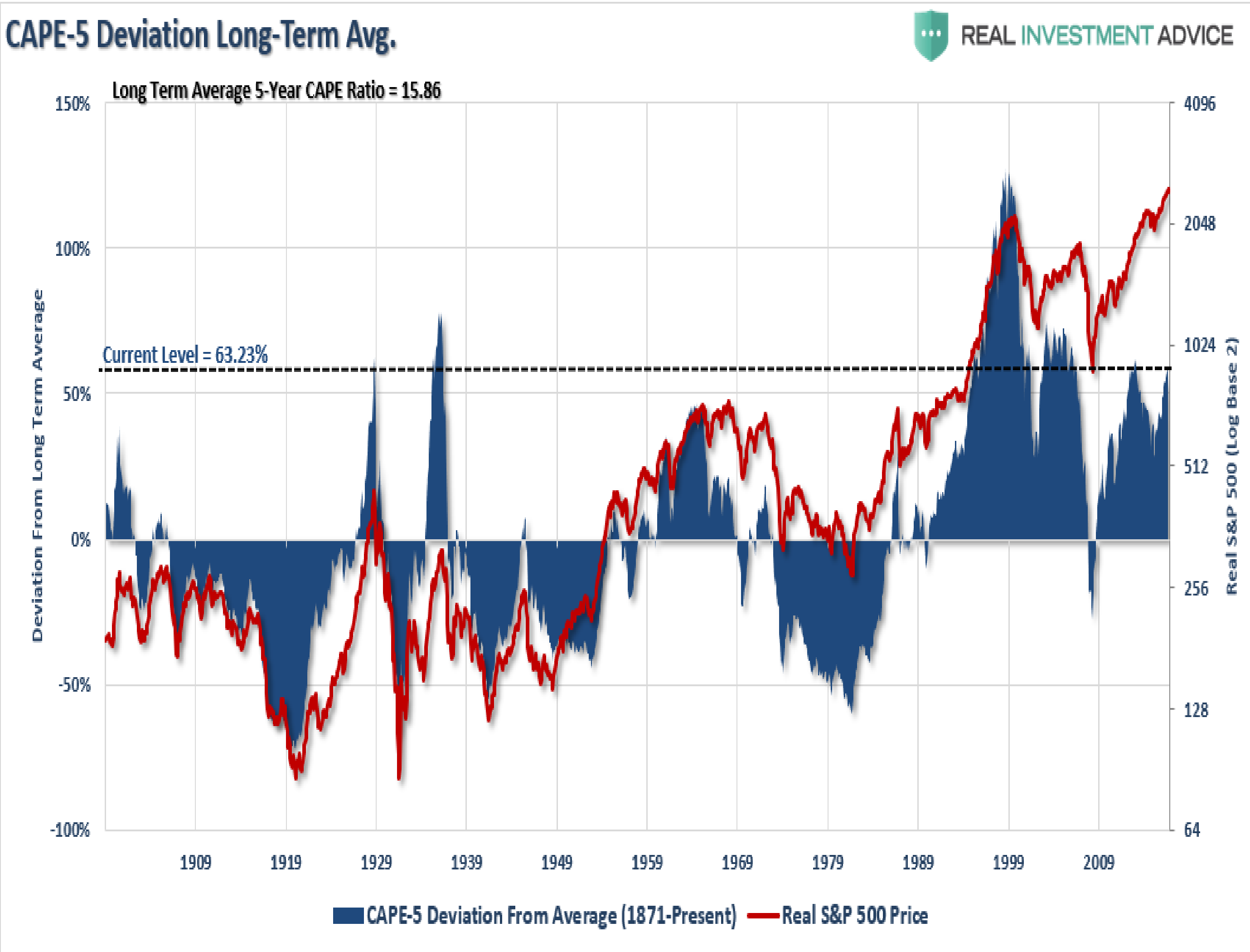

Are you a pre-retiree ready for the right-lane switch? There are a group of pre-retirees who become masters of the ?right lane.? They?re at a life?s bend point (as I call it), where the exit from current career paths are easily visualized. Simply, their retirement body clocks are beginning to ring and they?re listening and preparing accordingly. At Clarity, we believe if you?re 3-5 years from rebirth, reinvention, reignition, then congratulations! You?re a pre-retiree. At our Clarity *Right Lane to Retirement Workshops*, in face-to-face meetings, and questions that come in through Real Investment Advice, we address financial pitfalls that have potential to veer investors off course. A comprehensive plan at this juncture exposes financial vulnerabilities that may require a pre-retiree to remain in the workforce 2 to 4 years longer than expected. Several pitfalls we observe often are misallocated portfolio allocations, long-term care insurance coverage shortfalls, misconceptions about Social Security and cost-prohibitive healthcare expenses pre and post-Medicare enrollment. Warning to pre-retirees: **Multiple headwinds have arrived; if you haven?t done so, please prepare accordingly.** A strong bull market in stocks, especially since the presidential election has fostered overconfidence and complacency, especially when it comes to expectations for future portfolio returns. It?s time to face reality.

