Investor Insights and Outlook

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Planning For Known — and Unknown — Healthcare Costs in Retirement

The issue of health care costs in retirement – and planning for them well in advance of retirement – is becoming a centerpiece of any retirement planning discussion.

A recent study by Employee Benefit Research Institute (EBRI) projected that in 2014, men and women who wanted a 90% chance of having enough money to cover out-of-pocket health care expenses in retirement would need to have saved $116,000 and $131,000 respectively by age 65.[1] This is a sobering goal when you consider that just 42% of workers in their 50s and 60s report total savings and investments in excess of $100,000.[2]

Part of the problem with putting a price tag on retiree health care expenses is that every situation will vary depending on an individual's health, the type of health care coverage they carry, and when they hope to retire.

That said, EBRI has identified some "recurring expenses," or standard elements of cost that can be estimated and planned for in advance as well as "non-recurring" expenses that are less predictable but tend to increase with age.

Recurring vs. Non-Recurring Expenses

Using data gleaned from the Health and Retirement Study (HRS) – a longstanding, highly respected study of representative U.S. households with individuals over age 50 – EBRI was able to categorize utilization patterns and expenses for two separate types of health care services:

Recurring services – include doctor visits, prescription drug usage, and dentist services. Since these services tend to remain stable throughout retirement, it is possible to calculate an average out-of-pocket expense among individuals age 65 and older of $1,885 annually.[3]

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Growth Investing — A Core Part of Your Long-term Strategy

Long-term investment goals are as unique as the people who set them. Some investors set their sights on building a dream home; others may be looking to launch a new business. Still others seek the more traditional long-term goals of a comfortable retirement or funding a child's education.

No matter how they differ, all long-term investment goals have one thing in common - the need to accumulate wealth. One way to pursue long-term goals is to build a portfolio around a core of growth-oriented stocks.[1]

The Potential Power of Growth

Growth investing is a strategy in which an investor selects stocks based on strong track records of earnings growth. These stocks generally don't pay high dividends, but instead reinvest their earnings for the future. Such companies typically are well-established, serve growing markets, lead their industries with consistent market share gains and technological innovations, and produce strong financial returns.

Growth stocks are generally differentiated from other stocks, such as value stocks, based on their higher price-to-earnings (P/E) ratios. These measurements reflect how much investors may be willing to pay for a stake in a company's present and future success. The higher the ratio, the more investors are likely to spend.

Although growth stocks tend to be more expensive, history suggests that they have often rewarded those willing to pay the price. While past performance cannot guarantee future results, for the 30-year period ended December 31, 2014, growth stocks returned an average of 11.37% per year.[2]

Manage Risk Intelligently

All stocks involve a certain level of risk. That's one reason why growth stocks may be more appropriate for investors with long-term time horizons. The longer you hold on to these investments, the lower the risk may be that short-term losses will significantly affect your bottom line.

Another way to manage risk is to diversify your portfolio with other types of investments.[3] For instance, consider dividing your stock allocation among large-cap, midcap, and/or small-cap stocks.[4] Then think about adding bonds and cash instruments as well.[5] An investment mix that uses all three traditional asset classes may help you pursue desired returns while maintaining a comfortable level of volatility.

A Sound Strategy for a Variety of Needs

A well-crafted investment strategy built around a core group of growth stocks may help get you well on your way toward your long-term goals - whatever they may be.

Source/Disclaimer:

[1]Investing in stocks involves risks, including loss of principal. Because the prices of most growth stocks are based on future expectations, these stocks tend to be more sensitive than value stocks to bad economic news and negative earnings surprises. While the prices of any type of stock may rise and fall rapidly, growth stocks in particular may underperform during periods when the market favors value stocks.

[2]Wealth Management Systems Inc. For the 30-year period ended December 31, 2014. Growth stocks represented by a composite of the S&P 500/BARRA Growth and Value indexes and the S&P/Citi Growth and Value indexes.

[3]There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

[4]Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments. Midcap companies often have greater price volatility, lower trading volume, and less liquidity than larger, more established companies. For these and other reasons, investments in small-cap and midcap companies carry more risk than investments in large-cap companies.

[5]Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. CDs are FDIC insured and offer a fixed rate of return if held to maturity.

How Well Do You Know Your 401(k)?

The old saying "knowledge is power" applies to many situations in life, including retirement planning. The more you know about the benefits your plan offers, the more likely you'll be to make the most of them and come out ahead financially when it's time to retire. Here are some questions to test your knowledge about your plan.

How much can I contribute?

The maximum contribution permitted by the IRS for 2015 is $18,000, although your plan may impose lower limits. Further, if you are age 50 or older, you may be able to make an additional $6,000 "catch-up" contribution as long as you first contribute the annual maximum. Check with your benefits representative to find out how much you can save.

