

## Chapter One:

# How Much Is Enough?

**\$1,000,000**

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**R**emember Dr. Evil in *Austin Powers*? The clueless arch-criminal from the sixties is brought back to life in the nineties, where he threatens to destroy the entire civilized world—unless he is paid the breathtaking sum of . . . “One *million* dollars!” Everybody laughs, of course, because a million isn’t what it used to be. The fact is, \$1 million is more or less the minimum that an average American couple without a pension needs for a secure—but average—retirement.

Only about 2 million Americans are millionaires. But as we have already demonstrated in our introduction, saving just \$250 per paycheck, on top of an \$85,000 401(k), can yield \$1 million after twenty years, based on the average return of the Standard & Poor’s (S&P) 500 since 1929.

Still, it's understandable that \$1 million seems out of reach to anyone struggling to pay bills and keep a head above water. You might be thinking, "A million dollars? I'll tell you what: pay off my credit cards and give me \$100,000 in the bank, and I'll be happy! Who needs to retire a millionaire?"

The reason is simple: *When you are retired, the paychecks stop coming.*

That might seem obvious, but it's worth thinking about because lots of people ignore that fact until retirement is almost upon them. Here's a valuable lesson we've learned from retirees: a paycheck is like fuel for your gas tank. As long as you keep putting the gas in, you can drive pretty much wherever you'd like, knowing that you'll be filling her up every two weeks. When you retire, however, you have only *one tank of fuel remaining* (your life's savings) . . . and as you would with the "last chance for gas" fill-up before crossing the Mojave Desert, you'd better make it last! Ask any first-year retiree and they'll tell you: it can be uncomfortable adjusting to a world without paychecks.

The other related problem (though it's actually good news) is that you are likely to live a long, long time in retirement. The average American retiring at age sixty-five can now expect to live eighteen more years. That's nearly one-fourth of his entire life with no paychecks. For a sixty-five-year-old couple, one member has a 50 percent chance of living to ninety-two!

But perhaps we're exaggerating. What about Social Security? Surely that will cover at least *some* of the expenses. It's true that

today Social Security is paying an average annual benefit of \$18,000 to a married worker retiring at age sixty-five. (For a more precise calculation of your own benefits, go to [www.ssa.gov/OACT/quickcalc](http://www.ssa.gov/OACT/quickcalc).) The future of government-sponsored retirement benefits is anybody's guess, but it's unlikely that they'll rise (beyond inflation adjustments) or get cut back drastically. It is highly likely, however, that future benefits will start at a later age—say, seventy.

Keep in mind that Social Security is *not* a pension plan, and was never meant to be. It's an insurance policy with a large risk pool (the whole country) designed to prevent old-age poverty. So even assuming you stay in good health, Social Security will not maintain your current lifestyle and will probably not even come close to replacing your current paycheck. (Interestingly, the children of boomers have already given up on *their* Social Security. One survey showed that more Americans under age forty believe in UFOs than in future Social Security benefits.)

Maybe you have a solid pension that guarantees 80 percent of your income for life, along with lifetime health care benefits. If so, congratulations! Between your pension and Social Security, you probably can get by without much in savings, assuming you stay in relatively good health. But pensioners are in an exclusive club, and one that's shrinking: according to the nonprofit Employee Benefit Research Institute (EBRI), just 20 percent of American workers now have so-called defined-benefit pension plans—down from 39 percent in 1975. (By the way, the federal



# Tools for the Money

## Calculating Retirement Savings

To get a fix on how much money is enough for your retirement, start by identifying how much annual income (in today's dollars) you will need. (Figure on at least 70 percent of your current income, but preferably 100 percent. For the purposes of this exercise, we're pretending Social Security doesn't exist—which it may not!)

