Three Mistakes With Retirement Planning Assumptions

When you last did your projections for retirement through the tools offered from your 401(k) plan or the book your financial advisor put together, are you sure the assumptions that were made were explained to you clearly? Or, did you challenge each assumption made within the financial plan to be certain that the assumptions matched your level of risk tolerance. The assumptions made within your financial plan can be very conservative or very aggressive depending on your viewpoint about planning for your retirement. Making assumptions is something we do every day in our lives. Essentially, as assumption is nothing more than something taken for granted or accepted as true without proof. In other words, it is belief without proof. When it comes to your retirement, you need to ask about these three assumptions or your retirement plan may really be nothing more than a pipe dream.

1. Inflation Assumption- Most financial plans give you or a financial advisor a chance to assume a certain inflation rate. If the software only uses whole numbers, than you have a problem with your financial plan already. The difference between using 3% and 4% is astronomical when it comes to calculating your overall retirement numbers. To give you perspective, from January 2002 to January 2012, inflation grew at a total ten year rate of 27.99% (average 2.8%). From January 1992 to January 2012, inflation grew at a total twenty year rate of 64.13 (average 3.21%). The reason I shared the data this way is that most of the financial plans typically show a client a 3% whole number inflation rate. While it is true that inflation rate has been low historically, you should consider that using a lower inflation rate within your plan will show an analysis that you need less money in retirement. The difference between using 3.0% and 3.5% within a financial plan can literally mean more than an extra $500,000 that you will need to save to reach your retirement goal. By using more aggressive assumptions, you will leave yourself much less margin for error if in fact inflation spikes again here in the next decade.

2. Rate Of Return On Your Money Assumption - Most of you who have put money in your 401k's over the last decade have likely noticed that your increases have strictly come from your extra contributions from you and your employer. Every financial plan will ask you to make a data entry on the expected rate of return with your assets. You can choose to tell the computer that you will earn 4%, 6%, 8%, etc. on your retirement assets. Remember that with the simple rule of 72, you can generally tell how it will take for your original principal to double. If you choose 10% as a rate of return assumption, it will only take 7.2 years for your original money to double. If you use 4% it will take a whopping 18 years for your money to double in value. I see far too many financial plans done by firms showing clients be able to earn 8% or 10% in the retirement section of their financial plans. This is a huge mistake. By using something more conservative in the 5% or 6% range, you will give yourself a more realistic view about how much you really need to save for retirement.

3. Tax Assumption- Making assumptions about overall income taxes can require a great deal of discussion with your financial advisor, but you should make sure you ask the details on how tax assumptions were made. First, federal tax rates can be used with marginal or effective rates which means the tax rate on the last dollar of earned income you bring in or your overall tax rate. You should take a look effective tax rate based upon the income you are projecting to earn throughout retirement. Remember, the higher the federal tax rate you use, the more dollars you will need to save for retirement. In addition, you will need to consider whether you will pay state and or local taxes in

retirement. This can be dependent on whether your state (or retirement state) has state taxes and how the local municipalities tax as well. Don’t forget if the state you retire in has personal property taxes or other taxes that need to be considered in the overall analysis. Many financial plans have default tax assumptions which financial advisors don’t even bother paying attention to when they run the numbers.

There are many other assumptions that can go wrong including health care assumptions and overall expense assumptions where mistakes can be made, but these are the big three that I would ask deeper questions about whether you do your own financial plan or hire a professional to do one for you. Knowing how to make conservative assumptions can give you much more margin for error as you develop your retirement plan over your lifetime. Avoid assumption mistake so the day you get on the doorstep of retirement and ring the doorbell you don’t find out nobody is home!

Avoid these mistakes and put yourself on track for financial independence, purpose, and freedom. Call 847-205-9300 or go to www.fisherfinancialgroupllc.com for a free consultation with Fisher Financial today.