RIA Advice

How Millennials Can Retire At 56 - Part 1

A TD Ameritrade poll of 1,500 Millennials *(those born 1981-1996 according to Pew Research Center)*, outlines how Millennials? expectations about retirement age may be too ambitious. **They expect to retire at 56 which is seven years younger than the current average retirement age.** Admittedly, it?s a lofty aspiration. Millennials are not going to hit their retirement goals at 70, let alone 56. Wholesale financial media advice such as invest aggressively in stocks and buy a house is offered up as solutions that ostensibly bankrolls Wall Street and the banking industry. This generation must embrace heterodox financial lessons to make retirement a reality. They must march to different drummers, be selective with the financial advice followed and take to heart the mistakes of Baby Boomers. After all, secure retirement today is a privilege. At a time when Americans should be seeking to wind down and enjoy the golden years, 15 million households are in worse financial shape than the prior generation to do so. **Why?** Many Americans are victims to irresponsible financial industry guidance, aggressive actions of greedy corporate boards and organizations that have dismantled pensions and haven?t raised median incomes for the middle class going on close to two decades. They?re victims of the lingering effects of the financial crisis including devastating job loss that forced them to tap retirement savings early, adherence to traditional financial industry dogma to load up on stocks for the long run, and the devastating loss

of guaranteed income options like pensions. The fortunate ones who can afford retirement have exhibited steeled fiscal resolve, ignored traditional Wall Street dogma, embraced vehicles to guarantee income for life and lived smaller than their fiscally-strained brethren. Millennials ? Listen up! I genuinely believe you can retire at 56 however, you?ll need to embrace the following **Real Investment Advice** steps to get there. I?ll warn you up front. An early retirement goal isn?t going to be easy. Open your mind. Think mental clean slate and maybe there will be hope for you. **Take to heart the previous generation?s mistakes**. Unfortunately, Baby Boomers are suffering from serious shortfalls, several out of their control, that you should do your best to understand and avoid. Boomers kept the faith in their employers to provide guaranteed retirement benefits, the banking, financial system not to implode and the buy and hold advice from the financial services industry which for many, proved to be detrimental to building wealth. We are all now witnessing the damage that has been done. The aftermath. Toss in soaring prices for children?s education and healthcare, divorce rates rising for those 50 and older and cloying debt levels near to retirement, and 40% of Boomer households are now forced to remain in the workforce and or dramatically adjust their retirement lifestyle expectations. Become an objective observer. Take notes. Don?t be afraid to respectfully ask Boomer family members and friends how they?re preparing (or not) for retirement. **The *?pay and continually improve yourself?* mantra must drive every action you take starting now.** To become a *pay-and-improve yourself* powerhouse is tantamount to turning an early retirement flame of desire into a raging fire. Above all else and all that drives your behavior with money, this credo is the genesis you seek. Frankly, if you stop reading here, decide to pay yourself first and continually improve your skills to earn more or increase your human capital, then my work is done! So, what is human capital investment exactly? The human capital investment is simply, YOU. Yes.?**YOU are an investment**. The greatest investment. A lifetime money-making powerhouse. Earnings if directed wisely, result in long-term financial security and perhaps more important, a career passion that continues up to and far into retirement. As adults, we have been counseled to invest financially through real estate, stocks, retirement, etc. but not always in ourselves?at least not to the same extent.? At Real Investment Advice, we believe that human capital investment is one of the biggest ROIs and should be treated with the same importance as traditional financial investment.? We call it ?*Return on You.?* The Census Bureau data shows the average American with a bachelor?s degree earned $2.4 million over their lifetime in 2013.? It is hard to argue with these figures when AARP published the average seasoned American (e.g. at least 55-years-old) had $255,000 in their retirement account during the same year. Formal education is important to earnings potential, but it?s merely the beginning of a lifelong learning process. The economy and career paths appear to be in constant flux; it?s easier than ever to lose the competitive edge. Fortunately, unlike financial investments where many variables are out of our control, we do possess the ability to strategize and take ownership of human-capital gains whether personal or professional. Unfortunately, Millennials cannot depend on employers to provide consistent wage increases. They?ll need to take matters into their own hands by raising the bar on their skillsets and using them to switch employers or begin a part-time business to turn up the cash flow. Plenty of dangerous financial rules of thumb exist. We passionately bust the myths and showcase the truth about your money. A tenet that indeed holds up however, is to *pay yourself first* . You may want to sit down for what I?m about to share. Take a deep breath. A Millennial born in 1981 is 37 this year. If I assume $1,000 currently saved for retirement, if I assume a *realistic inflation-adjusted rate of return (3%),* if the assumption is made Ms. Millennial earns a gross income of $50,000 and can pay herself first **30% of pre-tax income annually for 18 years** (*with the huge assumption that a financially disruptive life event doesn?t occur),* Ms. M. would wind up with a nest egg of $363,455. Taxes were not considered as I hope a Roth 401(k) and IRA would be utilized over the often-suggested tax-deferred alternatives. *Wait. What? A Roth? Yes, a Roth.* A 2017 Harvard Business School Study for the Journal of Public Economics suggests that most investors will have more money or retirement consumption dollars if they use a Roth 401(k) instead of a traditional choice. Roth accounts do not require mandatory retirement distributions at 70 ? and qualified distributions including earnings are tax free. Although $363,000 isn?t a fortune, it?s a