Write that number here: \_\_\_\_\_

You'll need to generate your required annual income by withdrawing an average of 5 percent annually from your nest egg. So the formula is:

$$\text{Annual Income} \div .05 = \text{Retirement Money Needed}$$

For example, if you need \$50,000 in annual retirement income, the formula would be  $\$50,000 \div .05 = \$1 \text{ million}$ .

Write that number here: \_\_\_\_\_

Once you identify how much money is enough for retirement, it's not hard to calculate how much you should be saving every month to reach that goal. Figure you'll be investing in growth stock

funds that spin off a 10 percent annual return over the long run. Factor in a 4 percent inflation bite, and you're realizing actual growth of 6 percent. Assuming you plan to retire at age sixty-five, multiply your retirement fund by one of the following factors to determine your monthly savings. (You can get figures for any retirement age or amount on Web-based calculators, such as those at [www.choosetosave.org/calculators](http://www.choosetosave.org/calculators).)

<b>Current age</b>	<b>Factor</b>
25	.000500
30	.000699
35	.000991
40	.001436
45	.002154
50	.003422
55	.006072
60	.014262

For example, if you are currently age forty and need \$1 million to retire at age sixty-five, the formula would be \$1 million x .001436 = \$1,436 per month in savings.

Write your monthly savings here: \_\_\_\_\_

Pension Benefit Guaranty Corporation, which insures pension plans when companies go belly-up, is billions of dollars in the red and sinking because so many companies have made pension promises they can't keep. That doesn't include the huge public pension bill—for teachers, cops, bureaucrats at every level of government—that is guaranteed by taxpayers.)

Like it or not, for most of us retirement has become a do-it-yourself project.

Apparently, many of us think it's a *weekend* project. According to EBRI, four in ten workers currently are not saving anything for retirement. And even those who do save are not saving nearly enough—possibly because they don't know better. One study found that 42 percent of boomers have no idea how much they'll need for retirement. And two-thirds of Americans over thirty are clueless as to what their monthly budget should be in retirement.

It shouldn't be such a mystery. In fact, it isn't. One focus of economists' attention has been determining how much you can withdraw from your investments without burning through the principal before you die. That's pretty important when the paychecks stop coming and your investments are all you've got. We explain the details in a sidebar (see the Tools for the Money section on "Rolling the Monte Carlo Dice" on p. 16), but for now it's enough to know that a conservative investment advisor might recommend safely withdrawing about 4 percent annually; a more aggressive investor might be okay with 6 percent or more. Our actual advice would take into account the age of the client and

the recent performance of the market, but a reasonable average—for the sake of argument—would be 5 percent.

Now let's go back to our million-dollar retirement fund. We can see that a 5 percent annual withdrawal equals \$50,000, or about \$4,000 a month. Can you live on that? No doubt many can—with ease. Others will say no way, and many are probably not sure. One common mistake in retirement planning is to assume you'll need less money than your current income. We don't always agree on that, but, at the very least, you should plan for 70 percent or 80 percent of your income—and that presumes good health.

But enough blackboard economics for the moment. Rather than calculate percentages, we think it's more useful to actually *imagine* your retirement. Visualize it! By starting at the end point and getting a handle on where you want to be, you will bring your financial needs into focus. To get you thinking about life after the retirement party, we created four typical retirement scenarios, ranging from basic to lavish. We were thinking of that classic song by George Jones and Tammy Wynette called "We're Not the Jet Set (We're the Old Chevrolet Set)." Whether you drive a Chevy to the general store or jet off to Gstaad for the holidays, you need a retirement plan that fits your lifestyle. Of course, no two people are alike (even twins), but it's possible that your retirement looks something like one of these scenarios (see pages 8 and 9). Keep in mind that the numbers are in today's dollars, and that they assume you'll also be receiving Social Security benefits.

One thing you can see right off the bat is that a million bucks

### A very basic retirement

You're happy in a very small house, with low utility bills and no mortgage.

You live, or plan to live, in a community with a low tax rate.

You enjoy preparing and even growing your own food; restaurant meals are a waste of money to you.

