Getting Started in

A FINANCIALLY SECURE RETIREMENT

Henry K. Hebeler

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I dedicate this book to my children and grandchildren whose generations will experience the things that I describe. May they show wisdom and properly prepare themselves for a lengthy period of adverse economic conditions that is an inevitable part of their future and, by so doing, gain comfort and health throughout their lives.

Henry (Bud) K. Hebeler

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About the Author

Henry "Bud" K. Hebeler earned three degrees from the Massachusetts Institute of Technology (SB, AerE, MB), and his academic career includes the Honors Program, Outstanding Student Award, Kuljian Humanities Award, Mead Prize for Aeronautical Engineers, Tau Beta Pi (engineering honorary), Sigma Zi (aeronautical honorary), Sperry Gyroscope Fellow, Sloan Fellow, MIT Sloan School Board of Governors and boards of several other colleges.

Bud Hebeler, as an aeronautical engineer, taught ballistic missile design at Cal Tech and has patents on an aeroelastic analog computer and reentry heat shield. In addition, he has managed several classified defense projects, developed the Short Range Attack Missile, led Minuteman Ballistic Missile systems engineering, and served as vice president engineering, vice president corporate planning, and president of Boeing Engineering and Construction. He then served as president of Boeing Electronics and president of Boeing Aerospace Company.

As an active citizen, he has been an economic advisor to the governor of the state of Washington and, at the federal level, a policy consultant to the secretaries of Commerce, Interior, Energy, and Defense as

well as a consultant to the U.S. Congress on fusion. In his community, he is active on many church and local community projects.

A successful writer, Mr. Hebeler is the author of *On the Offense Against the Defense* (Arcata, CA: Humbolt State University, 1986); *J. K. Lasser's Your Winning Retirement Plan* (New York: Wiley & Sons, 2001); *Deception, Dynamics and Decisions* (a paper delivered for the National Association of Personal Financial Advisors at 2003 Philadelphia Conference); and numerous retirement articles on www.analyzenow.com, which are referenced in many national magazines and newspapers including the *Wall Street Journal*, *BusinessWeek*, *Kiplinger's*, *AARP*, *Money*, *Smart Money*, and *Financial Planning* as well as television and radio programs.

As a retired Boeing exective and working without compensation, Mr. Hebeler assists thousands of people with answers to retirement questions. When not doing this, he and his wife enjoy an active life of skiing, golfing, and church activities. They are high-handicap golfers but accomplished skiers who are not afraid to tackle deep powder and double-black expert slopes even though now in their 17th year of retirement. The Hebelers have four daughters and thirteen grandchildren, all skiers or snowboarders.

Foreword

Growing old is not an option. We don't have a choice. But we do have choices that will greatly affect our quality of life for the rest of our life. That in a nutshell is what this book is about; how to make the right decisions regarding our resources to maintain a retirement lifestyle similar to the one we have grown comfortable with during our income-producing years of employment.

As a financial advisor of 25 years, I have taken a keen interest in this topic, doing my best to make sure that my clients have enough dollars to sustain themselves for the rest of their lives. I have often felt that what is needed for people who are intent on meeting this challenge is a comprehensive and concise "how-to" retirement manual. I have hunted long and hard to find such a book. Thankfully, my hunt is over. Henry Hebeler has delivered—but first a little history . . .

In 1982 a cultural financial shift of seismic proportions took place. Corporate America began doing away with defined benefit plans by introducing self-directed 401(k) retirement accounts to their employees. Essentially, companies started unloading the burden of employee retirement saving off their own backs and onto the backs of their workers.

Instead of looking forward to a monthly pension check from their employer upon retirement, employees were now faced with the responsibility of first saving enough money, and second, investing it wisely so that eventually this account would sustain them throughout their retirement years, or what I more bluntly refer to as a 20- to 30-year period of unemployment.

As a result, millions of Americans began turning to the Wall Street crowd of stockbrokers for a little help and guidance and came face to face

with an industry that was far more concerned about making the next commissioned sale than offering prudent, intelligent investment advice.

Unfortunately, for much of the 1980s and 1990s this problem was masked, largely because the stock market generated returns during this period almost *twice* that of its historical long-term average. As the saying goes, everyone is brilliant in a bull market, especially your stockbroker.

The good times of great returns came to a screeching halt in the spring of 2000 when the stock market bubble burst. 401k accounts plummeted, and investors started realizing they needed to get serious and start making some smart decisions about retirement planning.

Who do these investors turn to for commonsense, unbiased advice now? The financial industry is still intent on making the next sale, and the financial press is intent on meeting its next deadline, so not much help there. Providentially, Mr. Hebeler has stepped up and filled an enormous void with this book.

