

4 dangerous assumptions that could hurt your retirement plan



By **Christine Benz** February 9, 2015 1:00 AM

As inveterate watchers of sitcom reruns (and a real-life Felix/Oscar combination), my sister and I loved *The Odd Couple* while we were growing up. One of our favorite episodes featured [a courtroom sequence](#) in which Felix (Tony Randall) berates a witness to "never assume," and proceeds to use the chalkboard to demonstrate what happens when you do. More years later than I care to admit, the mere mention of the word "assume" makes me smile.

But assumptions aren't always a laughing matter, and that's certainly true when it comes to retirement planning, where "hope for the best, plan for the worst" is a reasonable motto. Incorrect--and usually too rosy--retirement-planning assumptions are particularly problematic because, by the time a retiree or pre-retiree realizes her plan is in trouble, she may have few ways to correct it; spending less or working longer may be the only viable options.

What follows are some common--and dangerous--assumptions that individuals make when planning for retirement, as well as some steps they can take to avoid them.

Dangerous Assumption 1: That Stock and Bond Market Returns Will Be Rosy

Most retirement calculators ask you to estimate what your portfolio will return over your holding period. It may be tempting to give those numbers an upward nudge to help avoid hard choices like deferring retirement or spending less, but think twice.

To be sure, stocks' long-term gains have been pretty robust. The S&P 500 generated annualized returns of about 10% in the 100-year period from 1915 through the end of last year, and returns over the past 20 years have been in that same ballpark. But there have been certain stretches in market history when returns have been much less than that; in the

decade ended in 2009, for example--the so-called "lost decade"--the S&P 500 actually lost money on an annualized basis.

The reason for stocks' weak showing during that period is that they were pricey in 2000, at the outset of the period. Stock prices aren't in Armageddon territory now, but nor are they cheap. [The Shiller P/E ratio](#), which adjusts for cyclical factors, is currently at 27, versus a long-term mean of 17. [Morningstar's price/fair value](#) for the companies in its coverage universe is a not-as-scary 1.04, meaning that the typical company is 4% overpriced relative to our analysts' estimate of intrinsic value. But that slight overvaluation surely isn't a bullish signal, either.

What to Do Instead: Those valuation metrics suggest that prudent investors should ratchet down their market-return projections somewhat just to be safe. Morningstar equity strategist Matt Coffina has said that [long-term real equity returns in the 4.5% to 6% range are realistic](#). Vanguard founder Jack Bogle's forecast for real equity returns is [in that same ballpark](#).

Investors will want to be even more conservative when it comes to forecasting returns from their bond portfolios. Starting yields have historically been a good predictor of what bonds might earn over the next decade, and right now they're pretty meager--roughly 2% or 3% for most high-quality bond funds. That translates into a barely positive real (inflation-adjusted) return.

Dangerous Assumption 2: That Inflation Will Be Mild or Nonexistent

In a related vein, currently benign inflation figures--CPI measured less than 1% in 2014--may make it tempting to ignore, or at least downplay, the role of inflation in your retirement planning. Like robust return assumptions, modest inflation assumptions can help put a happy face on a retirement plan. But should inflation run hotter than you anticipated in the years leading up to and during your retirement, you'll need to have set aside more money and/or invested more aggressively in order to preserve your purchasing power when you begin spending from your portfolio.

What to Do Instead: Rather than assuming that inflation will stay good and low in the years leading up to and during retirement, conservative investors should use longer-term inflation numbers to help guide their planning decisions; 3% is a reasonable starting point. And to the extent that they can, investors should customize their inflation forecasts based on their

actual consumption baskets. For example, food costs are often a bigger slice of many retirees' expenditures than they are for the general population, while housing costs may be a lower component of retirees' total outlay, especially if they own their own homes. (This [article](#) looks at historical inflation rates for a broad range of goods and services.)

The possibility that inflation could run higher than it is today also argues for laying in hedges in your retirement portfolio to help preserve purchasing power once you begin spending your retirement assets. That means stocks, which historically have had a better shot of outgaining inflation than any other asset class, as well as Treasury Inflation-Protected Securities and I-Bonds, commodities, precious-metals equities, and real estate. The good news is that most of these asset classes--apart from stocks--are arguably trading cheaply today, as discussed [here](#).

Dangerous Assumption 3: That You'll Be Able to Work Past Age 65

Never mind how you feel about working longer: [The financial merits are irrefutable](#). Continued portfolio contributions, delayed withdrawals, and delayed Social Security filing can all greatly enhance a retirement portfolio's sustainability. Given those considerations, as well as the ebbing away of pensions, increasing longevity, and the fact that the financial crisis did a number on many pre-retirees' portfolios, it should come as no surprise that older adults are pushing back their planned retirement dates. Whereas just 11% of individuals surveyed in the 1991 Employee Benefit Research Institute's Retirement Confidence Survey said they planned to retire after age 65, that percentage had tripled--to 33%--in the 2014 [survey](#). In 1999, just 5% of EBRI's survey respondents said they planned to never retire, whereas 10% of the 2014 respondents said that.

With that in mind, there appears to be a disconnect between pre-retirees' plans to delay retirement and whether they actually do. While a third of the workers in the 2014 survey said they planned to work past age 65, just 16% of retirees said they had retired post-age 65. And a much larger contingent of retirees--32%--retired between the ages of 60 and 64, even though just 18% of workers said they plan to retire that early. As Morningstar.com assistant site editor Adam Zoll discusses [here](#), the variance owes to health considerations (the worker's, his or her spouse's, or parents'), unemployment, or untenable physical demands of the job, among other factors.

What to Do Instead: While working longer can deliver a three-fer for your retirement plan--as outlined above--it's a mistake to assume that you'll be able to do so. If you've run the

numbers and it looks like you'll fall short, you can plan to work longer while also pursuing other measures, such as increasing your savings rate and scaling back your planned in-retirement spending. At a minimum, give your post-age-65 income projections a haircut to allow for the possibility that you may not be able to--or may choose not to--earn as high an income in your later years as you did in your peak earnings years.

Dangerous Assumption 4: That You'll Receive an Inheritance

Here's the good news: While it's a convention in movies for children to be crestfallen when their parents don't leave them an inheritance, a recent [study](#) showed such surprises to be relatively rare. In fact, the study found that just the opposite scenario is common: More parents intend to leave their children an inheritance than the children expect to receive one. A Fidelity [survey](#) found that adult children underestimate the value of their parents' estates, to the tune of \$300,000, on average.

But that doesn't mean there's not the potential for some adult children to receive less than they expected to. Increasing longevity, combined with long-term care needs and rising long-term care costs, means that even parents who intend for their children to inherit assets from them may not be able to. Alternatively, the parents may not be inclined to give at all, even if they have the money: A U.S. Trust survey found that wealthy baby boomers are less likely than other generations to believe in leaving money to their heirs; just 53% of those boomers surveyed said they believe that leaving an inheritance is important, whereas 68% of high-net-worth investors over age 69 said that it's important to them to do so.

Adult children who expect an inheritance that doesn't materialize may be inclined to overspend and undersave during their peak earning years. And by the time their parents pass away and don't leave them a windfall--or leave them much less than they expected--it could be too late to make up for the shortfall.

What to Do Instead: Don't rely on unknown unknowns. If you're incorporating an expected inheritance into your retirement plan, it's wise to begin communicating about that topic as soon as possible. Alternatively, if you don't want or need an inheritance but suspect that your parents are forgoing their own consumption to give you one, you can have that conversation, too.