You're happy driving older cars.

You take occasional vacations by car, and you stay in budget hotels.

You shop for clothes only when you need something.

You have no club or membership dues.

You will have no debt of any kind, including car loans or leases.

You would consider part-time work.

**Cost: \$500-\$2,000 per month**  
**Retirement Funds Needed:**  
**\$150,000-\$500,000**

### An average retirement

You currently enjoy a typical middle-class lifestyle, and you want to maintain it in retirement.

The house you own now is just fine, needs no renovations, and will be paid off by retirement.

A dinner out and a movie once a week, or every other week, is plenty of entertainment.

You plan to take infrequent vacations, and time them to take advantage of off-season rates.

You're happy spending time with grandchildren, who live nearby.

When you read magazines, you don't long for the stuff in the ads.

You like simple hobbies such as gardening, walking, fishing, and reading.

You have no credit card or automotive debt.

You're willing and able to work part-time if property taxes or health care costs increase during retirement.

**Cost: \$2,000-\$8,000 per month**  
**Retirement Funds Needed:**  
**\$500,000-\$2 million**

## A very comfortable retirement

You want to retire in a resort community, such as a beach or golf development.

Or you want to retire in a big city and enjoy cosmopolitan amenities such as theater and professional sports.

You plan to join a gym or other club.

Your home or condo will probably be paid for, but high taxes and association fees are likely.

You plan to have nice furniture and new appliances.

You enjoy restaurant meals two or three times a week, especially at new places in town.

You hope to take at least one “memorable” vacation in season per year, such as Europe in the summer or the Caribbean in the winter.

You’ll need a good-sized closet full of nice clothes to wear when you’re out and about.

Social activities are important, and you plan to entertain often.

**Cost: \$8,000-\$50,000 per month**  
**Retirement Funds Needed:**  
**\$2 million-\$10 million**

## A lavish retirement

You want (or already own) a large home in a very expensive area.

Utility bills on your home will total \$1,000 or more a month.

You will own more than one home.

You plan to eat lunch and dinner mostly in restaurants and clubs.

You drive expensive cars, and buy new cars every few years.

You’ll belong to several clubs and have season tickets to sports and cultural events.

You plan on taking many luxury vacations, staying in four-star hotels.

You spend \$1,000 or more a month on clothes.

When you thumb through magazines, you can definitely see yourself buying the stuff in the ads.

**Cost: \$50,000-\$100,000 per month.**  
**Retirement Funds Needed:**  
**\$10 million and up.**

won't do it for many of you. Do you yearn for a very comfortable retirement? Get saving! Even if you see yourself as the average guy next door, the high end of that average retirement will take more than a million.

On the other hand, average retirees really *can* get by on less than \$1 million in retirement. We actually know lots of them. They live frugally and simply, which is not a bad way to go. One of our favorite people is our uncle, Tim Palmer, who is not yet retired but lives a simple life that most people would envy. When we were growing up, Tim worked as a county planner in central Pennsylvania. His job required a lot of communication skills—helping people to understand how land use and environmental decisions made today would affect their community long into the future. “It was a great job,” Tim recalls, “but the fundamental problem was that many people didn’t believe there was a problem. They couldn’t see what was happening to their place because the changes happen so gradually. Because of that, I got interested in communicating better with people, which led me to writing.”

After seven years on the job, at age thirty-two, Tim decided that his true calling was writing books about the natural environment. He quit his county job, loaded up his van, and headed West. “At the time, it was scary,” he says. “I had a little bit of money invested, but not much. So I became quite proficient at minimizing my needs. For twenty-two years I essentially lived out of my van, collecting stories and writing books.”

Tim, who’s now fifty-eight, went on to publish seventeen

books—and counting. One of his latest, *Pacific High: Adventures in the Coast Ranges from Baja to Alaska*, chronicles his nine-month journey from Mexico to Kodiak Island. When he's not writing, Tim travels the country delivering talks and slide shows on environmental issues.