Relying on his expertise as a long-range planner for the Boeing Company, he brings clarity and wisdom to the individual investor, through his website www.analyzenow.com and through his frequent articles. Now he offers us a splendid little book that is packed full of common sense advice on all dimensions of the retirement planning process.

Make no mistake, preparing for retirement is still a daunting challenge. There are so many different topics to address, everything from Social Security payouts to replacement budgeting to reverse dollar cost averaging. This book addresses them all.

Despite the popular (and accurate) notion that Americans are woefully unprepared to embrace their retirement years, it has been my experience that many of these same folks have a keen desire to accept responsibility for their financial well-being; it is just that the task is so daunting that they don't know where to start and what to focus on. Hebeler's book is certain to become the definitive guide to long-term planning for investors who want to accomplish the elusive goal of a worry-free retirement.

Bill Schultheis,
Financial advisor, journalist, and author of
The Coffeehouse Investor

Preface

> I've been rich and I've been poor. Believe me, honey, rich is better. —Sophie Tucker

Sophie, you were poor before being rich. It is even worse being poor after you've been rich—as too many people are going to learn! Today, most people are rich compared to lifestyles several decades ago. Yet in several decades in the future, a large contingent of our older people are going to be truly poor because they are not willing to pull back a little now so they will have some resources in retirement.

The problem is compounded because it is a social problem, not just an individual problem. In order to get elected, politicians cannot run on a platform advocating real fixes for future generations. Then, once in office, they promote public spending and consumerism that makes the current economy look good and keeps employment high.

The individuals who are attentive and motivated will do much better because they will have looked ahead and included some relatively simple things in their plans that will help them achieve a better lifestyle than the vast majority. This book will pave the way for those who heed its advice. Then, like Sophie, they can say, "Rich is better."

Introduction

If you have decided to read this book, we already share some things in common. When I was 55 years old, I started to look into retirement planning very carefully. Before then I always relied on a very competent financial advisor who was getting handsomely compensated for his effort.

Reaching the age of 55 was a critical point in my life because, like many, I started to consider when I could afford to retire and what other activities would replace those of my job. My financial planner said I already had accumulated enough to retire comfortably. In light of the fact that retirement is a one-time life-changing event, I decided to look into planning methodology very, very carefully, not only with regard to how the planner put the numbers together, but also with the same perspective that I had used for Boeing's corporate planning that I headed for six years.

I started attending seminars put on by other planners trolling for new clients. I went to an introductory class designed for people who were considering becoming professional financial planners. The professor outlined subjects and investments that I not only already knew much about, I had personally owned most of the types of investments that they would only read about. So I picked up some books on the subject to try and better assess the current state of the art in financial planning. In short order, I felt very uncomfortable about what I was learning.

Then I turned to the computer to help with solutions. I started to use some of the commercial retirement planning programs to see how close results were to my own planner's forecasts. I could not find any two programs that gave results that were even close, much less close to each

other. So I started to do some reverse engineering—that is, try to deduce what was causing the differences. After a while, I could spot troubles just by inspection of the way they were assembling the entries. For example, many of the media sources asked people to add their Social Security projection to their pension projection. We were all taught that you could not add apples and oranges in grade school, yet here they were adding inflation-adjusted Social Security to fixed income pensions. It does not take many years before this addition is painfully off—and in an unconservative direction.

Further, neither the programs nor the books nor the magazine planning methods seemed to include or even hint at the fact that it was important to be conservative. It wasn't just the methodology, it was the default values for investment performance which almost universally did not include costs and fees and used national life expectancy for the length of retirement, after which the person would exhaust all investments. Never mind that one-half of the population would live longer than this, and that the life-expectancy numbers included a significant number of early deaths from murders and could be woefully low if you were an Asian or white woman. Nor was there even a hint that maybe you should not plan on using all of your investments for normal retirement expenses when, in fact, almost everyone has numerous financial surprises that were never planned.

I learned the importance of being conservative when planning long before my years in Boeing's headquarters. At the division level, we had to submit both one-year operating plans and long-range plans every year. Our compensation depended on our performance as measured against our one-year operating plans, but the long-range plans gave upper management some perspective about the amount of research and development money a division should get. These were actually conflicting objectives, in a sense. The operating plans motivated a conservative outlook while the long-range plans motivated an optimistic outlook.

Why do I bring up this history? The answer is because the same thing is true in the financial industry. When they want you to sell a product, the amount they charge must be conservative to cover their costs and make a profit. On the other hand, to sell their products, they promote very high long-term expectations such as booming future returns.

