

10 Tough Retirement Questions

FORTUNE

Answers to your ten most urgent retirement questions from our two no-nonsense experts.

By Ellen McGirt and Andy Serwer

(FORTUNE Magazine) - William Shakespeare nailed the retirement thing, buying a country house for cash, then living off his investments until he died. When we went on the Internet to ask readers what they wanted from retirement, we found people wanted what he had - a secure stream of income (and to avoid the plague).

There's the rub: Satisfying these simple desires requires complex decisions. We want to help. Here are the ten questions that came up most often- and our answers.

How much will I need in retirement?

Ellen McGirt: The conventional wisdom is that you'll typically need 70 percent to 85 percent of your working income. But there is no one-size-fits-all answer. First, you need to consider what kind of retirement you want - and be realistic about what your resources are. Some late-blooming boomers have considerable debt; others have notions of retirement - say, that dream trip to Antarctica - that are, frankly, damned expensive.

Drew Tiganelli, a CPA and financial planner from Maryland who manages \$120 million, doesn't start with a number. "I've had clients retire happily on 50 percent of their salary and others who couldn't make it on anything less than 120 percent," he says. Instead, he encourages his clients to bring their dreams into focus first and work backward from there.

"Give me as much detail as you can about your goals, when you want to retire, where and how you want to live, and what you want to leave behind." It's a complex financial stew, requiring his clients to make tough decisions on spending, saving, and risk. And the calculations need to be adjusted as times, needs, and assets change.

Guessing, which is what the Employee Benefit Research Institute says almost half of all workers do, is not a good idea.

"To meet your goals, you may need to work longer, save more, or take more risk in your portfolio," Tiganelli says. "Most people need to set priorities and make tradeoffs."

For those who prefer talking about money face-to-face, consider a trip to a fee-only planner, who can help craft a plan for a flat fee (rather than one who will manage your portfolio for a percentage of assets).

SOURCES to consult: napfa.org; discovergarrettplanningnetwork.com

Where should I invest now?

Andy Serwer: Over the next five years or so, that's simple. Unlike building a wardrobe, if you are starting a portfolio, you want to invest in what is out of fashion at the moment. The least-loved sector in all of investingdom right now is a group of names most familiar to you, which is to say large-cap U.S. stocks.

Fact: The S&P 500 index has underperformed the S&P 400 mid-cap index and the S&P 600 small-cap index every single year this decade. (And over the past three years the U.S. market has been trounced - and we are talking wiped - by overseas markets.)

For a list of shunned names, look no further than the Dow Jones industrials. Remarkably, 11 of these stocks - [GE](#), [Coke](#), [IBM](#), [Home Depot](#), [Merck](#), [Dupont](#), [Intel](#), [Wal-Mart](#), [GM](#), [Verizon](#), and [AT&T](#) - have trailed the S&P 500 over the past five years. (The latter two telcos are down 30 percent and 24 percent, respectively.) Of course these companies have problems, but they are also out of favor.

It's almost indisputable that some of them will break out over the next half decade. Says Bob Smith, manager of the Growth Stock fund at T. Rowe Price: "Relative to the market, larger diversified companies are cheaper than they have been in the past ten years."

And no, no, no, do not bet your retirement on a tech-stock echo boom. Sure, there will always be a Google or three or four around to tantalize, but as far as a wave that lifts every ship, like the one we rode in the late '90s, get over it. That was a once-in-a-lifetime event - thank God.

For a world-changing event that is worth a flutter, though, check out those crazy foreign markets. Just about the insanest has been India. It was up 45 percent last year, then down 13 percent in the month of May. Still, Smith of T. Rowe is a believer, and in fact prefers India to China.

"The positive in India over China is that India has more dynamic companies than China," he says. "If you have a ten- or 15-year time horizon, I think owning India is going to be a really good thing. It's been volatile lately, but over the long term, if you own Bharti or Infosys, they probably offer better growth than some of the larger-cap U.S. companies." Smith also says to look to Eastern Europe for outsized gains overseas.

What about commodities?

Serwer: Yes, they've been huge winners, and a big score could set up retirement nicely. But sorry, it's late to get into this game. Up until the recent swoon, copper prices had more than tripled over four years, and silver had more than doubled in three, while everything from sugar to orange juice has pretty much followed suit.