He doesn't live in his van anymore. In fact, Tim and his wife, Ann Vileisis, also a writer, own a charming 1,200-square-foot home that's half a block from the ocean in Oregon. (They have no children.) And when we say they own it, we mean it—as in, no mortgage. “I am totally allergic to debt,” Tim says. He avoids debt by frugal living. “I finally replaced my old van when it had 180,000 miles,” he says with pride. “We wear our clothes out.” Tim has to think hard when asked to name something he recently spent money on. “Let's see, I just bought a new backpack; the old one was twenty-six years old.”

For Uncle Tim, life after retirement will look pretty much like life before retirement. “The things I'm passionate about are backpacking in the wilderness, skiing in the backcountry, whitewater rafting, and spending time with my wife and friends,” he says. “You don't have to pay a lot of money for those things. My emphasis is on experience rather than accumulation. I would not want most of the stuff that comes with a larger paycheck.”

In the next chapter, we'll talk about how frugal living is a sure path to financial security, even a path to riches. But we know that many people do want more than the basics in their retirement. And here's the really important thing: *having more*

*money gives you more choices.* Our dad always told us, “Money is freedom.” So if backpacking really does end up being the love of your life for thirty years of retirement, great! But if your knees give out in year ten, then what? Well, if you’ve saved enough money, you can decide that sailing is your true calling and ship out.

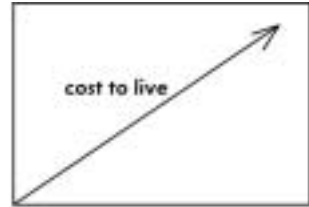
## HEDGING AGAINST INFLATION

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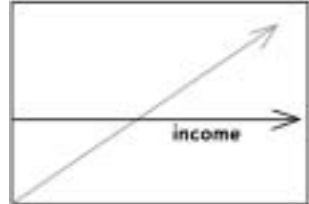
More money is also the best hedge we know against inflation. And *inflation is the enemy of your retirement security.* During your working life, inflation pressure is muted. The rising cost of everything from groceries to cars to real estate is tempered by the fact that you receive salary or wage increases along the way—probably not as much as you’d like, but the system generally works; if it didn’t, no one could afford to buy anything, and prices (and inflation) would drop according to the laws of supply and demand. Presently, the Consumer Price Index (CPI) is roughly 3.5 percent. Many components of the index however, are inflating at double or triple that rate. The fact that prices rise is proof, if you will, that the average person is earning enough to buy (or is willing to buy on credit, a problem we’ll talk about in Chapter Three). Some economists even argue that a little inflation is a good thing for the average worker, who benefits from rising wages over time.

By contrast, our retired clients tell us that inflation is never

good news for them. They don't call it inflation; they call it "the cost to live." If the "cost to live" looks like this:



and your income stream looks like this:



at some point in time, when those lines intersect, bad things will happen to you. That's why it's crucial for retirees to have an income stream—built from their investments—that goes up like this:



When you're retired, your only protection against inflation is from the return on your investments. And a skimpy investment portfolio might not generate enough gain to keep up with inflation. Here's where the mystery comes in: nobody can predict future inflation. But we *can* look at averages. Since 1914, the average annual inflation rate has been 3.49 percent.