Few financial firms put planning methodology very high on their priority list. I have helped financial journalists expose flaws in numerous widely used programs developed by mutual funds, insurance companies,

software houses, financial magazines, and nonprofit organizations supposedly dedicated to helping people do retirement planning. Some of the offenders have not changed their methods after years of prodding, and almost all are very slow to react.

If successful, the leading managers of financial companies often get compensated in excess of $10 million a year. This is just one part of what one firm estimates to be about $300 billion of annual financial companies' overhead that you and I pay through both disclosed and hidden costs in the products. My research concluded that my professional planner had done a good job recommending low-cost mutual funds, but I could never get anything very explicit on real estate partnerships. I do know that the general partner of several of these partnerships bought maintenance services from subsidiaries that the general partner owned, so the management decisions may not always have been in the best interest of the limited partners.

After some of this research, I agreed with my planner that I did have enough resources for my own fairly comfortable retirement, so I set a new goal. I would retire and devote a major effort in trying to help people do better retirement planning. I decided that I would do this on a not-for-profit basis not just to be charitable, but also so that I would be considered as objective and unbiased.

I now help several dozen financial journalists with articles that reach millions of people. I do not ask for credit, but often they will mention my website, www.analyzenow.com, or my J. K. Lasser series book. Sometimes newspapers and magazines publish an article I've written. For the past 15 years, I have provided these efforts without a request for compensation, and when the organization I helped insisted on paying me, I donated the money to charity.

I've come to respect authors who challenge the financial industry's conventional wisdom and those who provide practical help to their readers. Two of these are in my hometown of Seattle, Paul Merriman and Bill Schultheis. They not only write useful material, they help those in our community with seminars to motivate the audience. For the most part, I've never met my financial journalist heroes in person, although I've often had lengthy e-mail and phone conversations about challenging subjects. These are people like Jonathan Clements, Jonathan Pond, Tom Herman, Mary Beth Franklin, Jean Gruss, Lynn Asinof, Lynn O'Shaughnessy, Chris Farrell, Kelly Greene, Walter Updegrave, and many others, all of which help those in audiences far greater than I can reach.

I do not work alone to get my own material to the public. My website is supported largely by unpaid volunteers, many of whom I have never met in person. I have people that assist me in many states, Canada, and England. These vary from a volunteer who is my webmaster in Salt Lake City to a retired professor of finance from Oxford University who acts as a sounding board for many of my technical concerns. I get both ideas and help from professional planners and lawyers who like my work as well as a retired math professor who helps test my programs and an amazing retired Navy captain who almost daily e-mails me retirement planning news clips.

As the Getting Started title implies, this book has no pretense of being a scholarly treatise. Instead, its audience is intended to be those who know they would like to get started on a sound path to a financially comfortable retirement. It is my hope that the efforts I put into this project will provide a major improvement in the retirement lives of the Getting Started readers.

Chapter 1

Planning

The secret of getting ahead is getting started.

—Mark Twain

P*lanning* is all about creating an image for the future and the path to get there. If you are planning on upgrading your home, you envision the revised structure, estimate its costs and revise the image to bring it into sync with the amount that you can afford. Then you enumerate the things you have to do to get to that position in the future.

planning
a strategy and actions to get to an objective. In finance, it requires a projection based on some assumptions about the economy, resources, saving and/or spending that provides an estimate of future financial status.

So it is with retirement planning. You have to think about the future lifestyle that you want and the path to get there. You have to estimate what that will cost and bring the image of the future into sync with the sacrifices you have to make now.

The image we have of our retirement needs is far different than it was for our grandparents. Grandfather may have lived on a farm, depended on his children when he got old, had little use for a telephone, never saw a computer, had a few 78 rpm phonograph records, worked until unable, and, for the short time until he died, liked sitting on the front porch talking to neighbors and relatives.

Now our retirement image is vastly different. We are influenced greatly by the lifestyles of friends and images portrayed by newspapers, magazines, movies, television, and so forth. We are living longer, retiring earlier, relying heavily on technology, and are well aware of the lifestyles of those around us. So let's examine some of these things.

The Joneses

Today, it is all about keeping up with the Joneses. The Joneses may be real people in your neighborhood, business, relations, friends, or even celebrities you have never met. They create the lifestyle goals you seek. Images from TV, advertisements, holiday cards from acquaintances, and visits to other homes or areas may sway you. You may also feel pressure from your children whose friends may set your children's goals. All of this is reflected in your choice of houses, automobiles, furnishings, electronics, club memberships, sports, vacation spots, entertainment, restaurants, colleges for children, and the like.

inflation

A measure of increasing costs for the same items. Inflation is usually measured by changes in the *consumer price index* (CPI), which is based on a "basket" of items that are supposed to represent the kind and proportion of things consumed by the average person. Specifically, inflation is the cost growth (this year's costs less last year's costs) divided by last year's costs.

