Chapter 5: Retirement

Retirement planning is an important part of personal finance at every age. In the past, people could rely on company pensions and/or government provision for safe and adequate retirement income. But things are more complicated today: company pensions have declined along with long-term jobs, and generous "defined benefit" plans have been replaced by riskier "defined contribution" plans. At the same time, government coffers are under strain with rising longevity and health care costs, making pension promises harder to fulfill.

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The upshot is that people need to increasingly provide for their own retirement. If you think this is not a big concern for young people, who often can't make ends meet and have other things to worry about, think again! Retirement is something you need to start preparing for when you're in your 20s or 30s, not when you're 50. The earlier you start saving and accumulating wealth, the more likely you are to retire before you reach age 90...

Here are the main sources of retirement income and what you should know about them:

1. **GOVERNMENT PROVISION**, like State Pension in the UK or Social Security in the US: provides basic retirement income to all eligible citizens or residents. You need to understand the conditions and criteria in the place you live in. Even if you are eligible, don't rely on it exclusively: public budgets are under strain as populations age, and there are many competing demands on government spending. This is even more true in emerging economies, where public pensions are often small or non-existent. Keep yourself informed of changes in policies, as they may have a big impact on your retirement. And ask tough questions, for example, how are promised future benefits funded, and will they be fully adjusted for inflation?

2. **COMPANY PENSIONS**: they are a key source of retirement income in many countries. There are two problems: (a) they have become less easy to obtain, as permanent jobs are replaced by short-term or temporary employment; and (b) they have become less generous, as "defined benefit" plans (where retirement income depends on years of service and final salary) are replaced by "defined contribution" plans (where income depends on the money contributed and returns it generates, without any guarantees). Company pensions are still great if you can get them, but you may need to supplement them with other retirement income.

3. **PERSONAL WEALTH**: being rich is a good thing as far as personal finance is concerned… If you have accumulated assets, you could sell some of them or rely on the income they generate for your retirement living. But you need to take a few things into account: (a) living off interest is not easy as interest rates have been very low in recent years and often do not or barely cover inflation; (b) dividends can be a good source of income, but they are not guaranteed as companies can reduce or eliminate them anytime; (c) income-generating property (like buy-to-lets) can provide rental income, but need to be managed, e.g., finding reliable tenants, arranging for repairs, etc.

4. **ANNUITIES**: they pay regular income and can be bought through a lump sum or a series of payments. Annuities can be fixed or variable, depending on whether the amount they pay is fixed or changes with the performance of an investment portfolio. Annuities can be

complex and you need to review and fully understand their features.

5. **HOME EQUITY**: for retirees who are less concerned about bequeathing wealth, there are tools to generate income from assets like homes during their lifetime. For example, reverse mortgages or equity release options can provide cash to homeowners without requiring monthly payments; instead, they are repaid from the value of the home when the owner dies or the home is sold.

6. **GUARANTEED INCOME**: while this does not yet exist in most parts of the world, the idea of guaranteeing a universal basic income for everybody regardless of employment is debated in many places. Some of this may become reality by the time today's youths retire. It would not be wise to rely on a distant future possibility, but it is good to know about it and keep track of developments.

What is a comfortable retirement income? Financial advisors used to recommend around 70% of your previous salary, on the grounds that you have less needs when children are self-dependent and you are older. However, there are no fixed rules: it all depends on your level of income, standard of living, and personal circumstances and preferences. Reading books or going for walks is cheaper than touring the world on a catamaran! You also need to take into account the potential need for long-term care or nursing help. Medical advances have lengthened human life with amazing new technologies, but you need to think who and how this will be paid for.

If the retirement income you expect does not meet your requirements, you could try **to retire later or shift gradually from full to partial retirement.** Many part-time jobs are available for people who do not want to work full time but seek to complement their retirement income and remain active. The growth in part-time jobs, outsourcing, and distance working facilitates this trend.

If you rely on your savings and investments for part or all of your retirement income, here are some core principles that you should follow:

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1. **START EARLY**: the time to start saving is when you're young, especially when you start earning "serious" money beyond your most pressing needs—not 10 years before you want to retire!

2. **DON'T WITHDRAW** money from your retirement account unless you absolutely have to, and reinvest all interest and dividends—they accumulate and compound over time, making a big difference to your ultimate retirement pot.

3. Take full advantage of all **TAX-ADVANTAGED** schemes, such as ISA in the UK or IRA in the US.

4. Take full advantage of all **EMPLOYER-SPONSORED** schemes—they usually match part of your contribution.

INVESTMENT PRINCIPLES

As you build your retirement portfolio, you need to follow sound investment principles. These are the subject of a separate lesson (Investing, Basic and Advanced), but here are a few things to remember:

1. ***DIVERSIFY**: target a balanced mix of cash, fixed-income and equities; include possibly some gold and real estate; rebalance periodically to stay close to your desired portfolio allocation.*

2. ***STOCKS FOR THE LONG RUN**: equities should account for the largest proportion of your portfolio, though you could slightly reduce their share as you get older and want to take less risk.*

3. ***BUY AND HOLD**: avoid excessive trading and don't try to time the market. If you take an occasional punt, limit it to a small portion of your assets so you won't break the bank if it goes sour!*