Morgan Stanley

Plan Perspectives

Retirement Insights From Morgan Stanley

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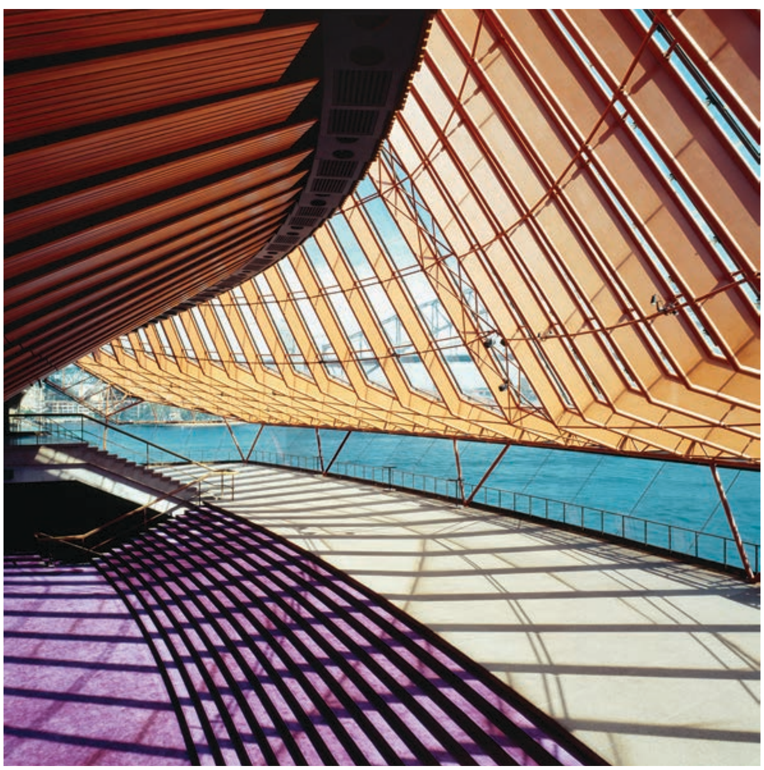
Taking the Guesswork out of Your Retirement Planning

You contribute to your companies' retirement plan with every paycheck and perhaps you've even managed to save additional dollars in an IRA or other account.



How do you assess your progress toward the retirement goals you've set for yourself?

If you're like many retirement plan participants, you simply compare the performance of your investments to an appropriate market index like the Standard & Poor's 500 for blue chip stocks or the Bloomberg Barclays US Aggregate Bond Index for bonds. But just because your investments are keeping pace with or even beating a market index, does that mean you will be able to retire on time and as anticipated?

Goals-based retirement planning offers a more focused approach that can enable you to determine exactly where you are in relation to your retirement goals and what you must do to pursue them more effectively.

How Goals-Based Planning Works

As its name implies, goals-based retirement planning measures your success by determining how close you are to reaching specific retirement goals. The process involves the flowing steps:

1. **What does retirement look like to you?** Different people have different ideas about what constitutes an ideal retirement. You might want to fulfill your itch to travel or simply spend more time with your family. What about your living arrangements – will you downsize, stay in your current home or perhaps live in multiple residences? Do you and/or your spouse plan to work part-time? And finally, when would you actually like to retire?

2. **How much will your retirement lifestyle cost?** Admittedly, it's a tedious exercise, but somebody has to do it. Make a list of your current expenses and determine which will apply once you retire.

Some expenses may increase, while others may disappear – everyone is different. Think about mortgage or rent payments, utility bills, travel, transportation and recreational expenses and see if you can get a handle on how much you will have to spend each month to maintain your retirement lifestyle.

3. **What are your current assets and projected sources of income?**
   Your retirement plan will hopefully provide you with a healthy share of the funds you'll require, but what about your other savings? You might also want to visit the Social Security website at www.ssa.gov and determine how much you'll be eligible to receive at various ages.
4. **Do you have a gap or a surplus?**
   Once you understand the cost of your anticipated retirement and the funds you'll have to meet those costs, you can determine whether you'll have enough, more than enough or not nearly enough to reach your goals.
5. **How do you fill any gap you've identified?**
   The strategy you develop depends on not only the size of your gap, but your years until you hope to retire, your risk tolerance and your desire to leave a legacy to loved ones. At this point, you must determine whether your current asset allocation is aggressive enough or perhaps overly aggressive. You should also realize that as you get closer to retirement, your asset allocation should gradually become more conservative to reduce the possibility of losses you may not have time to recoup.
6. **Do you need professional assistance?**
   You may be able to perform steps 1-4 of the goals-based process on your own. Once you get to strategy formulation, however, it may pay to seek the advice of a professional. In addition to helping you create a customized asset allocation, he or she can work with you to determine how to convert the assets you've spent a lifetime accumulating into income that will help you meet day-to-day expenses. A professional Financial Advisor can also educate you on how you might protect yourself from unforeseen long-term care and other healthcare-related expenses that can sabotage a retirement if not carefully planned for.