(An aside: The highest annual inflation rate in the United States was 17.80 percent in 1917, reflecting wartime debt, and the lowest was negative 10.85 percent—that's called deflation—in 1921. In the latter case, rising unemployment coupled with a

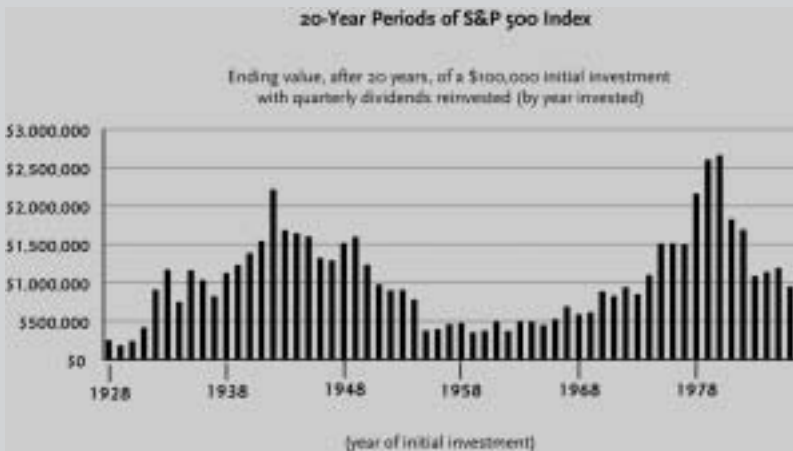
*(continued on p. 18)*



# Tools for the Money

## A Better Way to Look at Historic Stock Market Returns

If you were to go all the way back to 1928 and dissect the S&P 500 into rolling twenty-year periods, there would be fifty-nine of them (1928-1947, 1929-1948, etc.). The average annual rate of return over those periods was approximately 12 percent. At that rate, your money doubles every six years. (Remember the “rule of seventy-two” from Economics 101, which teaches that a rate of return divided into seventy-two reveals how many years it will take for your money to double.) Over that “median” twenty-year period, a \$100,000 investment grew to \$948,542! The best twenty-year period occurred from 1980-1999, when investors earned an eye-popping 17.83 percent per year on their money. During that fortuitous twenty-year span, your \$100,000 investment (including dividends reinvested)



Source: Thomson Financial

grew to a whopping \$2,660,912. No wonder investor Warren Buffett once said the best time to sell stock is never.

The worst twenty-year period for stocks occurred from 1929 to 1948—no surprise as it included the Crash of '29, the Great Depression, and World War II. Average annual return during that period was 3.09 percent. (\$100,000 grew to \$183,000.)

Here's an overview of the results from those periods:

- Two twenty-year periods doubled your money.
- Five tripled it, seven quadrupled it, and two quintupled it.
- In two periods, your \$100,000 grew to more than \$600,000.
- In two more, it grew to more than \$700,000.
- Five periods saw growth to more than \$800,000, and five grew to more than \$900,000.
- *In twenty-eight of the rolling twenty-year periods (47 percent of the time), \$100,000 grew to more than \$1 million: a tenfold increase in twenty years. And in four of those periods, you'd have more than \$2 million.*
- In *none* of the twenty-year periods would you have lost money.



# Tools for the Money

## Rolling the Monte Carlo Dice

To get a handle on those worst-case scenarios, economists employ a risk analysis tool called the Monte Carlo method. Essentially, it's an algorithm that automates statistical sampling through the use of a computer. (Statistics junkies can purchase Monte Carlo software for Excel called Crystal Ball at [www.crystalball.com](http://www.crystalball.com).)

The Monte Carlo concept was developed by the Polish-born mathematician Stanislaw Ulam, who worked on the atomic Manhattan Project during World War II and later invented the hydrogen bomb with Edward Teller. During a long illness in 1946, Ulam occupied himself playing solitaire and began to ponder how many ways existed to win (or lose) at the Canfield variation. Ulam later recalled, "After spending a lot of time trying to estimate them by pure combinatorial calculations, I wondered whether a more practical method than 'abstract thinking' might not be to lay it out, say, 100 times and simply observe and count the number of successful plays." (This was already possible to envisage with the beginning of the new era of fast computers.)

It's not a perfect system. For one thing, Monte Carlo simulations don't reflect that portfolio performance depends on future returns, which no one can predict, rather than past performance. And they don't take into account the various asset classes that a real stock portfolio would have; everything is random, which is not the way real people allocate their investments. Finally, Monte Carlo simulations assume an investor will stick it out, even in a bear market; that is often not the case.

