

Q: What is the risk that you could outlive your assets?

Q: How will inflation impact the cost of maintaining your lifestyle?

Q: When does a bear market have the most significant effect on your retirement?

Q: How much will you spend on health care in retirement?



# Retirement Standard Risk Review

## SUMMARY

As a growing number of Baby Boomers reach retirement, understanding the potential risks that await them has become ever more important. Although planning for retirement traditionally has focused on the years leading up to retirement, the changing nature of work, health, longevity and other factors has given way to a growing awareness of a range of risks that retirees face after they cross the threshold and enter retirement.

Certain risks are unknowable and can't be foreseen. And even the most carefully laid plan cannot take into account the truly unexpected. But there are steps that can be taken today to prepare for the risks of tomorrow.

**This brief can help you identify and address some common issues that can lead to the comfortable retirement you envision.**

### Retirement Standard Checklist:

- Lifestyle Review
- Family Records Organizer
- Beneficiary Review
- Retirement Account Assessment
- Your Retirement Income Plan
- Risk Review
- Pension Election
- Social Security Benefits
- Healthcare Cost Evaluation
- Retirement Goal Analysis

**Q. What is the risk that I may outlive your assets?**

**A.** Managing retirement assets contains risk. No one knows how long those assets need to last. Life expectancy in the United States has been rising steadily for the past century, and yet longevity—and the risk it poses to your retirement and ability to manage the assets set aside for retirement—remains poorly understood. Life expectancy numbers represent an average, rather than a fixed life span: 50 percent of the people will die before reaching

the average life expectancy while the other half will live beyond the average.<sup>1</sup>

Moreover, life expectancy is not static, but a moving target: the age to which you're expected to live increases steadily with age. At age 65, average life expectancy for American men is 17 years and 20 years for women. But half of those reaching 65 will live longer than that. Some 30 percent of women and nearly 20 percent of men age 65 can expect to reach 90 years old.<sup>2</sup>

Improved medical services and pharmaceuticals, along with healthier

lifestyles, mean that you may outlive your own lifespan projections. The odds that at least one member of a 65-year-old couple will reach the age of 92 is 50 percent and there's a 25 percent chance that one of them will reach 97.<sup>3</sup> You need to plan for the possibility that you'll live much longer than you anticipate. Instead of assets and income designed to last 25 to 30 years, you may want to plan for postretirement income and assets that can last up to 40 years.

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**Morgan Stanley Smith Barney takes a holistic view of preparing for retirement. Here are some risks you face:**

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**Longevity Risk**

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**Inflation Risk**

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**Market Risk**

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**Health Care Costs**

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**Long-Term Care Costs**

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**Death of a Spouse**

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**Liability Risks**

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**Dependent-Care Risks**

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**Q. When does a bear market have the most significant effect on your retirement?**

**A.** The worst possible time to experience a market downturn is when you have the greatest amount of money at stake, which is typically right before and right after retirement.

Yet market risk is a double-edged sword. There is the risk of course of getting caught in a protracted decline in the equities market. However, there is another kind of market risk, which is that you will not be participating in the equities market at that very moment when you should be invested in stocks. A too-cautious approach towards asset allocation may leave you overly exposed to the impact of inflation and the threat that you may outlive your assets. Dealing with the risk of market timing is a risk that requires a balanced approach.

**Q. How will inflation impact the cost of maintaining your lifestyle?**

**A.** Inflation is of ongoing concern for people living on a fixed-income stream. While Social Security is annually adjusted for inflation, private pension plans often are not. In the period from 1981 to 2010,<sup>4</sup> the change in the consumer price based index ranged from a low of 0.1 percent to 8.9 percent. Even a relatively moderate inflation rate of 2 percent annually over five years would have the effect of reducing the purchasing power of \$100,000 to \$82,035; after 30 years of

steady 2 percent inflation, the purchasing power would be \$55,207 or nearly halved.

However the top line numbers don't tell the full story, as the effects of inflation are not distributed equally across all the categories of expenses that make up the consumer price index. Certain categories such as food, fuel, and energy costs are particularly volatile and have a greater impact on retirees. The inflation rate for medical care has averaged almost 6 percent. Providing for inflation is a necessary component of retirement planning.

**Q. How much will you spend on health care in retirement?**

**A.** The rising cost of health care poses a significant risk to those nearing retirement. With retiree medical expenses rising faster than general inflation, retiree medical coverage offered by employers is becoming the exception rather than the rule as companies shed generous post-retirement benefits, and possible shortfalls looming for Medicare and Medicaid will mean maintaining adequate health care coverage will be a challenge for retirees. A survey conducted by the Society of Actuaries (SOA) in 2010<sup>5</sup> found that 62 percent of pre-retirees are not confident that they are saving enough to handle health care costs in retirement.