By foregoing some parts of the Joneses' lifestyle now, you are likely to do better than the Joneses in the long run even if you have lower income now. This book is going to tell you what the future may well hold and the benefits you will be able to enjoy by lagging a little behind the Joneses, showing some restraint, and putting aside enough money for a decent retirement which, after all, could well be one-third of your life.

By the time some people will be reading this, they will already be retired. This book also is for retired people. Whether still working or already retired, the same principles apply. Everyone has to save, everyone has to invest, everyone is exposed to *inflation*, and everyone is subject to taxes. Retired people are not an exception, but they have a serious disadvantage compared to younger working people, namely, it is very hard for them to get back into the workplace after they discover that their financial problems force them to seek more income.

Don't forget, this is a *long-range* planning book. You will not likely see any of the effects that I forecast for a long time. This is to your advantage because the more everyone else spends, the better off you are as a consequence of greater investment opportunities and lower taxes. But someday, that will change, and you will be far ahead if you follow the advice in this book.

The Planning Path

The first step to do better than the aging Joneses is to develop a conservative financial plan that provides a reasonable lifestyle in your retirement, particularly your late retirement. We are looking for how much you will be able to spend in retirement, and, if you are not yet retired, how much you will have to save beforehand. It is an amazing thing to me that many people expect to live twenty to forty years in retirement and still have not made an attempt to reconcile how much they would have to save in order for their savings to support a reasonable retirement lifestyle without going broke in short order.

Eighty percent of success is showing up.—Woody Allen

The future environment, as influenced by massive overspending in the last few decades, requires forecasts of lower than historical returns, higher inflation, and higher tax rates. It also means setting aside some money as a contingency for unforeseen events, which could include things that could happen to your adult children or aged parents and at least partial provisions for long-term care.

You can make such plans yourself using the simplified approach in the appendixes of this book, use a competent computer program, or rely on the help of a professional planner. You may have to lean on the planner to use conservative inputs because less experienced planners often believe they can foresee the future—and they would have you believe the future is going to be glorious with their help. It is common to use historical data for things like inflation and returns, but it is very unlikely that the long-term future will be like the past. So don't let an apparently sophisticated planner have you believe that a comprehensive computer program with a *Monte Carlo analysis* will give you high confidence. Plan more conservatively than this.

Uncertainties in Forecasts

There are many uncertainties in long-range plans, but even an imperfect plan is likely to give a better basis for your economic decisions than no plan at all.

- Family emergencies
- Aging parents' care
- Adult children troubles
- Returns
- Inflation
- Taxes
- Social Security
- Pension viability
- Medical costs
- Years your money must last

Monte Carlo analysis
a statistical analysis involving a large number of trials of randomly drawn values. In financial analysis, the values are usually historical daily or monthly returns on investments. The result is the probability that investments would have been exhausted in a certain number of past years. Caution! It represents what happened in the past, not necessarily what will happen in the future.

There are many imponderables when doing planning including economics, health issues, and unforeseen events. Although you cannot be precise, every year that you redo your plan, you get closer to reality and build a financial base that hopefully gives you some resiliency to accommodate the unknowns.

There is a saying that expresses the other side of uncertainty:

"When nothing is certain, everything is possible." Our objective in this book is to show you some things that are possible and help you rise above the crowd. If you seize on the possibilities, you will succeed.

Overcoming Planning Uncertainties

No one can predict the future. We don't know how long we are going to live, what surprise events will develop, nor what is going to happen in the economic world of returns, inflation, and taxes. Yet

all of these things need to be specified to develop a financial plan that determines how much you should be saving before retirement or how much you can spend after retiring. Fortunately, there are some things that we can do to provide some insulation from the uncertainties in planning.

> There are only two groups of forecasters—those who do not know and those who do not know that they do not know.
> —John Kenneth Galbraith

I would like to go back in my own history and give you an analogy that may help you understand some things that most financial planners do not. I started my working career in the Boeing Company in a stress group of a technical organization called *Structures*. My first project involved the design of a very advanced and highly classified new airplane. I was responsible for the preliminary design of the wing structure. In order to size the wing structural members and skin, we needed to know the loads and the strength of the materials. Our stress group computed the loads and we received "allowable" stresses for various materials from a group that specialized in the strength of materials.