respectable effort. However, to retire at the ripe old age of 56, Ms. M is going to require a multi-step plan of attack. Consider an interminable pay yourself first discipline coupled with the ability to increase annual earnings *[thus bolstering your 30% PYF (pay-yourself-first dollars)]* as a solid financial two-step strategy. **Respect stock market cycles and don?t take excess risk because your age dictates you do so.** I believe the stock market should be a part of a Millennial?s wealth-building plan. It?s just not a panacea as relentlessly touted by financial media. Stocks appear to be the solution to every financial problem. If the pros didn?t make stock investing sound so definitively positive and objectively, equally exposed the risks, perhaps we?d see a healthier stock market participation rate from this group. My first year in the financial services industry was 1988, in the midst of a great bull market. However, I expected the industry, those who preached stale theories and ostensibly set investor portfolios up for the kill, to change their tunes about allocations and risk after the tech bubble burst in 2000. I had encouraged investors to shift portfolios to more balanced, less aggressive allocations, as early as 1998. Markets cycle data has been out there for what feels like an eternity, yet now more than ever, it?s rarely discussed. However, the facts are the facts. Markets shift; they?re more than just bull as the public is led to erroneously understand. Although bull markets occur historically with greater frequency, people are surprised to discover that since 1877,?bear markets have accounted for 40 percent of market cycles. Yet, the narrative doesn?t budge. In the media and in client meetings at brokerage firms, the stock market fantasy bull is the financial Energizer Bunny. The bullish flipcharts keep flipping; visuals are designed to foster regret if one ?misses out,? on the endless bliss of stock returns. Those that outline risk of loss are nowhere to be found. I believe it to be blatantly irresponsible. Retail big-box investment factories are steadfast ?set it and forget it,? peddlers. I?m amazed at their tenacity. The spiel is rarely altered. Minds never changed.

> *Respected academics do change their minds. Objective students of market history do.*

What has changed is how millennials and generations which follow,?*are on to the biased rhetoric*. Sadly, chronic skepticism and trepidation is hurting younger generations as they should participate in stock investing. They just don?t know who to trust. Unlike the pervasive, cancerous dogma communicated by money managers like Ken Fisher who boldly states that in the long-run, stocks are safer than cash, stocks are not less risky the longer you hold them. Unfortunately, academic research that contradicts the Wall Street machine rarely filters down to retail investors. One such analysis is entitled?*?On The Risk Of Stocks In The Long Run,?*?by prolific author?Zvi Bodie, the Norman and Adele Barron Professor of Management at Boston University. In the study, he busts the conventional wisdom that riskiness of stocks diminishes with the length of one?s time horizon. The basis of Wall Street?s counter-argument is the observation that the longer the time horizon, the smaller the probability of a shortfall. Therefore, stocks are less risky the longer they?re held. In Ken Fisher?s opinion, stocks are less risky than the risk-free rate of interest (or cash) in the long run. Well, then it should be plausible for the cost of insuring against earning less than the risk-free rate of interest to?*decline as the length of the investment horizon increases.* Dr. Bodie contends the probability of a shortfall is a flawed measure of risk because it completely ignores?*how large the potential shortfall might be.?*Sound familiar? It should. We write of this dilemma frequently here on the blog. Using the probability of a shortfall as the measure of risk, no distinction is made between a loss of 20% or a loss of 99%.

> ***If it were true that stocks are less risky in the long run, it should portend to a lower cost to insure against that risk the longer the holding period. The opposite is true. Dr. Bodie uses modern option pricing methodology i.e., put options to validate the truth.***

Using a simplified form of the Black-Scholes formula, he outlines how the cost of insurance rises with time. For a one-year horizon, the cost is 8% of the investment. For a 10-year horizon it is 25%, for a 50-year time frame, the cost is 52%. As the length of horizon increases without limit, the cost

of insuring against loss approaches 100% of the investment. The longer you hold stocks the greater a chance of encountering tail risk. That?s the bottom line (or your bottom is eventually on the line). **Short-term, emotions can destroy portfolios; long term, it?s the ever-present possibility of tail risks or?*?Black Swans.?*** I know. Tail risks like market bubbles and financial crises don?t come along often. However, only one is required to blow financial plans out of the water.