Those caveats aside, Monte Carlo simulations can help us understand, and avoid, worst-case scenarios. For example, projections show that withdrawing 8 percent annually from a stock fund can sometimes be very bad for your health. How bad? During nine

twenty-year periods of withdrawing 8 percent annually from the S&P 500, you ended up with less than your original \$1 million at the end of the game. During eight more twenty-year periods, *you lost everything . . . ran out of money . . . died broke*. In other words, in seventeen out of fifty-nine periods of taking out 8 percent a year, you ended up with *less principal than you started with*. That's 30 percent of the time. There are circumstances in which we'll take those odds—but not with our life savings.

So the point is, yes, stocks have been a proven way to build wealth over time. A fully invested portfolio of stocks is an excellent way to grow your money. But if you have income needs (the way retirees do), and you're thinking about taking money out of stocks, you'd better be extremely careful about *when* and *how much* you withdraw. During a bear market, even withdrawing 4 percent annually can be risky especially if you have retired recently and you need that money to last for decades.

In a bull market, we'd recommend limiting withdrawals to 6 percent or 7 percent. If you're looking for a simple back-of-the-envelope number to use for a withdrawal program (from a good blue-chip stock fund), plug in 5 percent. Normally, if stocks continue to average 8-12 percent per year returns, you should be okay. Be sure to talk to your financial advisor, however. Your situation may warrant a more cautious approach.

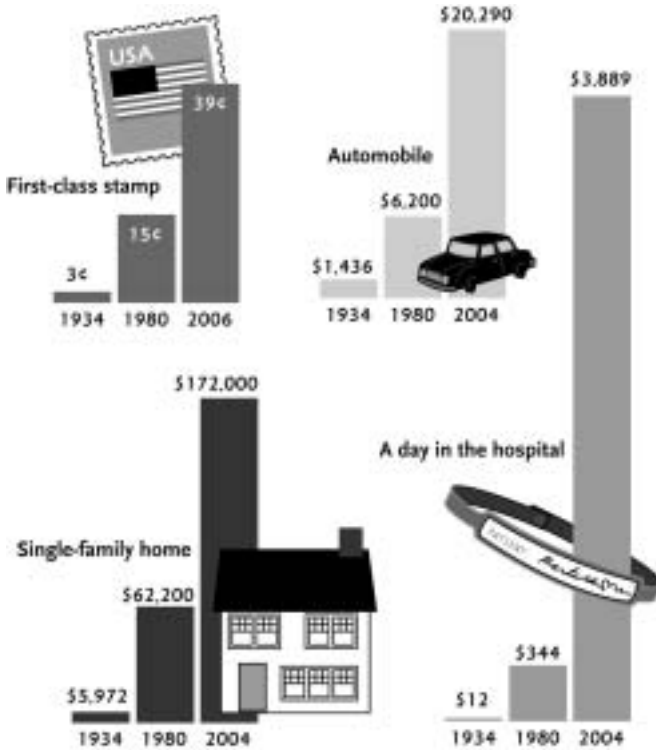
notoriously obstinate Federal Reserve that refused to lower interest rates led to plunging prices, since no one could afford to buy anything. That's supply and demand for you. That year beat the worst deflation in the Great Depression, which clocked in at negative 10.30 percent in 1932. The worst *inflation* in our own time was not in the much-maligned 1970s but actually in 1980, when it peaked at 13.58 percent. The prime rate in 1980 hit 20 percent! For more fascinating historic and current information on inflation, go to [www.inflationdata.com](http://www.inflationdata.com).)

Often, people see that inflation has been “tamed” at about 3.5 percent over time and they get a warm, fuzzy feeling. Hasn't the Federal Reserve Bank “cured” runaway inflation? Is this really an issue in your retirement planning?

Definitely.