It's only been the biggest commodity boom in 50 years, and that, says superstar investor Bill Miller, portfolio manager at Legg Mason, strongly suggests that you will be chasing a train that has long since left the station. "The time to own commodities is when they are down, when everybody has lost money in them, and when they trade below the cost of production," Miller wrote recently. "That time is not now."

Except, maybe, for oil. The notion that demand for petroleum products will suddenly dry up, or that we will find huge new supplies, or that we will suddenly - presto! - convert to alternative energy sources (with all apologies to Willie Nelson) seems unlikely at best.

Regardless of the macroeconomic environment, over time investors in [Exxon](#) seem to make out almost as well as the company's former CEO Lee Raymond. The bottom line is impressive: Since the end of 1980, Exxon has recorded a total return of 3,789 percent, compared with 1,836 percent for the S&P 500. I wouldn't be surprised if this stock and certain other oil and gas plays, such as Petroleo Brasileiro and Total (both part of our [FORTUNE 40 portfolio](#)), do well for the near future. For a domestic play, [Valero](#), the largest U.S. refiner, had a great year and still looks awfully strong.

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What if I'm getting close to retirement and don't have enough?

McGirt: The tough truth: Keep working. "By working an extra five years, it's possible to increase annual [retirement] income by 25 percent," says Andy Eschtruth from the Center for Retirement Research at Boston College. Even working part-time will allow you to keep more of your IRA assets growing tax-free.

You may be tempted to start taking Social Security the day you become eligible. Hey, you've earned it. But waiting could mean a bigger payout - an annual benefit of \$10,000 at age 62 could grow to \$15,000 if you hold off until age 66. The hope, of course, is that you'll live long enough for the bigger, later payout to exceed what you would have collected if you'd started earlier (to age 76 in this example).

But the peace of mind that comes with having a bigger monthly income later on, when you may need it for non-negotiable expenses like health care, can outweigh the simple math. You need to decide what's more important to you. Retirement may also be a time to think outside your zip code. A small pension and assets from the sale of a home in an expensive state like Maryland can go a long way in, say, Tennessee.

How will I pay for health-care expenses?

McGirt: Ah, paying for replacement parts. According to Fidelity's 2006 Retirement Index, the typical American worker retiring today without employer health coverage will probably need \$200,000 - yup, that's a big number - for expenses not covered by Medicare throughout retirement. And there's more: Since most people retire at 62 and Medicare doesn't kick in until 65, retirees start their golden years with a significant coverage gap.

Part-time work may offer the best solution: a bit of income, a bit of stimulation, and access to health benefits at a reduced cost. If your spouse is still working and has employer coverage, joining the plan of the working spouse is also an easy fix.

Another option is to continue your group coverage through the federal COBRA (Consolidated Omnibus Budget Reconciliation Act, 1986). Anyone who works for a company with more than 20 employees is eligible. You'll still pay out of pocket for premiums, up to 102 percent of the cost, but it may be cheaper and better than anything you can get on the open market - particularly if you have pre-existing conditions.

Your COBRA coverage will last for only 18 months. After that, you'll be entitled to purchase a policy with no pre-existing exclusions in the open market. But they can be pricey. One bright idea in the private market: high-deductible health plans linked with tax-advantaged health savings accounts. For those in good health, HSAs offer a nifty way to save for health-care costs over time, and premiums on high-deductible plans can be significantly lower than those on ordinary plans.

(Sources: Naic.org; Ehealthinsurance.com; HSAinsider.com; Nahu.org; healthdecisions.org)

How much should I worry about inflation?

Serwer: Some - but not too much. Let Fed chairman Ben Bernanke do the worrying for you.

Many pros - like Harvey Hirschhorn, portfolio strategist with Bank of America - say inflation jitters will continue over the short term, but they are confident that the Fed will be able to tame this dragon. Still, Hirschhorn says, inflation over the next decade or so could well be modestly higher than it has been over the last decade.

Hirschhorn recommends Treasury Inflation Protected Securities (widely known as TIPS); both the face value and the payout rise in value with inflation. While TIPS won't give you the kind of superheated gains that investors have gotten recently from commodities, which are also perceived to be a hedge against inflation, Hirschhorn believes they are a safer bet at this point.