What investments are available to me?

Recent research indicated that a third of retirement plan participants were "not at all familiar" or "not that familiar" with the investment options offered by their employer's plan.[1] The study went on to reveal that individuals who were familiar with their retirement plan investments were nearly twice as likely to save 10% or more of their annual income, compared with those who report having little-to-no knowledge about such investments.[1]

Understanding your investment options is essential when building a portfolio that matches your risk tolerance and time horizon. Generally speaking, the shorter your time horizon, the more conservative you may want your investments to be, while a longer time horizon may enable you to take on slightly more risk.

What are the tax benefits?

Contributing to your employer's retirement plan offers two significant tax benefits. First, since your contributions are taken out of your paycheck before taxes are withheld, you get the up-front benefit of lowering your current taxable income. Plus, since you don't pay taxes on the money you contribute or on any investment earnings until you make withdrawals, more goes toward building your retirement nest egg.[2]

Will my employer make contributions to my account on my behalf?

Many companies try to encourage participation in their retirement plans by matching workers' contributions up to a certain percentage of each worker's salary. Defined contribution benchmarking studies indicate that the average company contribution in 401(k) plans is now 2.7% of pay.[3] The most common type of fixed match reported by 40% of plan sponsors is $.50 per $1.00 up to a specified percentage of pay (commonly 6%).[3] For their part, employees interviewed recently cited "taking advantage of the company match" as the top reason for participating in their company's retirement plan.[4]

How long before the money in the plan is mine?

Any money you contribute to your retirement account is yours, period. However, any matching contributions made by your employer may be on a "vesting schedule," where your percentage of ownership increases based on years of service. Current research indicates that 40.6% of employers now offer immediate vesting of matching contributions.[3] Because vesting schedules vary from plan to plan, be sure you know the specifics of yours.

Your benefits representative can help you answer these and other questions about your employer-sponsored plan. Being "in the know" may help you avoid missteps and make as much progress as possible on the road to retirement.

Source/Disclaimer:

[1]*Pensions & Investments*, "TIAA-CREF: Participants with knowledge of investment options more likely to save," February 26, 2014.

[2]Withdrawals from tax-deferred retirement accounts will be taxed at then-current rates. Withdrawals made prior to age 59½ may be subject to a 10% additional federal tax.

[3]401(k) Help Center.com, "Benchmark Your 401(k) Plan, 2015."

[4]Deloitte Development LLC, "Annual Defined Contribution Benchmarking Survey," 2013-2014 Edition.

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Projecting forward, and factoring in the following assumptions: a 2% inflation rate, a 3% rate of return on investments, and a life expectancy of 90 years, EBRI estimates that one would need $40,798 at age 65 to cover the average out-of-pocket expenses for recurring health care needs throughout retirement. It should be noted that this calculation does not include expenses for any insurance premiums or over-the-counter medications.

Non-recurring expenses -- include overnight hospital stays, overnight nursing home stays, home health care, outpatient surgery, and special facilities. Unlike recurring expenses, the cost of most non-recurring services increases with age. For example, average annual out-of-pocket expenses for nursing home stays are estimated at $8,902 for those in the 65 to 74 age group, $16,948 for those aged 75 to 84, and $24,185 for individuals aged 85 and up.[3]

Yet because the likelihood of utilizing these services and the degree to which they will be needed is largely unknown, projecting the savings needed to cover these costs throughout retirement is an elusive exercise. However, by thinking about the total out-of-pocket savings goals of $116,000 for men and $131,000 for women cited earlier in terms of recurring and non-recurring costs may help retirees and those nearing retirement in their planning efforts.

Bigger Picture Planning

Financial advisors often recommend taking a holistic approach to calculating income needs in retirement, factoring in such costs as taxes and debt payments along with other typical expenses including health care. In addition to the out-of-pocket health care calculations discussed above, consider what you think you might have to pay in annual premiums if you were to apply for health insurance today. Lastly, and perhaps most important, add in an allowance for inflation -- both general and health care inflation.

Your financial planner can help get the retirement income planning discussion started and -- as part of that exercise -- can work with you to put some numbers around your health care planning needs.

This article offers only an outline; it is not a definitive guide to all possible consequences and implications of any specific saving or investment strategy. For this reason, be sure to seek advice from knowledgeable professionals.

Source/Disclaimer:

[1]Employee Benefit Research Institute, news release, "Needed Savings for Health Care in Retirement Continue to Fall," October 28, 2014.

[2]Employee Benefit Research Institute, *2014 Retirement Confidence Survey*, March 2014. (Not including the value of a primary residence or defined benefit plans.)

[3]Employee Benefit Research Institute, "Utilization Patterns and Out-of-Pocket Expenses for Different Health Care Services Among American Retirees," February 2015.

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