*The winds, they are a shiftin.?*

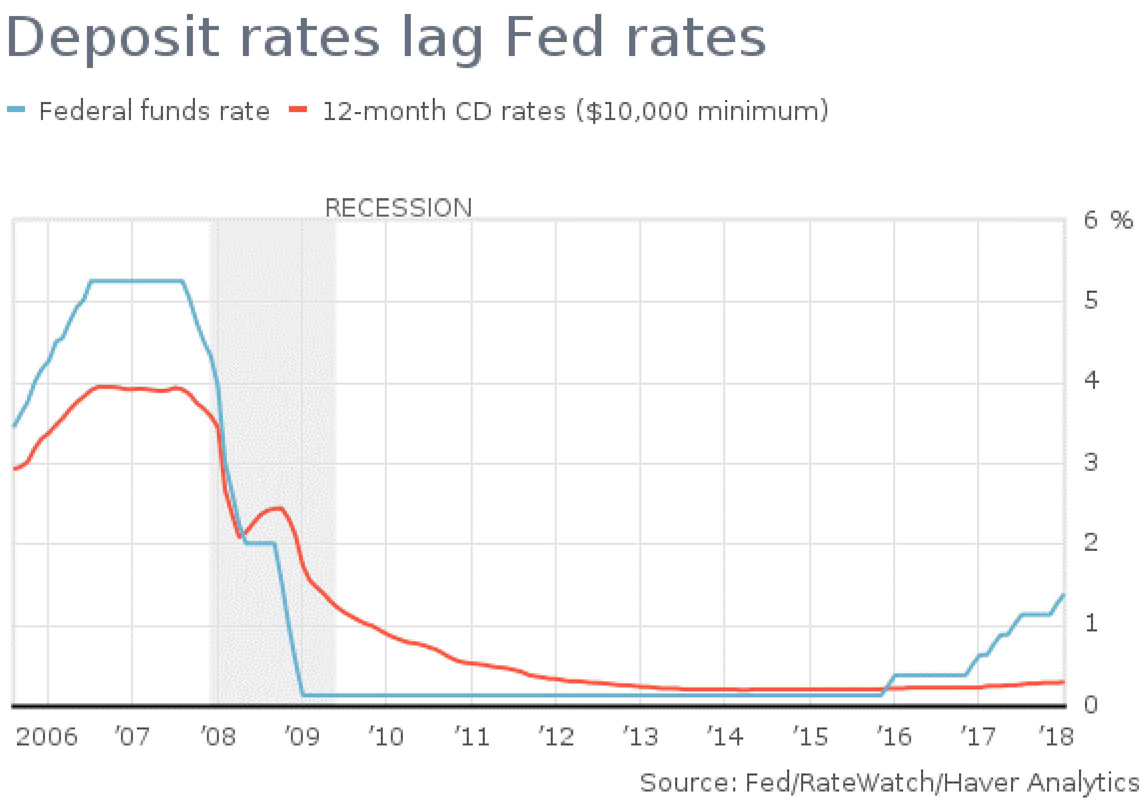
Larry Swedroe a principal and director of research for Buckingham Strategic Wealth, penned a strong piece for Advisor Perspectives titled [?The Four Horsemen of the Retirement Apocalypse,?]• which was expanded upon for a [Real Investment Report], •by RIA team member, and analyst, John Coumarianos. If you can envision a right-lane switch, then it?s time to change-up your thinking, make some adjustments then hit the turn signal. I?ve corralled these horsemen into four broad categories ? Portfolio allocation, healthcare, retirement income, and long-term care. From a planning perspective, pre-retirees should consider:

1. **A portfolio asset allocation re-shuffle:**

*Think conservative*. Don?t fret over missing out on the possibility of future portfolio gains. Focus on potential losses that can postpone retirement plans. If it reduces FOMO (fear of missing out), consider how rich stock valuations are today as measured by the average of 5 and 10-year inflation-adjusted earnings. With the current Shiller P/E at 33x and other market valuation metrics at stretching points, those who are 5 years or less from retirement should take action today to reduce portfolio risk. Our CAPE-5, a more-sensitive adjunct compared to the Shiller P/E, correlates highly with movements in the S&P 500.