What's the best way to take money out of my retirement accounts?

McGirt: There are three key points where you don't want to mess up - at rollovers, at the mandatory distribution age of 70½, and at death.

First, the rollover. Because the rules of your 401(k) plan may require you to take your money out at retirement or force you into a distribution schedule that doesn't work for you, you're often better off rolling over your account into an IRA. But one mistake can be costly and irreversible. If you take a check from your plan, you have 60 days to open a new account. A lot can go wrong.

"I've seen advisors steer the money into taxable accounts," says Ed Slott, a New York-based CPA and expert on IRAs. "And plans can be late processing the check, or the consumer doesn't understand the deadline."

Miss the deadline or open the wrong account and your nest egg will get seriously cracked by stiff penalties and unnecessary taxes. Instead, initiate what's known as a trustee-to-trustee transfer, which takes place between institutions. Any bank or brokerage firm can open an IRA and initiate the rollover on your behalf. It should take a matter of days. If it doesn't, pipe up.

Withdrawing your funds takes a bit of planning as well. Although the minimum amount you need to withdraw every year is calculated using a fixed formula based on your age and the account balance, you can choose which account to take the money from.

"You don't have to take the minimum from each account," explains Barry Picker, a CPA from New York. "If you've got multiple accounts, you're going to have to think about which assets to liquidate first, based on your portfolio strategy."

Finally, there's death. "You've got to remember to name a beneficiary directly," explains Slott. If you forget or designate your estate as the beneficiary, you will lose a key tax benefit described as a "stretch IRA," which lets your heirs spread out the mandatory distributions over their actuarial life expectancy - so more money can grow tax-deferred.

(Sources: IRAHelp.com; IRS.gov/retirement/participant/index.html)

What's my best asset mix looking ahead?

Serwer: Of course it's difficult to generalize here. If you really don't want to think about it, go with 60 percent in stocks and 40 percent in bonds and cash. Harvey Hirschhorn of Bank of America breaks it down thusly: "We would have 64 percent in equities at this time, 33 percent in bonds, and 3 percent cash. Of the equities, 15 percent to 20 percent would be international."

Morgan Stanley's model portfolio for investors with between \$1 million and \$20 million has different flavoring: 46 percent equities (30 percent of it in the U.S.), 29 percent bonds, 5 percent cash, and 20 percent in real estate and REITs, commodities, hedge funds, and inflation-protected securities such as the aforementioned TIPS.

Where does my home equity fit into my plan?

McGirt: Tie it into a safety net, not a noose. Unlike retirees of yesteryear, many boomers are trading up. "People now want to buy bigger or second homes in retirement and take on more debt," says fee-only planner Stan Johnson from Durango, Colo. Crazy talk. Instead, stay put or pick a smaller house that you can buy with no mortgage or a low one, and use any leftover cash to pay off other debt and pad savings.

Your home equity should be the ultimate failsafe. "Your savings and pensions will secure your retirement," says Tignanelli. "If something should go wrong, you still have the equity in your home."

What if I don't want to retire?

McGirt: When my distinguished co-conspirator, Andy Serwer, asked me what I wanted to do when I retired, I drew a blank. (Answer: My editors will be prying my computer keyboard out of my cold, dead hands.) Truth is, I love what I do, and I want to keep doing it--at least part of the time. Turns out, I'm not alone.

A new survey by Merrill Lynch suggests that 71 percent of us hope to work in our golden years. But there's a mismatch here: Only 24 percent of employers, Merrill estimates, are ready to manage the wave of retiring baby-boomers by accommodating older workers.

So until employers get with the program, you'll have to get serious about yours. Think about, and budget for, the new skills, equipment, or training that you may need to stay relevant in the workforce. Keep professional licenses or other designations current. And

remember, it doesn't have to be a paying gig--tap local nonprofits and houses of worship for special opportunities to keep yourself busy and give to the greater good.

"It's about engagement and contribution," says Nancy Johnson of AARP. People who continue to work in retirement report feeling healthier and have a greater sense of well-being.

Sign me up for that.

(Sources: Aarp.org/bestemployers; SCORE.org)