Where's My Inheritance?

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By Charlie Douglas,
With *Terry Ford*

An in-depth discussion on the demanding financial realities that Baby Boomers will face during retirement and their growing need for a timely inheritance to help make ends meet.

Believe it or not, Baby Boomers are getting ready to retire. It is a sobering thought that this generation, which once embraced Barbie Dolls and Captain Kangaroo, started turning 60 this year. Born between 1946 and 1964, this mega-generation of some 77 million people are turning 50 at the rate of more than 12,000 a day ─ one person every eight seconds. This massive demographic shift is sure to have profound personal and societal implications.

As Boomers prepare to embark upon retirement, many are discovering the demanding economic realities of retirement that they are unable to meet. Having been credited with putting the word "shop-a-holic" into our lexicon and with valuing personal gratification over delayed gratification, Boomers are now faced with the precarious problem of the three to four decade, two-person retirement.

With too much life ahead to live and too little money to get them through it, more and more Boomers are hoping that a timely inheritance will help them meet the onerous demands of retirement.

Retirement Reality Check

Many Boomers are expecting an extended period of leisure at the end of their careers, similar to that being experienced by their parents. Banking on "The Golden Age of Retirement" continuing unabated, Boomers would be better off banking more dollars away for a more modest retirement. In fact, Boomer's "Golden Age of Retirement" is likely to be one without much gold.

Longer retirements and likely declines in retirement incomes have put many Boomer households at risk of being unable to maintain their pre-retirement standard of living. The Center for Retirement Research at Boston College recently released a study that showed that even if people retire at age 65 and households annuitized all of their wealth, including reverse mortgages on their homes, 43 percent would still be at risk.[1] While more than a few retirees live comfortably in their own homes today, will Boomers have to live in apartments, while living off the sales proceeds from their prior homes just to make ends meet during retirement?

The report from Boston College's Center of Research is not the only one with gloomy predictions regarding Boomer and younger generation's retirements. Consider that the Employee Benefit Research Institute (EBRI) estimates that there will be a $45 billion a year funding gap between retiree's essential living expenses and their projected incomes by 2030. And Fidelity Investments recently conducted a survey which revealed that 83 percent of American workers are not socking enough money away for retirement. The survey showed that workers are saving at a pace that would cover only 57 percent of their current income in retirement, which includes workplace and personal savings, as well as Social Security and pension benefits[2].

So what has happened to dampen the promising era of the retirement landscape?
Well for one thing, retirement's traditional three-legged stool, consisting of Social Security, pensions and personal savings lost two of its three legs. Social Security is now questionable and defined benefit pensions will only cover about 3 in 10 Boomers, with an average benefit of around $800 per month for life.[3]

Without question, Social Security and traditional pension plans will be playing a much smaller role in retirement income in the future. According to EBRI, current retires receive about two-thirds of their retirement income from Social Security and traditional company pensions. However, workers today can expect to have only one-third of their retirement income needs met from these sources.[4]

The other factors which have dramatically changed the face of retirement are longevity and health care costs. The fact is that people are living much longer in an environment where health care costs have exploded.

Let's take a closer look at just what's happening.

The Insolvency of Social Security and Paltry Personal Savings

In 1935, after bank failures and a stock market crash had wiped out the savings of millions of Americans, the nation turned to government to guarantee the elderly a decent income. In those days, only a handful of workers had access to pensions from their employers or through State governmental pension programs.

At that time, over half of America's elderly lacked sufficient income to be self-supporting. Therefore, the Social Security Act was enacted at the urging of President Franklin D. Roosevelt to create a social insurance program that would ensure workers would have a source of income after they retired.

Since its inception, Social Security has provided stable and meaningful retirement income benefits. Over the years many retirees have steadfastly depended upon this reliable income source to meet their primary retirement needs. Still today, for one-third of Americans over 65, Social Security benefits constitute 90% of their total income.[5] And although many future retirees will have a similar need for Social Security during their retirement, the truth is that Social Security is in serious trouble.

