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SUREVEST

WEALTH MANAGEMENT

# Saving for Retirement – How Much Do You Need?

How much should I be saving for retirement? That seems like a straightforward question for your financial advisor. Wouldn't it be nice if you could get a straightforward answer? Everyone wants to boil down financial planning to simple rules like "Always save 10% of your pay." Saving a percentage of your income is one of the cornerstones of financial planning. There is some debate regarding the exact percentage, but **10-15% is a commonly quoted range** in regards to saving for retirement. The amount of savings needed varies based on a variety of factors such as whether you will have a **pension in retirement**, whether your home will be paid-off prior to retirement, rate of return on your investments, and what percentage of your retirement spending will be covered by Social Security. Note that Social Security only covers 40% of the average retirees spending, but it covers a higher percentage for low income retirees and a smaller percentage for higher income retirees, who spend more than $100k per year.

## Saving for retirement, beware of lifestyle creep:

Some people claim that they can't save 10%. Here's a newsflash … even if you do save 10% of your income, you may never have enough to retire if you increase your spending by 90% of every raise and bonus. Most people spend 80-100% of their pre-retirement spending level in retirement. So, even though you may be saving 10%, the amount needed to retire also grows as you increase your spending. This is known as lifestyle creep. Once you move to the bigger house and nicer car, it's hard to go back.

Many families who are not saving enough for retirement assume that their earnings will continue to increase and will, therefore, catch up with their lifestyle costs. A recent study by the Federal Reserve of NY found that **workers' earnings rise the most rapidly in their 20s and 30s**. The rate of wage growth slows in our 40s and earnings peaks in our early 50s. Contrary to popular belief, earnings actually decline in the last 5-10 years of the average career.

## Income growth in your later years is *not* likely to bail you out of earlier decisions:

This path of earnings is important because income growth in the later years of your career is *not* likely to bail you out of earlier decisions. This may leave little choice but to work longer or make spending cuts. **Workers in their 20s or 30s, on the other hand, can reach financial independence, even starting from a savings rate of zero by limiting spending increases to 50% of each future pay raise (and bonus) and saving the other 50%.** The end result of such an approach is that increases in your standard of living rise more slowly, your savings grows quickly, and you can even retire earlier…all while feeling like your lifestyle is steadily rising.

Imagine a twenty-five year old earning $50,000 per year (after taxes). He would be making $163,000 a year by age 65, assuming he got a 3% raise each year for 40 years. However, he would be spending $146,791 if he increased his living expenses proportionally so that he saves 10% of each raise and spends the other 90%. His spending would only grow to $90,700 per year if he limited his spending increases to half of his raises (1.5%) each year, and he would be saving over $72,000. As you can see, the amount saved each year is much greater and, more importantly, the amount needed to retire is much lower because lifestyle spending is so much lower.

## How much should you have saved by retirement?

A very simplistic answer to this question is…you should have in the neighborhood of 25 times the amount of money you would like to withdraw from your portfolio annually at the beginning of retirement. For example, you would need $1 million if you want to withdraw $40,000 per year at the beginning of retirement (around age 65) and increase that withdrawal each year to keep up with inflation. (See: **Safe Withdrawal Rate in Retirement**)

## How much does the average person save?

All of this may have you wondering: How much does the average person save each year? As of June 2019 **the personal savings rate** in the United States is 6.20%. This is below the long-term average savings rate of 8.80%. The personal savings rate includes employee *and* employer **contributions to retirement funds**. Our clients tend to be much better savers than the general public, so…thanks for bringing up the average.

Have a great weekend.

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