There is a positive correlation between the CAPE-5 and the real (inflation-adjusted) price of the S&P 500. Before 1950, the CAPE and the index closely tracked each other. Eventually, the CAPE began to lead price. The current deviation of 63.23% above the long-term five-year CAPE ratio has occurred only three times in the last 118 years. Unfortunately, valuation metrics such as cyclically-adjusted price earnings ratios are extremely poor at pinpointing turning points in markets. However, they are relevant predictors of the probability of future returns. Hey it?s math. Math eventually wins. Rich valuations are always worked off through reversion to averages. •Based on current levels, the most likely outcome is stock returns that average low single figures or negative (yes, negative). Three to five years before retirement as well as through the initial phase of a distribution or retirement income cycle (3-5 years), the primary focus should be on risk reduction and how withdrawals affect portfolio longevity. Unfortunately, where you retire in a market cycle is primarily a spin of the roulette wheel. Basically, luck. If you?re retiring today, welcome to the headwind. Adjust accordingly. However, one truth remains ? when attempting to produce a steady stream of retirement income from variable assets like stocks and to some extent bonds, then distributions must be consistently monitored and possibly adjusted depending on market head or tailwinds. If I had to go out on a limb using current valuations as a guide, I am confident that those close to retirement or just beginning the journey are going to face greater obstacles to future returns. Ignore market experts who appear knowledgeable and push self-serving narratives to validate overinflated stock prices. As we?ve witnessed in the past, faith in financial media darlings doesn?t end well for investors. After all, these pundits are rarely called out. Unfortunately, if you fall for their sound bites, you?re going to pay the price. Your plans will be ruined. Generally, a stock allocation that doesn?t exceed 30% should be considered. If greater, a sell discipline must be employed to minimize losses. There?s nothing wrong with maintaining two to three years of estimated future living expenses (or needs), laddered in short-term bonds or certificates of deposit that are staggered in maturities from six months to three years. I?ve recognized how brokers do a great job at selling product but are overwhelming deficient with helping clients rebalance portfolios. Most likely your allocation to stocks is too aggressive for an investor so close to a retirement date. There should be a sense of urgency to meet with a financial professional, preferably a fiduciary, who can assist with portfolio rebalancing suggestions. *Think virtual.* Brick & mortar banks are late to the game to raise rates on savings. Consider FDIC-insured online banks right now. For example,• www.synchronybank.com as of March 6, has a rate of 1.55% on high-yield savings.




2. **Don?t mess up Medicare enrollment periods or it?ll cost you.**

Unless you have a working spouse with employer-covered health insurance that is eligible to cover you as well, or fortunate enough to have healthcare benefits as part of a corporate retirement package, purchasing healthcare insurance or ?bridge coverage? before Medicare benefits begin is going to be cost prohibitive in most cases. If you?ve decided to postpone Social Security benefits to take advantage of the annual 8% delayed retirement credit that accrues after full retirement age up until age 70, you?ll need to proactively sign up for Part A and B coverages during the initial enrollment period which begins the first day of the third month before your 65th birthday and extends for seven months. Part A or hospital coverage has been paid through payroll taxes. Part B requires ongoing monthly premiums. The standard Part B premium is $134 per recipient and may be higher depending on income. If your modified adjusted gross income is above specific thresholds then you?ll pay the standard premium plus an ?Income Related Monthly Adjustment Amount.? Part B (inpatient/medical coverage) enrollment can be tricky. For example, if covered by a qualified employer plan that covers 20 or more employees during the initial enrollment period, then you may postpone signing up until you leave employment or group coverage is terminated, whichever occurs first. Now, this special enrollment period goes out eight months from the first day of the month employment ends. However, it?s best not to wait. Sign up for Medicare before group coverage ends to prevent a lapse of healthcare coverage. The problem I witness often is when Medicare Part B special enrollment intersects with COBRA which is a temporary continuation of former employer group health insurance coverage. Those who utilize it are under the misperception that COBRA is employer coverage thus it qualifies for the Medicare special enrollment period. COBRA may be continued as secondary coverage for expenses Medicare doesn?t cover; however missing special enrollment may result in a permanent late enrollment period penalty of 10% for each year (12-month period), missed. There exist multiple enrollment windows and open enrollment periods for Medicare coverages - Prescription Drug Coverage (D), Medicare Advantage, Medigap or supplemental coverage. It can easily get confusing which makes it important to work with a financial adviser who is well versed in Medicare planning. Make sure your financial plan accounts for healthcare expenses which thank goodness can be quantifiable due to Medicare which is comprehensive in nature.