There is cause for concern. The portion of assets and resources needed for health expenses has risen and will continue to grow. According to the Center for Retirement Research,<sup>6</sup> the average expected uninsured lifetime health care costs for a typical married couple age 65 is \$197,000 — including insurance premiums, out-of-pocket costs and home health care costs. This figure is an average; health care expenses rise dramatically for those with chronic illnesses or those who have had poor health habits. In the case of those with a catastrophic illness, medical expenses for retirees over 65 that are not covered by Medicare can exceed \$1 million for a couple over their lifetimes.

Moreover, there is a disconnect between what those approaching retirement view as a manageable increase in health care costs and what is likely to happen in the coming years. According to the SOA survey of pre-retirees age 50 to 64, some 68 percent of pre-retirees said that an increase of anywhere from 1 percent to 5 percent annually would be

**RISK OF BAD TIMING  
PORTFOLIO A**

Year	Portfolio Value	Return
	\$1,000,000	
Year 1	\$736,950	-21.60%
Year 2	\$552,195	-18.14%
Year 3	\$525,747	7.89%
Year 4	\$515,995	12.60%
Year 5	\$406,617	-8.79%
Year 6	\$386,630	15.89%
Year 7	\$334,574	7.68%
Year 8	\$270,750	5.92%
Year 9	\$201,576	6.86%
Year 10	\$127,633	9.86%
Year 11	\$44,455	14.52%
Year 12	\$0	19.93%
Year 13	\$0	16.70%
Year 14	\$0	14.41%
Year 15	\$0	20.54%
Average annual return a 6.1%		

**PORTFOLIO B**

Year	Portfolio Value	Return
	\$1,000,000	
Year 1	\$1,133,076	20.54%
Year 2	\$1,224,960	14.41%
Year 3	\$1,353,795	16.70%
Year 4	\$1,542,664	19.93%
Year 5	\$1,686,275	14.52%
Year 6	\$1,772,345	9.86%
Year 7	\$1,812,800	6.86%
Year 8	\$1,836,488	5.92%
Year 9	\$1,889,110	7.68%
Year 10	\$2,090,321	15.89%
Year 11	\$1,825,574	8.79%
Year 12	\$1,951,591	12.60%
Year 13	\$2,001,930	7.89%
Year 14	\$1,556,998	18.14%
Year 15	\$1,392,228	21.60%
Average annual return a 6.1%		

DATA: Morgan Stanley Smith Barney. For illustrative purposes only. Assumes an annual withdrawal rate of 6% (indexed for inflation at 4% per year). Assumes withdrawals are taken on the first of every year. Portfolio value is as December 31. Past performances is no guarantee of future results. This illustration is hypothetical and is not indicative of the performance of any specific investment. Actual results may vary. Neither the information nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. These strategies do not guarantee a profit or protect against loss and may not be suitable for all investors.

manageable; but in fact, the U.S. Department of Health and Human Services estimated last year that health care costs are expected to increase on average by 6.1 percent annually until the year 2019.<sup>7</sup>

**Q. What are the chances I need Long-term Care?**

**A.** The estimates of average out-of-pocket medical expenses that a retired couple will face over their retirement do not include costs of long-term care, which is not covered by Medicare. Retirees who are no longer capable of living independently have a range of choices, including: moving in with their adult children; a continuing care retirement community; assisted-living residences for those who cannot live independently but don't need skilled nursing care; or moving to a nursing home.

Each choice carries different price tags. While the average cost of nursing home care can reach \$74,000 per person a year and rising, according to the AARP,<sup>9</sup> it can cost even more depending on where you live. Employee health insurance does not pay for nursing home care. Out-of-pocket payments by people receiving long-term care and their families financed 19 percent, or about \$37 billion, of long-term care services in 2004.<sup>10</sup> It's estimated that at least 70 percent of those over the age of 65 will need some long-term care at some

point in their lives.<sup>11</sup> Unlike other costs like buying property or paying college tuition, health care expenses can strike anytime. Moreover, those costs are rising. Planning now can make a difference in how prepared you are to handle those costs when they do arise.

**Death of a Spouse.**

A common misconception that many couples have once retirement begins is that in the event of the death of a husband, the surviving spouse will

have plenty of money to live comfortably for the rest of her life. In fact, for many women, the death of a spouse is accompanied by a decline in standard of living. And because women generally have a higher life expectancy than men and typically are younger than their husbands, it is not uncommon for women to experience a period of widowhood of 15 years or more.