Read my lips, "Social Security is insolvent." There is no money in the Social Security Trust Fund and over the long run it cannot afford to pay the benefits that it has promised. The latest projections from the trustees of the trust fund are that in 2017 Social Security will begin paying out more money than it takes in. By 2070, Social Security is projected to face a $27 trillion shortfall.[6]

Unfavorable demographics have, in no small way, helped lead Social Security to its downfall. In 1945, there were 42 workers supporting every 1 retiree. That number has steadily declined over the years to 3 workers per retiree. By 2040 that number is projected to decline to 2 workers per 1 retiree.[7]

The shortfall in Social Security will, at some point, have to be made up by dipping into other government programs, raising taxes, or cutting benefits. But America's ability to borrow undeterred against future generations cannot go on forever. As the economic well of financial reserves continues to be depleted at a progressive rate, benefits will surely be cut and taxes will be raised in some combination.

Currently, people born before 1938 can retire at age 65 and receive full benefits. For people born in 1938 or later, however, the full retirement age gradually increases, until it reaches age 67 for Boomers born after 1959. In the future, younger generations would do well to plan on the age for receiving Social Security retirement benefits being pushed out to 70 and beyond, and then, at a reduced benefit amount.

Social Security's debacle would be less painful if personal savings were better positioned. The facts are, however, that most of the working-age population save virtually nothing outside of their IRA or their employer-sponsored pension plan. Even then, only 15% of working age Americans have an IRA and only 22% contribute to a 401(k) plan, according to EBRI. Hopefully these percentages will rise in future with automatic enrollment of workers into 401(k) plans under the new pension law.

For the time being, the stark truth is that our national savings rate is practically zero (currently negative and the lowest savings rate in the developed world), and consumer debt along with personal bankruptcies are at an all time high. Contrast that when Americans during World War II saved about one-third of what they made, or with India or China today, who save nearly 30% of what they make.

Like the grasshopper from Aesop's fable, are Boomers basking in the relative ease of today and forgetting about saving and preparing for the days of necessity ahead? Today's summer for many Boomers is sure to give way to retirement's winter, where the storehouse of economic resources will not last through that long and trying season.

The Demise of Defined-Benefit Pensions

The defined-benefit pension, long the gold standard for retirement because it guaranteed a fixed income for life for retired employees, is now a thing of the past. The number of such plans offered by corporations has plunged from 112,000 in 1985 to less than 27,700 today. From 2001 to 2004, nearly 200 corporations from the Fortune 1000 killed or froze their defined benefit plans. During the three decades from the mid-1970s to now, the number of workers covered by defined benefit plans fell from 44% to 17%.[8]

The shift away from guaranteed pension plans was largely encouraged by Congress. In the late 1970s Congress passed a law that invited corporations to abandon their defined-benefit plans in favor of defined-contribution plans, most notably 401(k)s, in which employees set aside a fixed sum of money toward retirement.

Corporations soon discovered in an increasingly competitive global marketplace that they could improve their bottom lines by shifting workers out of costly defined benefit plans and into cheaper 401(k) plans. And even if a corporation in some way contributes towards an employee's 401(k) plan, the contributions will never be enough in many cases to match the lifetime benefits from defined-benefit plans.

It is often touted that there is in excess of $2 trillion invested in 401(k)s, but the underlying numbers are less impressive. The average balance in 401(k)s for employees is about $65,000, but more than half of the accounts held less than $20,000, and nearly one in four had less than $5,000.[9] 410(k)s, while a solid savings vehicle for retirement, are simply no substitute for defined-benefit plans. Yet, defined-benefit plans have problems of their own.

Overall, defined benefits plans do not have enough assets to meet their future obligations and are underfunded by an estimated $450 billion. Of the 369 Standard & Poors companies that offer pension plans, 311 do not have enough money to cover their commitments.[10] Also alarming, is the fact that the Pension Benefit Guaranty Corporation (PBGC), which was created by the Employee Retirement Income Security Act of 1974, to guarantee minimum standards for retirement plans in the private sector, may well be in need of a multi-billion dollar taxpayer bailout as it is running a $22.8 billion deficit.

The PBGC currently protects the pensions of 44.1 million American workers and retirees in 30,330 private single-employer and multiemployer defined benefit pension plans. However, the PBGC receives no funds from general tax revenues. Operations are largely financed by insurance premiums set by Congress (currently $19 per worker per year) and paid by sponsors of defined-benefit plans.

It should also be noted that the PBGC is not backed by the U.S. government. Recent Congressional efforts have attempted to put the nation's defined-benefit pension plans on sounding footing by forcing companies with underfunded plans to meet obligations to their workers. Yet funding requirements are no more predictable under the new pension law and it could actually force more companies to eliminate or freeze their plans.

