Retirement planning assumptions are just that

by Carmel Fisher, Fisher Funds | Mar 21, 2014

You will have heard the quote, apparently penned by Oscar Wilde, that "to assume is to make an ass of u and me". I do think that in the world of finance at least, assumptions can be dangerous. I have seen many an assumption lead to expectations and hopes being dashed.

With this in mind, I was interested to read several articles this week which confirmed that accepted assumptions about retirement planning and life after retirement need rethinking.

A discussion from Reuters highlighted that there are two realities of retirement – one that exists in spreadsheets, calculators and rules of thumb used to help people plan for retirement and the other in the actual life lived by individuals and couples in retirement. The two differ significantly. While retirement planners and calculators assume various aspects of human behaviour, it turns out we do things differently when we retire.

People don't typically enter retirement with 20 times their annual spending in the bank, even if they've been advised to do so; they don't switch from shares to bonds on the day they retire; they don't carefully calculate their monthly spending based on their spreadsheets; they don't typically work until 70 in order to make their savings last longer; and they don't tend to run out of money.

What we do know is that over time retiree spending drops substantially. Household spending peaks for people around the age of 48 and their spending is almost cut in half by the time they are over 75.

The first couple of years of retirement can be expensive as retirees enjoy long deferred trips, do up the house or invest in hobbies and 'retirement toys'.
However although spending in the early retirement years can be high, and similar to the amount spent in the final years of work, it soon declines and remains relatively low.

Retirees don't stop thinking when they retire! Although planning models suggest that retirees will struggle if they don't receive a constant, predictable retirement income, it turns out that retirees will adjust their spending according to their income. They will tighten their belts in leaner years and will spend more freely after experiencing good returns.

Some of the other accepted assumptions that need rethinking are life expectancies and the source of retirement capital. People should be planning on making their nest eggs last for 30 years rather than 20 years, because we are all living longer.

And often people assume that their home will fund their retirement lifestyle, however when you reach retirement and love your house, and don't find it too big, and don't mind doing the garden (in fact you love it because you have tended it for years) you may not want to have to sell it to pay for your retirement lifestyle.

That is not to say that retirement planning is futile. Quite the contrary – apparently people tend to increase their savings when they use retirement income projections and have access to information about the benefits of saving now for use later.
But they should remember what assumptions can do to us.