Strategies for Approaching Retirement

There are 3 key steps to take when preparing for retirement.

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Successful planning for retirement requires more than simply establishing an effective retirement plan at the start of a neurologist's career and then forgetting about it. In fact, retirement planning requires an ongoing commitment to review and redesign along with a dynamic approach to asset management and response to market volatility.

To enable successful retirement, there are 3 specific tactics that should be employed in the years leading up to that day. These are developing a budget, reviewing asset allocation, and designing a withdrawal strategy.

Developing a Budget

More Than a Mental Tally

It may seem like overly simplistic advice, but budgeting can either push a retirement plan to success or drive it to failure. Although many people believe a budget is a simple awareness of what they are spending, the actual purpose of a budget is to ensure that a person is living within their means and deploying every dollar earned with strategic purpose. To accomplish this goal, a written and managed budget, not a simple mental tally of expenditures, is essential.

To begin, physicians should make a list of their lifestyle needs, including basic necessities such as meals, mortgage, utilities, and insurance. This list should also include savings contributions.

Deciding how much to save today will depend greatly on how much you expect to spend during retirement. There is no way to determine that without attempting to project future expenses. You can accomplish this by creating budgets based on assorted postretirement factors including location, size of home, hobbies, frequency of vacations, and other postretirement lifestyle expectations. These budget exercises provide a broader view of how effective a retirement savings plan can be based on various lifestyle decisions. It can be helpful to model multiple scenarios, including both an aggressive and a conservative budget.

Question Your Assumptions

A common mistake many investors make during this exercise is to assume substantial returns on investments to justify expensive lifestyle choices. Expecting outsized returns on savings is dangerous to a retirement plan. Investors, including physicians, should consult with an advisor to determine a reasonable expected return based on historical performance, portfolio components, and other factors.

Review Asset Allocation

Asset allocation encompasses the types of investments within a portfolio and the various underlying industries, risk, and levels of market correlation for those investment types. Diversification is an important strategy for proper asset allocation.

Managing Diversification

Diversification is the process of varying the allocation of value in a portfolio among a variety of sectors, investment types, and risks. The goal of this practice is to reduce each investment's correlation with the others in order to create a buffer against significant swings in one sector or another wiping out an entire portfolio. Proper diversification is among the most effective ways of mitigating losses.

For investors to understand the importance of diversification, they should realize that history tends to repeat itself, and an unfortunate outcome can result in a complete loss of a lifetime of savings. For example, according to the *New York Times*, the Enron 401(k) plan, which was overweighted in Enron stock, lost more than $1 billion in value in 2001 when the company went bankrupt and shares of Enron stock fell 94%. Today, employees heavily invested in GE stock are feeling much of the same loss as Enron employees did 17 years ago.

Putting Returns in Their Place

Risk tolerance is an investor's ability to mentally and financially withstand volatility in investment performance. An investor with a high-risk tolerance may be young, with decades of expected income, and relatively unbothered by large swings in investment values. A more conservative investor may have fewer working years through which to replenish investment losses and become stressed at the idea of volatile investment swings.

As physicians age, they need to reallocate their assets into increasingly conservative investments to best limit their exposure to loss as their investment timeline shortens. Careful consideration must be made to limit downside risk properly, which may be done through fixed income and alternative investments.

The idea of reallocating to more conservative assets can be troubling to those who are focused on maximizing returns because conservative investments tend to have limited upside potential. To understand why this move is often more beneficial than seeking higher returns in later life, one needs only to be familiar with *sequence of returns* risk.

Sequence of returns risk is the danger that the timing of liquidation and withdrawal from a retirement account will coincide with a downturn in the market. If it does, then it effectively reduces the overall potential longevity of the entire portfolio because a high number of shares will need to be liquidated to get the income expected, thus leaving fewer shares in the portfolio to grow.

Sequence of returns risk may not be important during the accumulation phase, but during the withdrawal phase it is a critical factor in the overall success of a retirement plan, making it a higher priority than chasing returns.

Designing a Withdrawal Strategy

Although a physician's primary financial focus is to save and accumulate funds for retirement, the design of a withdrawal strategy is equally important to financial health in retirement.

Selecting a Withdrawal Rate

A fundamental pitfall in static retirement plans is setting a withdrawal rate that is fixed over a retirement period. Consider that, for many physicians, the retirement stage of life is likely to last at least 20 years. In that time, investment yields may vary widely, and both tax rates and personal spending habits could also change. Because of these changing variables, it is essential that flexibility be built into retirement planning, both in initial models (high, middle, low) and when reviewing the plan each year (or more frequently). Flexible planning models and periodic adjustment based on real-time results is the only way you can expect to follow a model that will endure throughout retirement—regardless of how many years, or decades that retirement may last.

Making Room for Taxes

No one knows what tax rates will be upon retirement. This statement does not mean physicians should ignore tax planning but that they should account for the potential costs of taxes and design a strategy to minimize them.

To do this, it is important to understand how taxes will have an impact on withdrawals and liquidations. Having a plan that considers which withdrawals will trigger ordinary income taxes, which will incur capital gains, and which will realize no tax, is essential.

Physicians should understand delaying distributions from their assets will have the greatest impact on their ability to have a successful retirement. Physicians in certain specialties have the option of easing into retirement and exploring varying roles within a practice. While still working and engaged with numerous individuals throughout the medical industry, physicians may want to consider making connections that will enable them to transition into consulting roles. This strategy can allow them to generate a supplemental income for several years, thus moderating the stress on their portfolios by reducing the rate of withdrawal.

Financial success or failure in retirement is generally determined in the first several years of retirement. Transitioning into retirement gradually without a sudden loss of income can enhance the odds of success.

Conclusion

Most physicians see a comfortable retirement as a reward for decades of hard work. Do not let the absence of preretirement planning hinder this goal. While understanding the 3 strategies in this article are a good start, there is no substitute for working with an experienced advisor in the field who can make analyses and recommendations specific to your situation. The authors welcome your questions. ■

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