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Determining the Size of Your Nest Egg

Whether You Intend to Spend Luxuriously or Squirrel Away Savings,
Consider Your Target Standard of Living

by

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"You've got to be very careful if you don't know where you're going," Yogi Berra once said, "because you might not get there."

The great New York Yankees catcher probably wasn't talking about retirement, but his fractured syntax captures a solid truth about the worry and uncertainty facing American workers as they look ahead and try to plan for a secure old age.

With the fading of traditional employer-funded pensions, millions of workers and their families will have to depend on Social Security and whatever money they have been able to accumulate through 401(k)-type retirement plans and their own savings to support them when they stop working. This shift of responsibility for retirement well-being onto individuals and away from their employers looms as one of the most fundamental and perhaps most worrisome changes in the economic lives of Americans since the Great Depression.

It is true, as proponents of do-it-yourself retirement plans such as 401(k) plans and individual retirement accounts argue, that faithful saving and investing over many years can produce a nest egg large enough to support a comfortable old age and perhaps even an inheritance.

But how much is enough? Am I investing properly? Am I on track to reach my goal?

These are key questions facing today's workers, and, as it turns out, even the experts cannot agree on the answers.

The conventional wisdom among academics and others who study retirement is that retirees need 70 to 80 percent of their pre-retirement income to maintain the standard of living they had when they were working. This figure is often used by sellers of mutual funds and other financial products, and is widely cited in the press.

"But the people who write that have never lived through retirement," said Barry Glassman of Cassaday & Co., financial planners and advisers in McLean.

"What do you do when you have time off? The answer is spend money on more stuff. And when you have 52 weeks a year free," he said, "people can spend as much if not more" than when they were working, in the first few years at least.

On the other hand, some economists, such as Laurence J. Kotlikoff of Boston University, argue that Americans are being encouraged, even frightened, by the financial services industry into saving more than they will need. Those who listen to industry advice, these economists argue, may end up either unnecessarily lowering their present standard of living to accumulate wealth for retirement, or abandoning all saving in despair because the amount they are told they need is so large.

The argument is of far more than academic interest to today's workers, many of whom are stretched to pay everyday expenses and have little room to sharply increase their savings. Unfortunately, it is likely to be decades before it becomes clear who is right.

What should workers do in the meantime?

Well, one step that almost everyone agrees on, as Berra might say, is to figure out where you are going -- in other words, what kind of retirement you want and what your goals are.

For example, do you want your retirement to be a life of leisure, at least at first, filled with such activities as traveling, going to plays and concerts, eating in fancy restaurants and the like? This is the kind of retirement that, as Glassman said, might well be more expensive than your working years. Or, do you think you would be content putting your feet up, reading all those books you never got around to, watching sports on television, or writing in your blog? That sort of life would likely be inexpensive.

You need to start thinking about those sorts of issues to have any idea of how much money you will need to be comfortable.

Then there is the question of bequests. Do you want to leave a nice chunk of change to your children or other heirs? That would mean not drawing down all your assets during retirement, requiring, in turn, a bigger nest egg or less luxury -- or an earlier death, which solves many financial problems but is not the solution most of us would choose.

Now how much do you think you will need?

In the information age, there are dozens of calculators available to help you come up with a number. Just type "retirement calculator" into a search engine, and you will see. Many calculators are free, such as those sponsored by mutual fund companies such as Fidelity and Vanguard, and are generally simple to use. Just plug in a few bits of information, and they will either crank out a "goal" and how much you need to save to get there, or they will tell you where you will end up if you continue on your present path.

Most allow you to adjust various parameters, such as the percentages of stock and bonds or general rates of return or how long you expect to live in retirement. This is nice for playing what-

if games, but since few of us can predict market returns or how long we will live, it is not clear how much those results will mean.

Some firms offer more sophisticated calculators, usually for a fee, that ask for a more detailed picture of your situation. Some may offer Monte Carlo statistical simulations in which thousands of combinations of such factors as inflation and rates of return are run and the probability of various outcomes is computed.

The idea is to show the likelihood of success -- the money lasting as long as you do -- of various strategies, usually involving the share of your investments you put into stocks, into bonds, and so on.

Some of these calculators are quite detailed, taking into account Social Security, your existing portfolio, including assets not held in retirement accounts, and other factors.

But one thing most of these calculators have in common is that they assume you build up your nest egg until you reach retirement and then draw it down.

Kotlikoff, the Boston University professor, takes a different approach. His ESPlanner program calculates the amount of spending you can do and still maintain a constant standard of living. It can be used, he said recently, not only to figure retirement but to make many pre-retirement decisions such as choosing between a 15- and a 30-year mortgage or picking the proper amount of life insurance.

The program also allows a person to make informed choices about how much to save, he said. For example, he said, a worker may find that if he puts more in his 401(k) plan, his standard of living might take a 10 percent hit now but be 20 percent higher after retirement. "For some people it will make sense" to do that, for others not, but "all questions come down to the living standard."

Kotlikoff called the 70 to 80 percent replacement rule "blindingly stupid" because it assumes spending remains the same "right through age 90." In fact, he said, retirees generally spend less as they get older, so the traditional approach yields a retirement savings goal "for the average middle-class American [that is] four to five times too high."

Advocates of that methodology, of course, do not agree, noting that while it may be conservative, it is better to save too much than too little. The consequences of running out of money because you underestimated your retirement needs are extremely unpleasant.

Increasing numbers of employers are signing up with planners, mutual funds and other advisory firms to offer their workers free or cut-rate calculators and planning help. If your firm offers such help, it makes sense to take advantage of it.

Otherwise, you can try the free online programs, or perhaps buy one of the more sophisticated ones, which can cost up to several hundred dollars.

Or, if you would like more personalized help -- maybe you would just like a clearer picture of where you stand, or perhaps you're considering a major step such as retiring early but worry it might be financial suicide -- you can hire a professional financial planner. Of course, planners also use software, but at least you can ask questions about the assumptions the program is making.

Or you can do what most Americans seem to be doing: Save what you can and hope for the best.