By no means does having a pension plan mean that you are on easy street when you retire. Just ask those pilots from United Airlines and US Airways when their respective companies unloaded their pension obligations on the PBGC during bankruptcy. Six figure pension incomes were drastically reduced in short order. In 2005, the maximum plan benefit the PBGC guaranteed was only $3,801.14 per month ($45,613.68 per year) for workers who retired at age 65.

Many public-employee pension plans are experiencing financial difficulties too. A study of 64 state pension systems by Wilshire Associates, an investment advisory company, found that 54 of them were under-funded by a total of $175.4 billion.[11] The situation at the municipal level is even worse. Cities like San Diego, Philadelphia and Illinois all have multi-billion dollar unfunded pension liabilities.

Even if you are or will be receiving a stable monthly pension payment, with a 3 to 4 decade retirement to plan for, it is worth noting that the purchasing power of your monthly payment drops in half in 20 years at a 3.5% inflation rate. As can be seen from the chart below, inflation has quite an impact over a nearly 30 year period.

Consumer Price Changes 1976-2005

	1976	2005	% Change
Gallon of Gasoline	$0.59	$3.07	520
Gallon of Milk	$1.65	$3.30	200
First Class Stamp	$0.13	$0.37	285
New Home	$48,000	$213,900	445

All 1976 prices from website 1970sflashback.com; Gallon of Gasoline for 2005 from Energy Information Administration website; New home for 2005 from CNN.Money.com, 2/15/2006; Gallon of milk for 2005 from Federal Milk Order Administration publication

Longer Life Expectancies and Exploding Health Care Costs

Advances in science and medical research have pushed the lifespan envelope in recent years so that healthy individuals just entering retirement will have to make plans for the very real possibility of needing 30 to 40 years of post-retirement income.

People are living significantly longer today. During the Roman Empire, however, the average life expectancy was 22 years. By the Middle Ages it had risen to about 33 years in England. In the U.S. people of both sexes born in 1900 could expect to live 47.3 years on average, while those born in 1950 were set to live 68.2 years.

Between 1900 and 2000, life expectancy in the U.S. increased by 30 years. In fact, every year that we live our life expectancy improves. So even though the average child born in the year 2000 has a life expectancy of 77, if you were already 65, your life expectancy is 83. Right now, there’s a 50% chance that one person in a couple is going to live to 92.[12]

Few of us realize that even those who have reached 80 or 85, assuming they are in good health, still have high probabilities of living 10 or 15 more years. As medical breakthroughs continue in the years to come it would not be surprising to see healthy elders regularly reaching the century mark and beyond.

Living longer will come at the expense of living better for many Boomers. Health care costs have been exploding. The costs of prescriptions, nursing home care and assisted living have all been skyrocketing in recent times. Health care costs increased by more than 50% from 2000 to 2004.[13] And for the 20-year period from 1984 through 2004, medical costs in the U.S. increased 186% or an average of 9.3% year. This is more than triple the long term inflation rate of 3% that working Americans have encountered over the years. In light of this, a go-forward long term inflation rate of 4% may be more appropriate considering the escalating health care costs.[14]

The growing number and cost of prescription drugs is part of the problem. On average, individuals 65-69 years old, take 14 prescription drugs per year. That number jumps to 18 for people ages 80-84. The number is high because the longer we live, the more likely we are to have multiple illnesses, and because many drugs have side effects that are offset by additional drugs.[15]

Assuming the average cost of one prescription drug is $500, and you are taking 14, that's $7,000 of extra income that you may need─$14,000 per couple. Over 30 years, that equals $420,000. Enrollment in Medicare or Medigap can provide you with discounts or limed coverage for prescription drugs, but you still must pay annual fees and deductibles, and they may not cover all of the drugs that you take.[16]

Likewise, the need for nursing homes is adding to the escalation in health care costs. According to the U.S. Congressional Budget Office, 45% of people who turn 65 in the year 2010 will require some nursing home care. And although the costs differ depending upon where you live, if you want a private room, it will cost you more than $70,000 a year.

With respect to long term care Medicare offers little assistance. Generally, Medicare Part "A" only covers the first 20 days of skilled nursing home care and limited coverage for the next 80, but you must still pay the coinsurance. Beyond 100 days, the burden of paying for care will be your sole cost.