Retiring Before You're Ready

Unforseen events may force people to retire earlier than they were planning. This can be the result of a job elimination or other factors out of their control.

Whatever the case, these employees are now searching for another job and when they can't find one, they tell themselves they are now retired.

According to a recent survey cited in The Balance[1], more than 20% of American workers are forced into early retirement by layoffs, cutbacks and shutdowns. Many older employees find that getting another job is difficult. An analysis of September 2015 unemployment data by the AARP Public Policy Institute revealed that older workers (i.e., ages 50-plus) typically experience longer bouts of unemployment than their younger counterparts.

What should you do if you become a victim of this alarming trend?

1. **By all means, look for a job, but try to be realistic**
   Look for a temporary job while looking for something more permanent. Try to accept the fact that whatever job you do find may or may not offer the compensation and status to which you've become accustomed. Job hunting can take months and earning at least some income in the interim might do wonders for not only your budget, but your frame of mind. In addition, a temporary job might offer healthcare insurance and other benefits.
2. **Reduce your expenses**
   No, we're not talking about eliminating the $4 specialty coffee you've taken to drinking each morning, although that will help. In addition to tightening your budget, however, perhaps now is the time to think more expansively. Were you planning to downsize in retirement? Maybe you should accelerate your plans and at least find out what your home is worth in your local real estate market. Some early retirees also improve their situation by moving to a less expensive part of the country.
3. **Explore your benefit options**
   If you're under age 65, you don't yet qualify for Medicare. What can you do to protect yourself from unforeseen healthcare expenses?
   First, determine if you can obtain coverage through your spouse's employer. That will probably be your least expensive alternative. Another possibility is to look for coverage on the Affordable Care Act exchange, especially if you now qualify for a subsidy. Finally, COBRA coverage should be available through your employer for 18 months. COBRA stands for the Consolidated Omnibus Budget Reconciliation Act of 1986. This legislation ensures that you and your dependents have the ability to continue employer-sponsored healthcare insurance that was interrupted due to an event like termination of employment. The drawback is that COBRA coverage is expensive. You pay 100% of the cost that the insurance provider charges your employer.
4. **Investigate Social Security**
   You can apply for benefits at age 62, but the payments you receive will be about 25% less than they would be if you waited until what the Social Security Administration deems Full Retirement Age (age 66-67, depending on the year

you were born). In addition, taking payments before Full Retirement Age can reduce them if you decide to keep working. For every $2 you earn above a specific threshold, which in 2018 is $17,040, you lose $1 in benefits. Still, if you need cash to meet expenses, this might be a viable option. Visit the Social Security website at www.ssa.gove to receive a projected benefits estimate.

5. **Resist the Urge To Tap Your 401(k)** Once you leave your employer, you can cash out your 401(k) or perhaps continue to maintain it while taking withdrawals from time to time. Unless you have no other options, try to avoid either of these tactics.

First, assets withdrawn from your 401(k) are subject to income tax at your personal tax rate, plus a 10% penalty if you're under age 59½. However, the 10% penalty tax does not apply to a distribution from a qualified retirement plan (other than an IRA based plan), such as a 401(k) plan, to a participant after the participant's separation from service from the employer sponsoring the plan, but only if the participant separates from service in or after the year he or she has reached age 55.

After separation from service, if the individual is over 55 when taking a distribution from a qualified plan (i.e., 401(k)) the 10% penalty tax does not apply.

Second, you've been accumulating assets in your 401(k) for the retirement you hope to enjoy someday. Hopefully, your current situation is temporary. Until you determine whether it isn't, don't sacrifice your future retirement for a short-term solution.

If you have no other choice to access your 401(k) savings and your plan does not allow for partial withdrawals you may want to consider rolling over to an IRA so that you can access a portion of your retirement savings without cashing out the entire amount. However, if the funds are rolled to an IRA, and the individual is under 59 1/2, distributions are subject to income tax plus a 10% penalty tax unless for certain life distributions. Before making this decision you should carefully evaluate the costs and investments options associated with an IRA.

Developing Your Own Asset Allocation

According to many investment experts, asset allocation is by far the most important determinant of portfolio return, even more critical than securities selection and market timing.[3]

Asset allocation is simply the amount of your overall assets that you decide to invest in each major asset class – stocks, bonds and cash (some investors also include real estate, commodities and other asset classes, but for purposes of this exercise, let's keep it simple).

The percentage of your assets that you decide to allocate to each asset class is a function of your objectives, timeframe and most important, risk tolerance. But how do you use this information to create an allocation that's appropriate for you?

The Rule of Thumb Approach

It's not exactly science, but some financial pundits suggest that by simply subtracting your age from 100, you can come up with the percentage of your overall portfolio that should be allocated to stocks. For example, a 60-year-old investor would subtract 60 from 100 and invest 40% of his or her assets in stocks, with the remainder in bonds and cash. Obviously, this method is a bit simplistic and lacks precision. However, it might have sufficed when interest rates were at higher levels than they are today. With rates and therefore, bond yields, so low, a large allocation to bonds may not provide the income necessary to meet retirement expenses. Moreover, a small allocation to stocks might not provide the growth potential necessary to retire on time and as anticipated.