Retirees face an increased risk of poverty when their spouse dies before them, as one or more sources of income

With catastrophic illness, medical expenses for retirees over 65 that are not covered by Medicare can exceed \$1 million for a couple over their lifetimes.<sup>8</sup>

stop or are reduced. A spouse's pension is often reduced by half after their spouse dies, and if the couple receives Social Security benefits based on each of their own work histories, the survivor gets the higher benefit. Couples need to consider what their current expenses are, what their sources of income are, and how those factors will change when a spouse dies.

#### Liability Risks.

Retirees often place too great a focus on investing in assets and generating revenue streams — often to the detriment of protecting themselves against other potential liabilities. Just because you are retired that does not mean that you can stop worrying about maintaining an appropriate level of property and casualty insurance on a home or vacation property. If anything, the potential liability arising from such hazards can have as big an impact on the quality of your retirement as any downturn in the stock market. It is important to protect yourself against exposure to lawsuits involving a vacation property that you may rent part of the year and liability insurance if you own a pool.

#### Dependent Care.

Retirees sometimes must meet the unforeseen needs of family members, in

addition to their own. Retirees often assist their parents, children or other family, paying for the day-to-day costs of caring for an elderly parent, paying for higher education tuition fees for children or grandchildren, or offering short-term financial assistance to

adult children in the event of unemployment, divorce or other financial shock. Your planning should recognize the possibility of being obliged to support family member in such ways in the future, even if this does not seem likely before retirement.

It's estimated that 70 percent of those over the age of 65 will need some long-term care. Unlike other costs like buying property or paying college tuition, health care expenses can strike anytime.<sup>12</sup>

**Talk To Us.** Retirement has potential pitfalls. Understanding such risks as longevity, inflation, health care expenses and asset allocation is a key towards preparing for a successful retirement. Talk to us about the risks you may face once you retire. We can run a customized Retirement Analysis that reviews these risks and lets you include contingency margins to cover increases in expenditure, enabling to you to have a comprehensive plan for the retirement you envision.

1 Source: Annuity 2000 Mortality Table, Society of Actuaries (Figure assumes a person is in good health).

2 (Source: Social Security Administration, 2000 Period Life Table Extrapolated to 2008, in "2007 Society of Actuaries' Key Findings: Risk of Retirement Report.")

3 Annuity 2000 Mortality Table; Society of Actuaries. (Figures assume a person is in good health.)

4 Source: U.S. Inflation Calculator, Consumer Price Index Data from 1913 to 2011 [usinflationcalculator.com]; CPI-U data is provided by U.S. Department of Labor Bureau of Labor Statistics.

5 Source: Society of Actuaries 2010 Healthcare and Retirement Planning Survey. <http://www.soa.org/files/pdf/news-pub-healthcare-retire-survey-fact.pdf>.

6 Center for Retirement Research, Research Brief Number 10-4, March 2010: "What Is the Distribution of Lifetime Health Care Costs from Age 65?" by Anthony Webb and Natalia Zhiva.

7 Source: Society of Actuaries 2010 Healthcare and Retirement

Planning Survey. <http://www.soa.org/files/pdf/news-pub-healthcare-retire-survey-fact.pdf>.

8 Source: "Key Findings and Issues: Understanding and Managing the Risks of Retirement", 2007 risks and Process of Retirement Survey Report, Society of Actuaries.

9 Source: Get the Facts on Long-Term Care 2010-AARP [http://www.aarp.org/content/dam/aarp/relationships/caregiving/2011\\_05/long-term-care-fact-sheet.pdf](http://www.aarp.org/content/dam/aarp/relationships/caregiving/2011_05/long-term-care-fact-sheet.pdf).

10 Source: "National Spending for Long-Term Care," Georgetown University Long-Term Financing Project, January 2007.

11 Source: U.S. Department of Health and Human Services National Clearinghouse for Long-Term Care [http://www.longtermcare.gov/LTC/Main\\_Site/index.aspx](http://www.longtermcare.gov/LTC/Main_Site/index.aspx)Centers for Medicare and Medicaid Services.

12 Source: U.S. Department of Health and Human Services National Clearinghouse for Long-Term Care, 2011. [http://www.longtermcare.gov/LTC/Main\\_Site/index.aspx](http://www.longtermcare.gov/LTC/Main_Site/index.aspx)Centers for Medicare and Medicaid Services.



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