Purchasing Long Term Health Care insurance can help, but people are often hesitant in buying it because the premiums paid may never be used for the coverage provided. Moreover, premiums for this type of insurance can be pretty costly if you purchase it at older ages.

Fidelity Investments estimates that a couple retiring today at age 65 should plan on spending around $200,000 out of pocket over the course of retirement to pay for health care expenses that are not covered by Medicare. And with health care costs rising at a far greater clip than the overall inflation rate, today's 45-year-olds could easily wind up paying over twice this amount by the time they retire by age 65.[17]

Here again, corporate America is helping recent retirees less and less. In 1988, 66% of American companies offered retiree health benefits. By 2002, that percentage had dropped to 34%.[18] The dramatic drop occurred is the 1990s when the Financial Accounting Standards Board required corporations to expense retiree medical costs annually, a move that caused many companies to cut off medical insurance for retirees in order to maintain their earnings per share. With fewer and fewer companies now offering paid retirement health insurance as a benefit to their employees, future retirees will have to devote a significant and growing percentage of their income to cover health care costs.

Government Won't Be Able to Bail Out to Baby Boomers

Excessive government spending and the massive entitlements of America's "Great Society" have been a real boon for many of today's retired. They have allowed the majority of today's retirees to afford a decent standard of living. However, they are also providing for today's elderly at the expense of being able to provide for younger generations tomorrow.

It is not easy to ignore the fact that federal spending has skyrocketed in recent times—up over 33% since 2001. Now well in excess of $22,000 per household, federal spending is at its highest levels since World War II. There have been massive increases in defense, farm subsidies, education, and Medicare—where the Prescription Drug Program became the first major entitlement bill enacted without any taxes to pay for it.

"Spending cuts" are openly touted in Washington when there are no spending cuts, only minor adjustments that slow spending growth. For example, the White House recently proposed to "cut" Medicare by about $36 billion over the next five years. But this "cut" only represents 1.5% of Medicare's outlays and merely slows the growth of Medicare from 70% to 66% over the next five years.

We live in a time where tax cuts and spending increases are popular and painless, while tax increases and spending cuts are demanding and discarded. Yet, this reckless combination has all the makings of becoming a serious bombshell where the fallout will be severe. The federal debt has already increased from about $6 trillion in early 2002 to a projected $9 trillion by the end of 2007. Without major spending cuts, tax increases, or both, the national debt is projected to grow by more than $3 trillion through 2010 to $11.2 trillion.

Warren Buffet recently commented on the current political and financial debacle by stating, "Today, too many of our country's key economic decisions are being made with an eye toward the next election rather than to the next generation."

In contemporary times, America's longstanding commitment to fiscal restraint has been missing in action. Since 2002 we no longer have budget rules that require a future increase in benefit payments or cuts in taxes to be paid for by cutting spending in other areas or increasing taxes. The fervor for permanent tax cuts has replaced the restraint of a pay-as-you-go system.

Consider for a moment that prior repeals of the estate tax, shortly after the Civil War and just after the beginning of 20th century, were done at times when America's budget pressures had eased. Today, however, budget pressures abound. Yet, there has been a clarion call by many conservatives to repeal the estate tax, even though such a move would cost nearly $1 trillion in tax revenue to the United States Treasury over the first decade of the full repeal according to the Center on Budget and Policy Priorities.

There is no denying it; we have gone down the undisciplined path of having more government than we are willing to pay for with taxes. After all, it is the level of federal spending that determines the level of taxation; not the other way around. The primary problem in Washington is spending, not how it is financed.

Although many would like to believe that we will simply "grow our way out" of any economic plight without tax increases and accompanying benefit reductions, the unsettling truth is that we would be better off putting our faith in the benevolence of the Easter Bunny.

Perhaps part of our complacency is that the size of the federal debt—now in excess of $8 trillion—relative to the overall economy and GDP is perceived as manageable. But federal debt, due mainly to swelling entitlements, should be growing much faster than GDP in the years to come. In a few decades or less the federal debt will plainly be too large a percentage of GDP to ignore.

Are we willing to heed the latest warnings of the economic bombshell to come? As former Fed Chief Greenspan warned shortly before leaving his post, huge fiscal strains pose "significant economic risks" and the government should seek to "close the fiscal gap primarily, if no wholly, from the outlay (spending) side." Clearly, deficits are the symptoms, but spending is the disease.