3. **Retirement Income: Be smart about Social Security maximization strategies.**

We teach attendees at our workshops ? ?*Your Social Security claiming decision is a family decision*,? as the decisions made by retirement beneficiaries can also affect spousal and survivor benefits. Do not underestimate the lifetime income that Social Security can provide. Future recipients should begin the integration of Social Security into their retirement planning as part of a right lane to exit mindset. According to a *The Nationwide Retirement Institute• Consumer Social Security PR Study*•conducted by Harris Poll, **it?s not surprising to discover than • of a retiree?s fixed expenses are covered by Social Security benefits.** Per the study, surprisingly few retirees have a financial advisor who provides advice on Social Security strategies. The total incidence of having a financial advisor who provided Social Security advice was a dismal 11%. A 2015 study by the Consumer Financial Protection Bureau indicates **that more than 2 million consumers choose when to begin collecting Social Security retirement benefits.**•Many make the decision based on limited or incorrect information. Of those given Social Security advice by their advisors, roughly half or more had to initiate the discussion themselves. Now with pensions all but gone, Social Security is the only guaranteed monthly income for roughly 69% of older Americans. Unfortunately, in 2013,• **75% of retirees chose to start collecting before full retirement age which results in a permanent reduction in lifetime benefits. *This may be a very shortsighted decision*.**

**Read: The One Social Security Myth.**

As Wade Pfau, Ph.D., CFA and professor at the American College outlines in the 2nd edition of his Retirement Researcher?s Guide to Reverse Mortgages: *?Delaying Social Security is a form of insurance that helps to support the increasing costs associated with living a long life. It provides inflation-adjusted lifetime benefits for a retiree and surviving spouse, and those lifetime benefits will* *be 76 percent larger in inflation-adjusted terms for those who claim at seventy instead of sixty-two.?* According to Social Security expert Elaine Floyd, ignorance is the primary reason. The CFPB report outlines studies that represent how much people don?t know about claiming.**One study for example outlined that only 12% of pre-retirees knew how benefits differed if benefits were claimed before, at, or after full retirement age.** If you?re having a difficult time finding the help required, it?s worth the investment in a comprehensive Social Security analysis tool. The one I suggest was created by Laurence Kotlikoff, Professor of Economics at Boston University and available at www.maximizemysocialsecurity.com. The tool will guide you to the highest benefit you or you and a spouse may receive from Social Security. •It will assess thousands of strategies before it suggests the one that maximizes lifetime benefits. The output is easy to interpret. There?s the ability to run ?*what if?*•scenarios, too. The $40 annual license for a household is good for a year and worth the cost.

4. **Long-term care. The financially-devastating elephant in the room**.

Three out of every five financial plans we generate reflect deficiencies to fully meet long-term care expenses. [The Genworth Cost of Care Survey](#) has been tracking long-term care costs across 440 regions across the United States since 2004. Below as of June 2017, are the median monthly costs of the four levels of care from home health to nursing home:

## Monthly Costs: Houston Area, TX (2017)

| Home Health Care | Adult Day Health Care[1] | Assisted Living Facility[2] | Nursing Home Care |
|---|---|---|---|
| Homemaker Services[1] | Adult Day Health Care[1] | Assisted Living Facility[2] | Semi-Private Room[1] |
| 2017 Cost $3,813 | 2017 Cost $1,300 | 2017 Cost $3,500 | 2017 Cost $4,912 |
| Home Health Aide[1] | | | Private Room[1] |
| 2017 Cost $4,004 | | | 2017 Cost $7,224 |

Genworth 2017 Cost of Care Survey, conducted by CareScout®, June 2017 View the survey methodology

