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## Mickey Roth-Express News Article II

My last column was about various aspects of our current financial situation that had become understandable only after much digging. It's a very interesting story, but it has one drawback. It's all hindsight. I've been thinking about what I can see now that might be a clue to the financial future, and such clues could be much more helpful than hindsight. So for starters, let's talk about retirement.

There is a situation in the arena of retirement that has been brewing for decades. It stems from the fact that very few workers have pensions anymore. That's because most companies looked at the plight of firms like the Big Three automakers and decided a pension plan, especially after the advent of IRAs and 401(k)s, was something they were better off without. They could help employees with matching contributions to a 401(k), but they surely didn't want the huge liability of a pension. The problem, however, is that almost no employees who are eligible for a 401(k) plan have any idea about what that plan must provide when they retire.

A typical pension would provide, perhaps, 60% of a worker's final income. Let's say that was \$75,000 a year, so the pension would have paid \$45,000 a year. Social Security might add another \$12,000 to \$15,000 a year, so such a worker could be close to continuing his or her lifestyle. But, what size 401(k) plan is necessary to provide \$45,000 a year indefinitely? "Indefinitely" is important because retirement might last 30 years or more.

One thing we learn from large endowment funds is that a proper amount that can be withdrawn each year from a portfolio is about 5% of the market value. The important assumption here is that the fund's portfolio is invested in a way that provides an expected return around 9% or 10%. That, in turn, means it's about 60% in stocks and 40% in income securities. If this is the situation then the portfolio can support a 5% annual distribution indefinitely. That's the good news. The challenging news is that "5%" means 5% of the portfolio's market value at some particular date each year. So, if the market value has declined from the previous year on that date, the 5% is going to be fewer dollars. These are the basics.

Now, what size must your 401(k) be to provide a beginning distribution of \$45,000 per year? That's a simple question. Assuming a 5% distribution, the portfolio must be worth \$900,000. And that means you must accumulate \$900,000 in your 401(k) over your entire career. If your employer matches some of your contribution, that's fine. Your target, is \$900,000.

Unfortunately, few workers have done such a calculation and, even if they have, most 401(k) plans have a very unattractive feature. The workers can borrow from their 401(k) accounts and many of them do. If you assume a worker is on the job for 40 years and can choose a portfolio that returns an average 9% a year that person must set aside \$192 (their money plus employer match) a month into the plan to end up with \$900,000. But, if the worker borrows against the plan this calculation goes out the window. And experience tells me that borrowing against a 401(k) is extremely common, which means there are going to be very many people retiring with no pension and no meaningful portfolio from which to draw support.

The most hopeful part of this picture is that it doesn't have to be. We can almost all work, all save, not borrow and end up with a meaningful retirement portfolio. And we better.