In this regard, entitlements are the "Mother of all monetary time-bombs" and will surely cripple America without serious and immediate reform. Already, entitlements and interest on the national debt account for nearly two-thirds of federal spending today. The fact is the current pay-as-you-go entitlement system will become unsustainable in future decades as payroll taxes on a shrinking workforce will not provide the promised benefits for an expanding elderly base.

Alarmingly, there is a gigantic imbalance of around $46 trillion in unfunded obligations in our entitlement system.[19] To put this number in perspective, consider that if a person lived for 70 years, he or she would have to spend $39,138,943 every day for 70 years to equal just one trillion dollars. Our nation's unfunded liability number is a staggering sum of money.

It is interesting to note that under Sarbanes-Oxley corporate America is required to disclose its future obligations for retirement and medical benefits. This has an immediate negative impact on profitability. The government, on the other hand, has no such mandate. If the government were required to follow the same set of rules of transparency, however, the deficit in 2005 would have been $3.5 trillion, and not the $318 billion deficit figure that was recently reported by the government.

The fiscal battlefield will become even uglier when Baby Boomers begin retiring near the end of the decade, and Medicare expenditures quickly double in size. At that time, the cash-flow surplus from Social Security will no longer be able to be used to pay for Medicare's swelling deficits and escalating costs.

Lest we forget, our recent efforts at Social Security reform flatly failed and there is not a political prescription in sight to even attempt Medicare reform. The harsh reality is that entitlement programs have now become akin to massive "Ponzi schemes" and Boomers, as a whole, do not seem to care enough to do anything about it.

America's trade deficit also poses a real threat to our economy. Americans are now buying foreign goods with the money foreigners lend to finance our trade debt (nearly $700 billion annually). In essence, we are using borrowed dollars to buy goods we do not produce. Should foreigners ever lose their appetite for dollar denominated assets and the dollar loses it coveted status as the world's reserve currency, America's economy would be at serious risk. In a very real sense, foreign countries have America in the precarious position of being on economic life support.

As Baby Boomers retire in mass and become the major political force in Washington can they be counted on to press for fiscal restraint? Or will there be outright generational warfare if Boomers try and use the government to bail themselves out? Either way, the prolonged period of loose fiscal policy will have a day or reckoning. For the time being, we may do well to recall the admonition given by French political thinker, Alex de Tocqueville, in the early 1800s: 'The American Republic will endure until the day Congress discovers that it can bribe the public with the public's money."

Retirement's Perfect Storm

The perfect storm is a disastrous confluence of singly innocuous events. In such a situation, it is clear that if any one element had been displaced in time or space the result would have been far less powerful, but because just the right things were in the mix and with just the right timing, the situation ballooned. The term was aptly used in a movie of the same name to describe a confluence of weather conditions that combined to form a killer storm in the North Atlantic.

Likewise, as Baby Boomers near retirement a perfect storm seems to be gathering all around them. Longer life expectancies, exploding health care costs, dismal personal savings, fleeting pension plans, insolvent entitlement programs and an overspent government which is on economic life support are set to collectively unleash their singular forces.

But add to the mix the "mother of all demographic shifts" as Baby Boomers enter retirement and we could get an asset meltdown that could be felt far and wide for decades. If it is true that Boomers drove up the values of assets like houses and stocks because of their voracious buying behavior, would then the future sale of Boomer homes and draw down of their retirement accounts similarly cause those assets to decline?

Jeremy Siegal, the well-known Wharton School finance professor who has long recommended stocks as an investment now cautions, "I am convinced the demographic shift is going to be a determinant of asset prices going forward. Stocks and other assets could plunge by as much as 50 percent."[20]

It somewhat stands to reason that if Boomers try to sell their assets: stocks, bonds and real estate in a desperate effort to keep up their pre-retirement standard of living there may not be enough willing buyers as the ratio of working-age people to retirees declines over the next three decades to an estimated 2.6 to 1 from 4.9 to 1 today. The driving forces of supply and demand suggest that as retirees and pension funds sell their holdings into a thin market, asset values could plummet.

Perhaps there won't be an asset meltdown because Boomer selling would be spread out over a generation that spans 18 years, mitigating selling pressure at any one point. Or maybe, as the people from China, India and other emerging markets increase their wealth, they would serve as new global buyers for selling Boomers. Or possibly the wealthiest 10 percent of Americans, who hold near 90 percent of stocks, may not sell more than a small percentage of their holdings, thereby diminishing the chances of a market meltdown.

