Retirement Daily

Learning Center

This type of system would fall under the category of "unrealistic expense planning."

The Most Common Retirement Planning Mistakes and How to Fix Them

By Robert Powell | Nov 20, 2019 9:38 AM EST

When it comes to retirement, mistakes matter. Often, decisions are irrevocable. Often, you won't realize the cost of your mistakes until it's too late.

Or put another way: "As almost everyone goes through a retirement plan just one time," says Scott Bishop of STA Wealth Management. "Don't wing it."

What are some of the biggest mistakes that retirees make and how can they recognize and fix errors?

Underestimating Expenses

According to Ian Weinberg, the CEO of Family Wealth & Pension Management, one of the worst mistakes a retiree can make is underestimating their future expenses. "Many are in denial about their net cost of living, or what do they really live on after taxes," says Weinberg.

Others agree. "Failing to properly estimate their expenses," says Charles Adi, a financial planner with Blueprint 360. "This is the single biggest mistake I see. For some reason many think they will spend less during retirement, which is rarely the case."

How to Fix That

"We always have clients do the math," says Weinberg. "We insist they fill out a detailed budget sheet which is a real eye opener, comparing last year, this year and next year's projected living expenses."

Adi suggest that retirees (and pre-retirees for that matter) need to properly estimate the following:

- Healthcare costs and additional insurance, including prescription medication.
- Living expenses. "Every day is a weekend, so they spend more," Adi says.
- Family support. "Children, but mainly their desire to provide for grandchildren," Adi says.
- Home maintenance.
- Vehicle upkeep, and when necessary, a new car.
- Vacation and travel. "This includes true vacations, but also trips to see family and children," says Adi. "More and more families are spread out across the U.S."
- And last, but definitely not least, inflation. "This is a huge one as many are on fixed income," says Adi.
- Don't Overestimate Drawdown Rates

Another serious error that retirees make, according to Weinberg, is overestimating how much they can safely withdraw from their retirement accounts and have their nest egg last throughout retirement.

Historically, advisers have used a 4% withdrawal rate. But increasingly, given today's likely lower return environment and increasing life expectancies, advisers are using a lower and, perhaps safer, withdrawal rate of 3%.

"We have turned away potential clients who thought their portfolios could sustain 7% or 8% withdrawals," says Weinberg. "That math usually doesn't work for a retiree unless they're concentrating their portfolio in junk bonds, and those are before-tax returns. Net of tax, the math still doesn't work."

How to Fix That

Weinberg helps his clients understand historical rates of return on different asset classes -- stocks, bonds, cash, and the like. "But, going forward, we want investors to know that fixed income historical returns for the past decade-plus have had income and capital appreciation," he says. "So only count on the nominal or coupon rate of return in the future, since it looks like rates have begun to creep up."

Ultimately, says Weinberg, it's a matter of doing the math and keeping that math in mind. If retirees are willing to do that, "then they should be able to work well with their finances in retirement," he says.

Don't Wait Until the Last Minute

The biggest mistake retiree clients of Alexander Koury of ValuesQuest make is waiting until the last minute to make their retirement plans.

Among other things, he says, waiting and procrastinating can cost retirees valuable time when they are in their physically healthiest years.

"We tend to identify retirement in terms of a point in time, but not a lot of time and thought is placed on deciding how time and money will be spent when they are not working," says Koury. "Think about it. If you have been working for the past 30 years, how easy is it to transition to not working and filling your time differently? It's a difficult question to answer, unless you have a plan you can create and stick to."

Others share this point of view. "They don't carve out time leading up to retirement to explore their interests," says Tracy Sherwood, a senior financial adviser with Ogorek Wealth Management. "They don't give enough consideration to how they will spend their time in retirement."

Sherwood says there needs to be a balance between vocation and vacation. "It is important to stay engaged, to stay relevant, to help ensure a happy retirement," she says.

The mistake of retiring too soon and without a plan for how to spend the time and money is something that Michael Resnick, a senior wealth management adviser with GCG Financial sees with his retiree clients as well.