The strength of materials was determined by testing many samples, mainly in "pull" tests where machines pulled at each end of carefully cut samples and measured how much stress the materials could take either before deforming unacceptably or failing completely. After many pull tests on the several test sheets, the materials group used the statistics from those tests to give us a design "allowable stress" that had a high probability of surviving an "ultimate load." We got ultimate loads by multiplying known loads by 1.5 to account for unknown loads and provide a "factor of safety."

The material "allowable stress" is analogous to a planner using the statistics of investment returns and inflation in preparing a plan. Planners call the results "success probabilities." You want a conservative success probability just as you want a high probability of getting to your destination in an airplane. Of course, no planner ever recommends the ultrahigh success requirements used in the design of an airplane. Retirees would be able to spend very little indeed.

Moreover, the financial planner cannot go as far as an airplane manufacturer because the planner cannot sample the future to determine the statistics of the future. Unlike a financial planner, a materials specialist sets up stringent material content and process specifications and confirmation

requirements. But it does not end there because after the materials are produced and delivered, the materials are tested again to see that they meet the specifications. For example, they might require that a sheet of aluminum to be used for a wing skin have three pull specimens cut from the sheet and tested to see if the statistics of that sheet actually match the same kind of strength statistics that were used in the design.

The materials specialist then makes a technical calculation of the "confidence" that that sheet will survive by comparing the results from these samples with the more extensive tests used to develop the allowable stresses. If the confidence level does not meet the designer's requirement, the sheet is rejected. A financial planner not only cannot sample the future, he does not have the opportunity to reject the future if it does not meet the assumptions used in the plan.

Unfortunately, planners have become so enamored with statistical programs such as Monte Carlo analyses that, unlike the materials specialist, they fail to remember that they are not able to sample the future. So they blithely say that they have a certain success probability that a retiree can live on such and such income for a certain number of years. What they really should say is that *if* the statistics of future returns, inflation and taxes turn out to be very similar to those of the past, and *if* the reserves prove to be adequate for surprise events, then the chances of succeeding (or success rate) is some specific number.

Now that you have this background, the planner's qualified success statement is not likely to be very comforting. Of equal import is the fact that no one knows what financial surprises may confront you. Perhaps an aging parent needs some uninsured care and does not have sufficient funds, or perhaps a daughter with several children gets divorced and desperately needs financial help. All of these things point to the need to make a conservative plan by using less-than-average returns, higher-than-average inflation, longer-than-average life expectancies, and so on, as well as putting aside some reserves, even though arbitrary, for surprise events. Like the factor of safety used to get ultimate loads in airplane design, a reserve provides some cushion for unknown events that happen in everyone's life.

So how do we get confidence in the planning process? We do it by using conservative and repetitive analysis and by gradually shifting to the kind of investments that have much less uncertain performance. When young we can take risks and recover from stock and real estate volatility. When older, we shift to a larger share of fixed income securities like certificates of deposits (CDs), bonds, and immediate annuities. If we do a new conservative

Overcoming Uncertainties

There are numerous ways we can protect ourselves from retirement planning uncertainties:

- Conservative plans
- Reserves for unknowns
- Shift to fixed income investments
- Immediate annuities late in life
- Repeat planning process every year
- Fewer uncertainties as we age

plan each year, as we age we experience the surprise events and use some of the reserves. We get some of the event uncertainties behind us. Using the previous examples, aging parents finally die and the children of the divorced daughter finally become self-supporting adults.

If the economy goes awry, we have some cushion to accommodate it. If the economy turns out better, we raise our sights somewhat but still use conservative projection values. The plan will never be perfect so, unlike the theory, we will not spend our last nickel on our last day on earth—instead we try to have enough money to support us if we live longer than average. If not, we leave something for our children or some worthy cause.

immediate annuities
a contract with an insurance company that, in exchange for a lump sum of money, will make lifetime payments on a regular basis. These may be either fixed, have cost-of-living adjustments, COLAs, or be based on other kind of an index. Pensions are really immediate annuities, most of which have fixed payments and some have COLAs.

Early in retirement, your forecast may change significantly from year to year. Plans change; that is the nature of planning. Don't believe that you can set out on a course where during the first year of retirement you spend a certain "safe" percentage of your income and then continue to simply increase that by the amount of inflation in every succeeding year until your death. Realistically, you have to change your outlook every year. If you don't, you overspend so much in bear markets that you cannot recover. Or, if you really get lucky in a bull market, you are at your planner's door asking why you cannot spend more. And you know what? Your advisor will give you a new plan which is what you should have developed each year yourself as a matter of course (see Figure 1.1).