Regardless of where one comes out on the academic debate, however, one thing is for sure. We have never witnessed anything like this before and there is no telling just how this will play out. For the moment, however, the burdened retirement stars should be seen as an ominous sign and taken seriously.

Spending My Kids' Inheritances

As the odds of an easy retirement are stacking up against Boomers, many could use a helping hand. In many cases an income tax free inheritance, with a step-up in the cost basis of appreciated assets, would be like an oasis to Boomers who face a financial desert ahead of them. But timely inheritances that could help quench Boomer's retirement thirst may prove to be more like a mirage.

Bumper stickers made popular by retirees and found on luxury cars from time to time read: "Spending My Kids' Inheritances." And so far there is empirical data that seems to back that statement up. According to a recent MetLife study, the Silent Generation (approximately 30 million strong), born between 1927 and 1945, will not carefully budget for and leave an inheritance to their children and/or grandchildren. Most Silents in the study viewed leaving an inheritance to their children as relatively unimportant. Fewer than half of Silent Generation retirees (45percent) and pre-retirees (43 percent) say it is important to leave an inheritance to anyone other than their spouse.[21]

Consider also a recent study by Americas Association of Retired Persons ("AARP") that estimated that only about 19% of Boomers had received any inheritance. Of those recipients, the median amount received was $49,000, adjusted for 2005 dollars.[22]

But what about the trillions of dollars in wealth that Boomers were supposed to receive? Experts have estimated that more than $40 trillion will be transferred from one generation to another over the next 60 years. And Boomers are expected to receive $7 trillion to $10 trillion of that transferred amount.

It seems the primary beneficiaries of those transferred dollars will be families who are already well-off. Families with a net worth of $450,000 or more received nearly two-fifths of all inheritance dollars, AARP said. It is more than likely that rich Boomers will get richer, while the majority of Boomers will be scrambling to make retirement ends meet.

When Warren Buffett pledged $31 billion to the Bill & Melinda Gates Foundation in late June of 2006, he rekindled a debate among affluent parents of Boomers regarding inheritance: whether it is better to limit what you pass on to Boomers and younger generations so that you won't spoil them, or whether you let them inherit the wealth and build upon it. In those instances, affluent parents must draw the fine between enough and too much for their heirs. With wealth ownership more concentrated now than at any time since the 1920s, this is a critical decision. Keeping it in the family must be weighed against the risks of aristocracy and investing too little in society for the next generation.

But for the vast majority of Boomers, erring on the side of having enough is the real question. It is worth noting that Boomers come from families that were relatively large, with an average of 3.5 children. That means a smaller piece of the inheritance pie for most Boomers.

Like the Prodigal Son, found in the New Testament's Gospel of Luke, Boomers too, may ask for their share of an expected inheritance while their parents are still living. But unlike the Prodigal Son, it won't be for riotous living; rather, it would be for retirement's essential needs like food, housing and health care. And parents may flatly refuse Boomers request, not because of any lack in parental love, but because, they too, may see themselves needing those same assets for similar reasons.

$1,000,000 Nest Egg Provides Little Retirement Assurance

It used to be that if you had $1,000,000 socked away for retirement you were set for life. You were a millionaire at a time when a million bucks went a long way. But with a two person retirement plan that needs to last three decades or more a $1,000,000 nest egg provides little retirement assurance.

Consider that at a constant real rate of return (investment rate less inflation rate) of 4%, a $1,000,000 only yields $4,800 per month ($56,700 over the first 12 months or 5.76% in the first year) for 30 years before the nest egg runs dry. But rates of return are not constant, as investment returns and inflation rates vary from year to year. Therefore, running a Monte Carlo simulation (a mathematical model for computing the odds or probability of an outcome, such as the value of your nest egg lasting throughout retirement, by testing thousands upon thousands of possible results), may be a more accurate indicator of the nest egg's longevity. Using the same parameters in a Monte Carlo simulation for a $1,000,000 nest egg of balanced stocks and bonds, there is less than a 70% probability that the nest egg would be able to yield $4,800 for 30 years at a real rate of return of 4%.

