

Our Perspectives: A Reasonable Retirement Goal



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A million. One-point-five. Eight times your income. What is the right number for your retirement nest egg?

The final number depends on your individual circumstances. But it also relies on a lot of broad assumptions, like the future rate of inflation and investment returns, expected Social Security payments, timing of retirement and life expectancy. Though it's a simple math problem, it turns out you need to make a lot of assumptions.

We decided to work out the math for the “average American” — using things like average retirement age, average Social Security payment and average income level. We came to the magic number of seven — that if this fictional average person retired with about seven times their pre-retirement income, they'd be in pretty good shape. For instance, when this average worker makes \$59,000 per year in the final year before retirement, he should have about \$413,000 saved in a retirement nest egg. (\$59,000 times 7.)

To get to this 7x number, about how much should you have saved at each age along the way? The chart on the next page shows some ballpark milestones based on our assumptions.

Let Time Do the Work

Thanks to the effect of compounding earnings, a longer timeline can really ease the burden of how much you have to save each year. So if you're starting late, you can achieve more by delaying retirement. This also shortens the time that the nest egg needs to provide cash in retirement.

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Saving Milestones to Reach 7x

To get to this 7x number, about how much should you have saved at each age along the way? By our math, the graph shows the ballpark milestones to aim for.

We assumed our fictional person saved the same percentage of his income each year to get to the final nest egg. For each of the three scenarios, the graph shows how much he had to save at each milestone.

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Focus on a Reasonable Plan

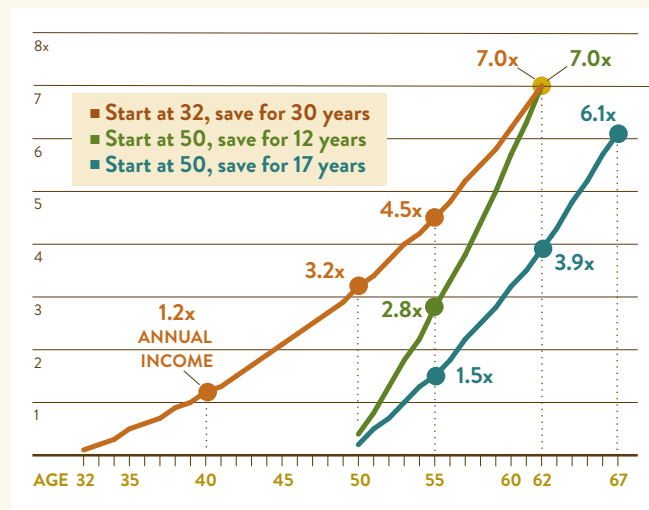
Most of the factors that determine these calculations are largely out of your control. Still, you can make most of the necessary headway by focusing on what you can plan:

- when you start saving
- how much you save
- when you retire
- how you invest during your earning vs retirement years

We assumed that our saver was fully invested in a stock/bond portfolio through his saving and retirement years. If these averages don't match your own circumstances, you should adjust your retirement saving goals accordingly. For instance, if you make a higher income or anticipate a lower Social Security payment, you'll want to save more than 7x your pre-retirement income. If you expect to have other sources of cash such as a pension in retirement, you could aim for a smaller nest egg.

Retirement Milestones

The Multiple of Annual Income to Have Saved by Each Age



Source: Calculations by Homestead Funds.

How did we get to seven?

Here's what we assumed:

Life expectancy: 87 years

Target replacement rate: 85% of pre-retirement income, with a combination of Social Security benefits and drawing from your nest egg

Annual income while working: \$59,000 in current dollars¹

Social Security benefits: \$1,342 per month in current dollars²

Annual inflation: 2.5% (used to grow each year's annual income and projected Social Security benefits)

Investment return: 7% (a reasonable annual average for a stock/bond portfolio over a very long time period)

Average retirement age: 62³

¹fred.stlouisfed.org/series/MEHOINUSA646N

²time.com/money/4644332/maximum-social-security-benefit-2017/

³money.usnews.com/money/retirement/articles/2014/05/12/the-ideal-retirement-age-and-why-you-wont-retire-then

Five Ways to Stick With Your Plan

Making a great plan will take you far on your path to retirement readiness. But what about sticking with it? Here are five methods that have sticking power.

1

One thing at a time.

You may have more success if you tackle one thing at a time. But good changes in one area may spill over to benefit other aspects. Consider spending cuts: when you spend less, you save more. You also adjust to living on a smaller amount, so you can retire on less or retire sooner. Living on less can be a tall order, however. Pare down your budget one category at a time, starting with an area where a little discipline would make the biggest difference.

2

Get specific.

Good intentions are important, but specific plans to implement intentions may double or triple success. In one study, health psychologists looked at how often a group of people exercised. In a control group, 38% of participants exercised once per week. In a second group, participants were read a motivational speech about the health benefits of exercise — and only 35% exercised once per week. In a third group, participants were asked to complete the following sentence outlining their specific plans:

- “During the next week, I will partake in at least 20 minutes of vigorous exercise on [DAY] at [TIME OF DAY] at/in [PLACE].”
- In the third group, 91% of participants actually exercised once per week!⁴ Think about how you can apply this to your retirement plan — how can you get specific?

3

Make it a habit.

To form a habit, try doing an action in response to a contextual clue. For instance, if you want to develop a habit of getting more exercise, you might take a short walk after breakfast every morning — soon enough, the action of eating breakfast will trigger the habit of going for a walk.⁵

How can you do that with your money? You can attach your “plan action” time to another activity. Perhaps every morning after you check your email, then you do some action to help your monthly savings, like planning a cooking menu for the week, or contacting a friend to borrow something instead of buying something. Soon enough, it’ll be a habit.

4

Automate.

Habit-forming is so productive because it removes willpower from the equation. In this digital era, automation is another tool that can override willpower. (Though automation won’t lace up your sneakers for that daily walk...yet.) Nowadays, you can set your bills to autopay, automatically transfer money into savings and investment accounts, automatically invest in pre-determined choices, and automatically reinvest investment earnings.

5

Put up a picture of your future self.

There’s one interesting theory about why we procrastinate when it comes to preparing for the future: that we view our future selves as strangers.

A Harvard study found that when people see an image of themselves digitally aged, they identify more closely with their future self, and are more likely to save for the future. In fact, study subjects who looked into a mirror and saw themselves digitally aged were twice as likely to put money in a retirement account as those who saw their regular image in a mirror.⁵

Try it: use your smartphone to download an age progression app that will show you what your older self looks like.

⁴Milne, Sarah, Sheina Orbell and Paschal Sheeran. Combining motivational and volitional interventions to promote exercise participation: Protection motivation theory and implementation intentions. *British Journal of Healthy Psychology* (2002), 7, 163, 184.

⁵www.ncbi.nlm.nih.gov/pmc/articles/PMC3505409/

⁶<https://hbr.org/2013/06/you-make-better-decisions-if-you-see-your-senior-self>

Homestead Funds client services team would be happy to talk with you about your goals and current investment program. Give us a call at 800.258.3030.

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