For starters, economies can develop minds of their own and sometimes don't respond to manipulation by the Fed. Double-digit inflation could happen again. But never mind that; the bigger issue is plain-vanilla inflation, which really adds up over time. Over the entire 20th century, inflation reduced the value of a dollar to a nickel. Many people are surprised when we tell them that, after twenty years, annual inflation of just 3.5 percent will *double* the cost of living.

Here's another concern: In 1999, changes in how the government calculates the Consumer Price Index (CPI) reduced the size of the resulting inflation increases. As a result, we believe the CPI is now underreflecting the true cost for retirees. To be safe,



Source: First-class stamp: Postal Rate Commission; all the other data: *The Wall Street Journal*, January 3, 2006

retirees should assume annual inflation of 5 percent. At that rate, someone retiring at age fifty-five with \$5,000 per month in annual expenses will need *four times* that amount by age eighty-five.

Inflation is a primary enemy of your retirement, but other factors also influence how much money you need to maintain your chosen lifestyle.

*double*  *take*

## How Much Is Enough for College?

The rising cost of college makes health care look like a bargain. The latest report from the College Board ([www.collegeboard.com](http://www.collegeboard.com)) shows 2005-2006 tuition and fees at a public university grew 7.1 percent over the previous school year, with a total cost of \$5,491. Private, nonprofit university tuition and fees advanced 5.9 percent, with a total cost of \$29,026. Another study suggested that, in ten years, the total cost of a four-year degree will hit \$140,000 for public universities and \$300,000 for private institutions. At that rate, two children (say, twins like us) would set back their parents \$600,000—*after taxes*. Translated, that means Mom and Dad would have to earn more than \$1 million, just to pay for college. Ouch.

**David:** Saving for your kids' college is great if you have the money, but it should not be your number-one priority. There are many ways to get financial aid for college—about \$129 billion is available annually—but there is no such thing as a retirement scholarship or loan. You need to keep your eyes on *that* prize, then worry about college. Plus, if you save and invest enough for your retirement, chances are good you'll leave your kids a legacy that will pay for *their* kids' college.

While we're at it, don't obsess over getting your kid into Harvard. Studies show that those exclusive Ivy League degrees may not buy happiness, and don't necessarily give grads a leg up careerwise. Chances are your child may be just as likely to succeed and be happy with a degree from a good state university. It's what the student puts into it and gets out of it that matters, not where she goes.

And don't forget that kids can help pay their own way through college. One idea gaining favor is that kids take a year off after high school. Many experts complain that college has become a high-pressure and obligatory career mill; a year off is like pressing the "reset" button. It also gives you and your child time to sock away extra cash.

I don't believe college tuitions will keep up their recent double-digit annual increases, because the law of supply and demand won't allow it. More than \$1 million in earnings to send two kids to a private college? Come on. If that becomes true, only the ultra-wealthy will be able to afford college, and nobody wants that. Something's gotta give.

**Jonathan:** Wow, Dave, what college did *you* go to? Didn't I go there, too? While I agree that college saving should be a lower priority than retirement saving, I can't counsel ignoring it completely. It's the elephant in the room for most families, and with skyrocketing costs you need a plan. I'd budget \$100,000 per kid for college, and that's just for a public university.

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As a former assistant dean of admissions, I know that most schools do try to separate merit from finances. Ideally, they want the best and brightest students, regardless of their ability to pay. The decision to grant or deny admission used to be totally separate from the decision to provide financial aid. In those days, many colleges were able to boast, “We meet 100 percent of the financial need of our students.” They no longer say that. Unfortunately, I’ve seen that wall start to crumble as rising costs make it harder for schools to ignore a family’s financial situation. More often than you might expect, the ability to pay has entered into the admission equation. Not that admissions officers come out and ask if a student has the bucks—but if the school’s development director just happens to mention that Johnny’s dad is the CEO of the Acme Global Corporation, well, that could be considered. You don’t want to be in the position of turning down an acceptance to your kid’s first-choice school because you can’t foot the bill. So start saving (and see Chapter Nine)!

