savings goal examples:

- There aren't any savings gaps because you should always add to your retirement savings even during periods that you are not eligible to contribute to a 401(k).
- All the money is left in the plan for retirement. None of the money is withdrawn for other purposes.
- The assumed return requires at least 60 to 70% in stock investments up to age 55. After age 55, the stock holdings drop to the 50 to 60% range.

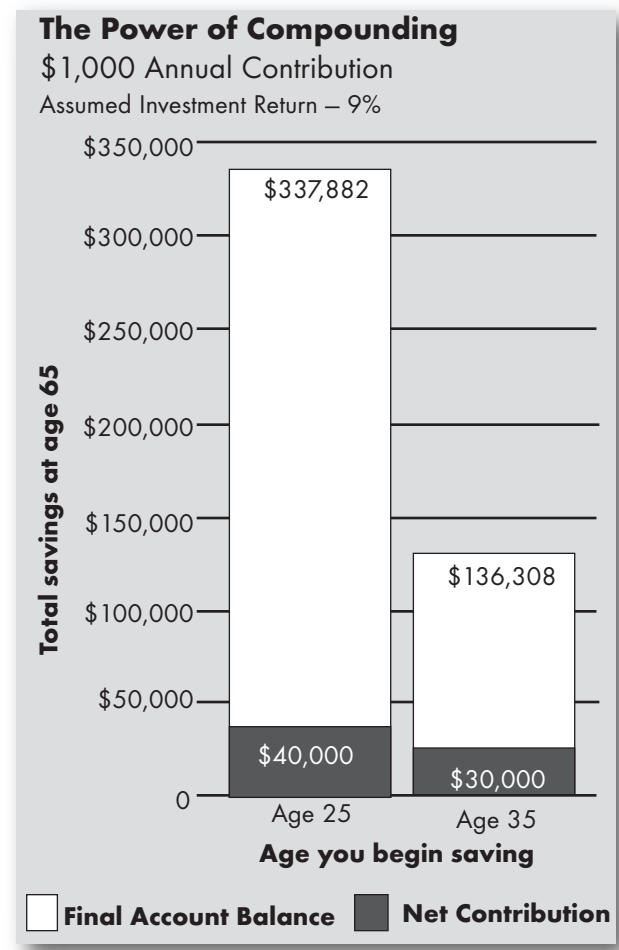
Of course, annual returns on a well-diversified stock portfolio will vary widely from year to year. As a result, your annual investment return will not be consistent. Some years you will earn more than what my examples assume, but in other years you will earn less. Despite these year-by-year variances, you should be able to achieve long-term returns similar to these examples.

Your retirement nest egg comes from your own and your employer's contributions and the investment return that is earned on these contributions. In the example above that shows your savings progress at age 60, this is your final breakdown among these three sources:

Employee contributions	\$226,173
Employer contributions	57,812
Investment return	728,601
TOTAL	\$1,012,586

You've probably heard about the magic of compounded growth. It's very real, but this magic

is significant only over long periods of time—20 to 30 years or longer. The above results are accomplished from age 25 to age 60, a period of 35 years. This is why it is so important to start saving at an early age and stick with your program. If you wait 10 years before you start, you'll substantially reduce your investment return. The difference can only be made up by a much larger savings rate or by extending the accumulation period through longer employment. The following chart illustrates the cost of waiting.



The best reason to do careful retirement planning is that once you know you'll be financially secure, you have the freedom to make life and career choices. You may think that there are only a lucky few who have this luxury. The fact is that

most of the people I know who have retired before age 65 weren't professionals or high-paid executives. They are individuals who saved what they needed to enjoy an early retirement. If you achieve this financial security in your late 50s or early 60s, you have the flexibility to continue working, retire totally or shift to something less demanding. If you do some basic planning, you can avoid being trapped into working until you drop at a job you don't like.

Your goal is to retire with an adequate level of retirement income. Even if you really enjoy what you are doing and have no specific plans to totally retire, it is much nicer to have alternatives. It's also good to be ahead in the savings game in case your health forces you to stop working.

Case Studies

Rhonda Hendrix is a Quality Assurance Analyst at Anheuser-Busch in Cartersville, GA. I met her when I was speaking at a 401(k) conference that she attended as a union representative.

Rhonda is only 30, but she has already accumulated \$78,000 in her 401(k) account. This amount will grow to more than \$1 million by age 60—even if she never contributes another dollar (assuming a 9% investment return). Rhonda saves 16% of her pay and Anheuser-Busch adds 6%. She started contributing to the plan at age 25. This reinforces a point I've made earlier: the importance of working for an employer that has a competitive 401(k) plan.

You're probably wondering (as I did) how Rhonda manages to save 16% of her pay. She and her husband have lived in a garage apartment for about three years. They are currently building a home and Rhonda is expecting their first child. Rhonda says, "I don't believe saving 16% of my pay has impacted my life in any negative way. This savings rate allows me to accumulate a nest egg very quickly without noticing the void in my pocket. We vacation every year at least 2 or 3 times. We own a recreational vehicle, jet skis, a

boat, and two tractors. We do save money where we can. For example, we try to eat out only 2 to 3 times a month and we do not have any expensive habits other than the water toys. For the most part I think we live a very full lifestyle."

Rhonda is not the only saver in the family. Her husband also works for Anheuser Busch in the beer packaging and shipping can lines. He contributes 8% of his earnings to a 401(k) and he receives a 6% match. When there are two savers in the family, you can reach your retirement goals even faster.

I met Danny Brantley, one of Rhonda's co-workers, at the same conference. Danny is a Maintenance Mechanic at the same Anheuser-Busch plant. He didn't start contributing to his 401(k) until age 36, but he is also contributing 16% of his pay. Danny is now 44 and he has accumulated \$130,000. This savings, plus a company pension, a separate investment account with Fidelity and the equity in his home, give him a grand savings total that is already close to 8 times his pre-retirement salary. This is a particularly impressive achievement, given that Danny did not start saving as early as Rhonda. (He is also the only saver. Danny's wife is currently a nursing student.) Danny will obviously build his account at a much faster pace than the examples above because he is contributing 16% of pay and is getting another 6% from Anheuser-Busch.

When I asked Danny why he contributes 16%, he said: "I can't afford not to. I save money every way around, because of the tax situation. Our company matches 6% and the other 10% just adds more money to the pot. I don't have to pay earnings tax on the 10%, which is a real savings boost." Most importantly, saving is an essential part of Danny's life: "To me, financial independence is far more important than social status."

Like Rhonda, Danny doesn't feel that a high savings rate affects his lifestyle. "Saving this amount of money from each paycheck makes me feel more confident and secure. I don't go out and