The chart below helps illustrate that annual withdrawal rates in excess of 4%, over a 30 year period, may well deplete the nest egg before the 30 year period ends.

30-Year Retirement
Probability of Having Enough Money
Stock/Bond Investment Mix

Withdrawal rate	100/0	80/20	60/40	40/60	15/85	5/95
3%	96%	99%	99%	99%	99%	99%
4	87	88	89	90	86	71
5	73	74	70	60	25	4
6	56	53	42	25	1	0
7	38	31	20	5	0	0

While you can plan to retire at a certain age, you cannot plan on how the market will perform when you retire. If your retirement portfolio experiences a decline when you are ready to begin taking income you will most likely run out money a lot faster than you had planned. For example, even though your retirement portfolio may average 7% over the long term, a few annual negative returns experienced at the beginning of retirement will deplete your retirement nest egg years earlier than other portfolios which also averaged 7%, but which did not experience a negative return at the beginning. (Table below based on $100,000 nest egg, starting at age 65 and spending $750 per month)

Impact of the Sequence of Your Returns

Return Sequence**	Avg. Return	Age Deplete Assets*	+/- from Avg. Return
+7%, +7%, +7%...	7%	86.50	
+7%, -13%, +27%...	7%	83.33	- 3.2 years
+7%, +27%, -13%...	7%	89.50	+ 3 years
-13%, +7%, +27%...	7%	81.08	- 5.4 years
+27%, +7%, -13%...	7%	94.92	+ 8.4 years

*Constant set of spending assumptions for each scenario.

**Return sequence repeats until account is depleted

As the largest generation in America's history begins the shift from asset accumulation to income distribution it is worth noting that Boomers will need 70% to 80% or more of their pre-retirement income to make it through retirement. Of that amount, 60% typically covers essential expenses like housing, health care, taxes and other needs. It is also worth noting that surviving spouses usually require as much as 75% of the retirement income number for both spouses—not just half.

In general, the only good news for Boomers may be that retirement expenses should be less than pre-retirement expenses. Among the reductions in expenses often experienced during retirement may be the following: a home mortgage that is paid off if not significantly reduced; less income taxes due to lower tax brackets as a result of less income, a decline in social security taxes paid as most retirees do not take a salary; and a reduction in expenses regarding children who should be self-sufficient adults. Not all expenses will be less; however, travel, vacation and health care expenses could be significantly higher.

Planning for this precarious life change and asset shift is difficult and is not an exact science. There is not one sophisticated computer planning model available that could accurately predict our world's future, with all of its geopolitical concerns, or the exact day we will die. Be that as it may, a well-crafted retirement income plan must guard against a number of risks: **Longevity Risk**—the risk of outliving your money; **Inflation Risk**—the risk of losing purchasing power; **Asset Allocation Risk**—the risk of having too much or too little equity exposure; **Excess Withdrawal Risk**—the risk of drawing down too quickly on your assets; **Health Care Risk**—the risk of not being able to afford long term care; **Point-in-Time Market Risk-** the risk of a decline in the market, especially during your early years of retirement.

Perhaps it is because retirement planning is such a difficult proposition that so few Boomers have engaged competent financial professionals, like Certified Financial Planners™ to help them do it. The majority of Boomers have no idea of what retirement asset base they will need to be able to retire on. Many do not have an inkling of whether their money will outlive them or they will outlive their money.

The Changing Nature of Estate Planning & Some Planning Suggestions

As Boomers prepare for the dramatic changes ahead, the estate planning industry seems to also be preparing itself to undergo some significant changes. While change is a certainty, the real question is: "In which direction will that change have us heading?"

Will it be toward a bill similar to the Estate Tax and Extension of Tax Relief Act of 2006 (H.R. 5970), with higher exemptions, lower tax rates and a carryover of the unused exemption from the first spouse to die? Or will it be back to NY Times columnist, Paul Krugman's, "Throw Mama From the Train Act of 2001," where estate taxes get repealed altogether in 2010, and then return in 2011 under the 2001 estate tax system?

A lot will depend on who has control over the House and/or Senate after the November, 2006 mid-term elections. Regardless of the differences in political ideology between republicans and democrats regarding estate taxes, the uncertainty surrounding estate taxes has gone on for too long. Sound tax policy needs to be predictable tax policy. Individuals, families and small business owners need to know how their estates will be taxed if they are going to make informed decisions. The time is at hand for Congress put partisan politics aside and pass a responsible estate tax law.