## THE LONGEVITY EQUATION

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“How long will I live?” If only we could answer that question! It would make retirement planning so easy. Plug in the number of years and the funds needed per year, build in some inflation protection, and voila!—one foolproof retirement package. Unfortunately, the rub is that no one really knows how long the money has to last. All we can do, of course, is base our planning on average life expectancies. But this is one of the most misunderstood aspects of retirement. When you consider that most people would rather not think about their own death, it’s strange how many of us *underestimate* how long we will live. The reason is that life expectancy for any individual is a moving target. For example, if you were born in 1950, your life expectancy *at birth* was 68.2 years. (That’s an average of men and women, and all races; one good source for details on life expectancy is [www.info-please.com](http://www.info-please.com).) But that figure takes into account that many people will die young—in car accidents, or military service, or job injuries, to say nothing of fatal illnesses that can strike at any age.

But once you get to age fifty-five, many possible causes of death have been eliminated or reduced. You probably don’t drive as fast as you did at age twenty, you’re not likely to die in war, and so on. In other words, once you’ve made it that far, there’s a good chance you’ll live way beyond your at-birth life expectancy. Right now, an American man in good health who makes it to age sixty-five has a 50

percent chance of living to age eighty-five. He has a 25 percent chance of making it all the way to ninety-two. For a woman, the corresponding figures are even higher. She can expect a 50 percent chance of living to eighty-eight, and a 25 percent chance of making it to ninety-four. So the odds are good that you'll be around in retirement for a long, long time—perhaps even *forty years*.

Age	Life Expectancy	Years out of the workforce (if retiring at 65)
65	83	18
70	85	15
75	86.5	21.5
80	89	24

Source: National Center for Health Statistics, National Vital Statistics Report, Vol. 53, No. 6

That's a long time to go without a paycheck, and another reason why you need more for retirement than you might think.

## FACTORING IN GOOD HEALTH

Modern medicine is why Americans are living longer in retirement. Yet, paradoxically, medical care can be one of the costliest drains on retirees. We talked about 3.5 percent average inflation. Health care costs break that mold. In 2001, they rose 8.1 percent, totaling 14 percent of the nation's gross domestic product.

In 2003, health care consumed 10.3 percent of pretax income for seniors aged sixty-five to seventy-four, and 15.1 percent of pretax income for folks seventy-five and older. That's a huge chunk of retirement funds! It's estimated that a sixty-five-year-old couple retiring now will burn through \$190,000 in health care costs during their retirement—above and beyond Medicare benefits.

What that figure does *not* take into account is the cost of assisted living or nursing-home care. If you're currently helping parents with long-term care issues, you already know how expensive that can be. The costs vary widely across the country, so it's impossible to generalize. Assisted living, a relatively new concept geared to retirees who need help with daily activities but don't require the intensive medical care of a traditional nursing home, can run \$10,000 to \$75,000 annually, depending on where you live and the level of service you need. Nursing homes cost more—from \$45,000 to \$125,000 annually—but also qualify for Medicare, which may pay for some of the cost. The best way to prepare for the possibility of assisted living or a nursing home is to buy long-term care insurance, starting at about age fifty-five. (Buying it sooner exposes you to the risk that you'll die before you need it; buying it later will cost more.) The best way to prepare for the overall cost of retirement health care is to plan for high medical bills when you calculate your retirement savings.

**Bottom line:** If you want a number to shoot for, \$1 million will buy a healthy couple a modest retirement. But if inflation spikes

or your health deteriorates, you could run out of money—especially if your portfolio hits a land mine, like the 2001-2002 bear market. A considerably more secure retirement can be funded with \$2 million, spinning off a six-figure income and protecting you against inflation and medical costs. If you are not there yet, read on. The rest of this book will help you get there.