His advice to correct or prevent this mistake? "Time spent with a financial planner establishing a relationship that will last through retirement is crucial," he says.

And Koury's suggestion to correct the mistake of not planning: Figure out how you are going to spend your days. Pick actual dates for when you will travel, and be specific about your plan in terms of money. When you know exactly how much that vacation will cost, you will be more likely to take the vacation.

Don't Rely on Rules of Thumb

According to Bishop, the biggest mistake many retirees make is that they really don't have a plan and rely on "rules of thumb" such as meeting a retirement goal number like $1 million, or just thinking about the 4% rule for withdrawals without considering portfolio risk or tax drag.

And what retirees (and pre-retirees) need, he says, is a well-defined retirement plan that considers:

A thoughtful retirement budget (versus a percent of their current income) that considers longevity risk and long-term care/healthcare risk.

An investment plan that is tied to their ability to stick with the plan and that is aligned with their withdrawal rate needed (and hurdle rate).

A portfolio distribution and income plan that has a good tax planning component.

Not Investing Appropriately

From her perch, Rita Cheng, the CEO of Blue Ocean Global Wealth, says retirees don't always invest their money appropriately; they invest either too aggressively or too conservatively.

In another adviser's practice, retiree clients make the mistake of becoming too conservative, too quickly. "Many of our clients have come to us having already made this mistake or are in the process of debating it," says Matthew Gaffey, a senior wealth manager with Corbett Road Wealth Management. "Some believe that when they have reached retirement, it's only natural to become more conservative."

For his part, Resnick says retiring with an investment portfolio that doesn't grow enough to allow for inflation, especially inflation of health costs, and not investing with a long enough time frame for a full retirement is a common mistake. "Invest with an eye toward long-term growth because you never know how long you will live," he says.

In his practice, Gaffey asks clients to envision retirement as more of a "pumping of the brakes" rather than a "slamming" of them. "We help combat this issue by incorporating a tactical component into their overall strategy," he says. "We feel this approach gives clients equity exposure, while still providing them with the emotional fortitude they are looking for after they have made that transition into retirement."

According to Gaffey, many advisers structure a client's solution strictly around a traditional ride-out-the-market-asset-allocation type of approach. "Tactical strategies, on the other hand, have the ability or flexibility to be at, or near, 100% stock when the market is healthy and at, or near, 100% cash/fixed income when the market is facing significant recessionary pressure," he says. "By combining traditional asset allocation models with tactical strategies, this allows the client to pursue the equity exposure that they need, while still providing them with some of the peace of mind, or emotional fortitude, that they want."

Cheng, by contrast, corrects the mistake of retirees investing either aggressively or too conservatively by using a bucket strategy.

"The appropriate asset allocation depends on the investment timeframe," she says. "Retirees don't realize that retirement is a long-term goal, so the minute they retire, they don't need to go to bonds and cash. The flip side is that an accumulation portfolio may not be the right portfolio to carry you into retirement for retirement income needs."

The first bucket contains cash, stable value and short-term corporates and is used to meet near-term living expenses of one to three years. "The first bucket addressed liquidity risk and market risk," she says. "Clients can get to money readily."

The second bucket contains more moderate conservative investments and is used for expenses three to five years away.

And the third bucket would contain growth-oriented investments to address inflation risk and be used for expenses 10-plus years away.

"Bucket strategies help the client maintain an asset allocation to support short-term needs for income, intermediate needs for income and growth and long-term needs for growth," she says.

Don't Overlook Risk Management

Many retirees fail to learn how to manage all the risks they might face in retirement, including healthcare shocks and long-term care expenses.

Resnick says retiring without long-term care protection often forces spouses to spend down assets for care. "A simple insurance policy would have allowed the spouse to stay in her house with no concerns," he says.

Likewise, retirees often let life insurance lapse because they weren't paying attention to premium adjustments. "Stay in touch with your insurance adviser or ask your financial planner to review all insurance policies to see if tweaks are necessary," suggests Resnick.

Got questions about money, retirement and/or investments? Email Robert.Powell@TheStreet.com