[1] Based on annual rate divided by 12 months

[2] As reported, private, one bedroom

Genworth?s results assume an annual 3% inflation rate. In today?s dollars a home-health aide who assists with cleaning, cooking, and other responsibilities for those who seek to age in place or require temporary assistance with activities of daily living, can cost over $45,000 a year in the Houston area. On average, these services may be required for 3 years - a hefty sum of $137,000. We use a 4.25-4.5% inflation rate for financial planning purposes to reflect recent median annual costs for assisted living and nursing home care. Long-term care insurance is becoming cost prohibitive. Not only is insurance underwriting to qualify draconian to say the least, insurers are increasing annual premiums at alarming rates. In some cases, by more than 90% ostensibly forcing seniors to drop coverage or find part-time work to pay premiums. In addition, the number of insurers available is dwindling. Today there are less than 12 major insurers when at one time there were 106. As I examine policies issued recently vs. those 10 years or later, it?s glaringly obvious that coverage isn?t as comprehensive and costs more prohibitive. The long-term care crisis is rarely addressed by the media; there isn?t a governmental solution to the growing needs of an aging population. Unfortunately, the majority of those who require assistance will place the burden on ill-prepared family member caretakers or need to undertake drastic measures to liquidate assets. According to Genworth, roughly 70% of people over 65 will require long-term care at some point in their lives.

## So, what to do?

One option is to consider a reverse mortgage. The horror stories about these products are way overblown. The most astute of planners and academics study and understand how for those who seek to age in place, incorporating the equity from a primary residence in a retirement income strategy or as a method to meet long-term care costs can no longer be ignored. Those who talk down these products are speaking out of lack of knowledge and falling easily for overblown, pervasive false narratives. Reverse mortgages have several layers of costs (nothing like they were in the past), and it pays for consumers to shop around for the best deals. Understand to qualify for a reverse mortgage, the homeowner must be 62, the home must be a primary residence and the debt limited to mortgage debt. There are several ways to receive payouts. One of the smartest strategies is to establish a reverse mortgage line of credit at age 62, leave it untapped and allowed to grow along with the value of the home. The line may be tapped for long-term care expenses if needed or to mitigate sequence of poor return risk in portfolios. Simply, in years where portfolios are down, the reverse mortgage line can be used for income thus buying time for the portfolio to recover. Once assets do recover, rebalancing proceeds or gains may be used to pay back the reverse mortgage loan consequently restoring the line of credit. Our planning software allows our team to consider a reverse mortgage in the analysis. Those plans have a high probability of success. We explain that income is as necessary as water when it comes to retirement. For many retirees, converting the glacier of a home into the water of income using a reverse mortgage is going to be required for retirement survival and especially long-term care expenses. American College Professor Wade Pfau along with Bob French, CFA are thought leaders on reverse mortgage education and have created the best reverse mortgage calculator I?ve studied. To access the calculator and invaluable analysis of reverse mortgages click here. Also, read my RIA commentary on reverse mortgages here. Insurance companies are currently creating products that have similar benefits of current long-term care policies along with features that allow beneficiaries to receive a policy?s full death benefit equal to or greater than the premiums paid. The long-term care coverage which is linked to a fixed-premium universal life policy, allows for payments to informal caregivers such as family or friends, does not require you to submit monthly bills and receipts, have less stringent underwriting criteria and allow an option to recover premiums paid if services are not rendered (after a specified period). Unfortunately, to purchase these policies you?ll need to come up with a policy premium of $50,000 either in a lump sum or paid over five to ten years. However, for example, paying monthly for 10 years can be more cost effective than traditional long-term care policies, payments remain fixed throughout the period (a big plus), and there?s an opportunity to have premiums returned to you if long-term care isn?t necessary (usually five years from the time your $50,000 premium is paid in full). Benefit periods can range from 3-7 years and provide two to five times worth of premium paid for qualified long-term care expenses. As a benchmark, keep in mind the average nursing home stay is three years. It?s crucial to complete a comprehensive financial plan before investigating available long-term care products. A plan will help quantify how much coverage is necessary. In other words, your long-term care plan can be subsidized by a reverse mortgage or liquidation of assets. From there, a financial and insurance professional educated in long-term care can assist with the proper amount of coverage required. The four horsemen of the retirement apocalypse are real. They must be taken seriously. For pre-retirees, there?s time to heed their warnings and adjust. For current retirees, it?s a wake-up call to re-assess portfolio withdrawal rates, spending habits, think outside the box with reverse mortgages and rebalance their allocations.