The Online Calculator Approach

As you would expect, the internet abounds with questionnaires and calculators designed to help you develop a suitable allocation. Some are more helpful than others, but none ask you to factor in how much retirement lifestyle to which you aspire will cost.

To formulate a more reliable asset allocation, you really have to go through the goals-based process we describe in our article on pages 1-2. In other words, you have to know how much you'll need, how much you have, how much you can afford to invest annually and how many years until you hope to retire. Put it all together and you can begin to determine what rate of return you'll have to receive on your investments to make your retirement dreams a reality. If you can't do the math on your own, find a good compound return calculator online and start plugging in numbers.

If you find that it's going to take annual returns of over 8 or 9% to reach your retirement goal, you're going to have to question whether that goal is realistic. Even an allocation of 100% in stocks will not guarantee a successful outcome and obviously, a portfolio consisting solely of stocks is a risky proposition.

The Professional Approach

Once you find that your retirement goals can be reached with a more reasonable annual return rate assumption (say, 3-7%), you're ready to determine what allocation can help you meet that assumption. Doing this on your own requires making more assumptions about asset class returns based on historical performance. It's far easier to consult with a Financial Advisor who has the experience and technology to create an allocation for you that meets your risk tolerance and other parameters. In addition, a Financial Advisor may create your allocation with ranges that allow you to take better advantage of changing market conditions as they occur.

Protecting Yourself After a Potential Data Breach

While most companies are dedicating more resources to Cybersecurity, you may still be impacted by a data breach. Being informed and proactive can help mitigate the risks associated with any data breach. Consider the below tips:

Sign Up for Identity Theft Protection Services that Provide

- Advanced detection and notification services
- Ongoing monitoring across all your accounts
- Single point of contact for resolution

Monitor and Review Your Credit Reports

- Review all accounts, inquiries and addresses on your credit report to identify unusual activity

Initiate a Fraud Alert with Any of the Three Major Credit Bureaus

- This initial security alert notifies potential credit grantors to verify your identification via the communication channel listed on the alert before extending credit in your name

Freeze or Lock Your Credit File with Any of the Three Major Credit Bureaus

- A security freeze is designed to prevent credit, loans and other services that require a credit check from being approved in your name without your consent. No one can access or make changes to your credit report while frozen
- You may unfreeze your account temporarily when needed

Monitor Your Financial Accounts

- Review your transactions regularly
- Consider placing transaction alerts to identify potential fraudulent transactions
- Cancel or freeze cards if you notice unauthorized transactions

File Your Taxes Early

- File your taxes quickly, before a criminal has a chance to make a fake filing
- Respond to letters from the IRS right away

Follow Up with the Organization That Was Breached

- Contact their fraud department via phone or on their website
- They may also contact you if you were impacted

[1] https://www.thebalance.com/dealing-with-forced-retirement-358025

[2] https://www.aarp.org/content/dam/aarp/ppi/2015-2/AARP953_LongTermUnemployment_FSFeb2v1.pdf

[3] Brinson, Hood and Beebower, Determinants of Portfolio Performance, Financial Analysts Journal, July/August 1986 and Brinson, Singer and Beebower, Determinants of Portfolio Performance II, Financial Analysts Journal, May/June 1991

IRA ROLLOVER FROM A FORMER EMPLOYER QUALIFIED PLAN Typically, as a retirement plan participant who may be receiving an eligible rollover distribution from the plan, you have the following four options (and you may be able to engage in a combination of these options depending on your employment status, age and the availability of the particular option):

1. Cash out the account value and take a lump sum distribution from the current plan subject to mandatory 20% withholding, as well as potential taxes and a 10% penalty tax,

OR continue tax deferred growth potential by doing one of the following:

2. Leave the assets in your former employer's plan (if permitted),

3. Roll over the retirement savings into your new employer's qualified plan, if one is available and rollovers are permitted, or

4. Roll over the retirement savings into an IRA.

Each option offers advantages and disadvantages, depending on your particular facts and circumstances (including your financial needs and your particular goals and objectives). Some of the factors you should consider when making a rollover decision include (among other things) the differences in: (1) investment options, (2) fees and expenses, (3) services, (4) penalty-free withdrawals, (5) creditor protection in bankruptcy and from legal judgments, (6) Required Minimum Distributions or "RMDs", (7) the tax treatment of employer stock if you hold such in your current plan, and (8) borrowing privileges.

The decision of which option to select is a complicated one and must take into consideration your total financial picture. To reach an informed decision, you should discuss the matter with your own independent legal and tax advisor and carefully consider and compare the differences in your options.

Asset allocation does not assure a profit or protect against loss in declining financial markets.

Stocks fluctuate in value and may be worth more or less than their their original cost. Past performance is no guarantee of future results.

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