Consider for the moment, however, the following planning areas that may be affected by a kinder, gentler estate tax law in light of the problematic retirement environment that many Boomers will be experiencing:

- Greater concern for retaining the step-up in cost basis on appreciated assets than with removing assets from the donor's estate. Undoing irrevocable estate planning vehicles like generation skipping dynasty trusts and family limited partnerships may become more common in order to pull back appreciated assets into the donor's estate for step-up in basis purposes. Likewise, creating Estate Defective Trusts, where the income is taxed to the trust and/or beneficiary, and the trusts assets are taxed in the grantor's estate may see an increase. Consider also, an increase in converting to Roth IRAs, which receive a step-up in cost basis and can better economically provide over the long-term for successive generation's retirement needs.

- A dramatic increase in the use of *disclaimer trusts*, which would give the surviving spouse 9 months to disclaim any of the decedent's assets into an exemption/by-pass trust, commonly referred to as the "B" trust or the credit shelter trust.

- Raiding the corpus of irrevocable vehicles, like borrowing from cash value policies in irrevocable life insurance trusts ("ILIT"), in order to help Boomer beneficiaries meet their current retirement needs. Likewise, insurance policy audits may become more commonplace as trustees seek to discharge their fiduciary duties by replacing inefficient policies for new one's with much lower mortality and expense charges as people continue to live longer. At a more basic level, trustees must discern whether or not an ILIT, which was created when the grantor had a taxable estate, should still be in existence if the grantor no longer has one.

- More Boomers using annuities, both fixed and variable, in order to help guard against longevity and market risk. In the investment product world only annuities have lifetime benefits and market guaranties that beneficiaries cannot outlive. They can serve as a personal defined benefit pension plan, with inflation protection based on insurance company guaranties. There is a cost for the protection, but many Boomers may be willing to incur the added expenditure in order to protect a lifetime source of guaranteed income for essential expenses like food, shelter and health care. In the future, it may not be uncommon to have 25% to 40% of Boomer's retirement portfolios invested in these types of annuities. Similarly, trustees under the Uniform Prudent Investor Act may now be called upon to move beyond traditional asset allocation in planning for beneficiaries' longer life expectancies. While modern portfolio theory ("MPT') is a prudent way to allocate a portfolio in an efficient manner, MPT does not adequately address longevity risk or provide the means of ensuring that a beneficiary will have an inflation adjusted income stream for life.

- An increase in Stretch IRAs and post-mortem Stretch IRA elections as a means to provide tax deferred earnings to Boomers and other younger generations. Currently, Stretch IRAs allow those who are over 70 ½ to set their minimum distribution level based on a joint life expectancy of themselves and a survivor who is more than 10 years younger. This allows IRA owners to save on current income taxes with reduced minimum distributions, as younger beneficiaries get substantial additional deferral years to compound earnings growth.

- More annual gifting to Boomers to help them meet the demands of retirement. Maximizing the annual gift tax exclusion, currently $12,000 per donee ($24,000 if a spouse agrees to split the gift), may be essential, not for the purposes of reducing estate taxes, but to help Boomers make their retirement end's meet.

- A decrease in charitable donations. People do not give to charity simply because of the estate tax deduction that comes with it. But the deduction does encourage a charitably inclined person to give more. With increased exemptions that would cover the estate tax burden in all but the most affluent estates, there would less economic incentive to make charitable contributions through one's estate plan.

In light of the preceding, a timely gift or inheritance could make all the difference in the world in allowing Boomers to make it through retirement. Whether Boomers will get one is a different matter altogether. President Franklin Delano Roosevelt once said, "To some generations much is given, of other generations much is expected." Boomers, who have been given much in the past, may now be that generation where much will be expected.

For their part, Boomers seem to profess that there are a lot more important things than money anyway. Allianz Life Insurance Company recently surveyed Boomers and their parents about their attitudes on everything form the importance of fulfilling their wishes to passing on real estate and other assets. Surprisingly, 77 percent of Boomers polled said that the most important inheritance they could receive or pass on would be values and lessons about life. In fact, values were 10 times more important to Boomers than money.[23]

Let's hope so. In the end, Boomers may have to depend much more upon an inheritance of values than upon an inheritance of money to help them meet the demanding challenges of retirement.

ENDNOTES

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