> *So, what does age have to do with how much of a portfolio is allocated to riskier investments like stocks?*

I?m not willing to believe those who are younger should be more exposed or increasingly vulnerable to market risk than anybody else, when the reward from stocks is less for every investor going forward. You see, **risk has no age. Risk is risk.** An investment allocation should be customized for your life, needs, and ability to withstand volatility. Most important, it should be based on the valuation conditions that exist at the time you?re looking to place dollars into the market. I witness cookie-cutter dogma blindly followed and money invested immediately regardless of where stocks are valued. Ultimately, the forward returns are anemic, or wealth is destroyed altogether. Financial consultants and brokers have needles deep stuck in thought grooves. It?s not just this rule per se. It?s the belief that younger people must,?**MUST**?be more aggressive because they have time to weather through disaster. Risk couldn?t care less about how old you are. When the environment is favorable to take on greater risk for higher returns, then why be so focused on age? How would you perceive my advice if I explained that Millennials shouldn?t fasten their seatbelts before driving however, grandparents should? I mean, after all, if there?s an accident and injuries suffered, common sense tells me that nana and papa may require a longer convalescence period, correct? Not to be flippant, but I can make a formidable case that based on savings accumulated and driver (investment) experience, older and perhaps wiser navigators may forgo seatbelts, but the novices cannot. Think about it. Don?t be shamed by financial media and professionals into investing aggressively into stocks at 32X which is the price-earnings ratio based on average inflation-adjusted earnings over the previous 10 years (known as the Shiller PE). Partner with a fiduciary or financial professional who studies and understands market cycles. Create an asset allocation that fits the environment or market cycle and doesn?t follow a meaningless rule of thumb created by Wall Street that your age should affect how much risk you take.

Real S&P 500 Total Return vs. 20-Year Total Returns

REAL INVESTMENT ADVICE

Growth Of $1000 Total Return
Rolling 20-Year Real Total Return

Real S&P 500 Total Return $1000
2,097,152
1,048,576
524,288
262,144
131,072
65,536
32,768
16,384
8,192
4,096
2,048
1,024

20-Year Total Return
50.00%
25.00%
0.00%

Still In Process
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Regardless of age, the current risk vs. reward equation is not in your favor as a stock investor. Examining the S&P 500 (including dividends) since as early as 1919, there have been periods where forward 20-year returns have been close to zero. If you?re 37 and seeking to retire by 56, the reality is you may encounter a headwind to domestic stock returns. Set your expectations accordingly for below-average investment returns and focus efforts on bringing more cash into your household. **Get a side gig or start a part-time business.** According to a recent survey by Bankrate.com, 4 out of 10 Americans work a side job (think driving for Uber). Greater than 50% of Millennials have side hustles to make extra income. On average, these side gigs bring in an extra $686 bucks a month. Unfortunately, a majority take on a business or provide a service in addition to a full-time job, just to survive. Those who seek to retire at 56 should strive to use these dollars to pay off student loans and other debts including credit cards. **Take responsibility to guarantee your own basic income.** As a student of Social Security, I?m concerned full retirement age will be pushed to 68 years-old or later for Millennials and younger generations. Social Security is a good thing and essential for retirement survival, regardless of the negative information you hear or read. Social Security was created in 1935 to provide a basic income to supplement employer-provided pensions. *Today, it is the pension replacement;* Social Security provides guaranteed lifetime income for you or you and a spouse. Millennials who want to retire at 56 are going to need their portfolios to shoulder the income burden for at least 11 years before Social Security kicks in. In addition, those who want to retire at 56 are going to inhibit the ability to maximize Social Security as benefits are based on a worker?s 35 highest earnings years. Those who exit the workforce in their mid-fifties are going to forfeit several peak earnings years that can make a big difference to lifetime Social Security income. The maximum amount of wages in 2018 subject to the 6.2% Social Security payroll tax is $128,400. When Social Security is considered, it?s crucial that Millennials focus on becoming earnings machines while in the workforce and meet Social Security wage limits. Ten years into saving and investment, Millennials should look to direct financial resources into a deferred income annuity. Income annuities are solely designed to provide a stream of income now or later that recipients cannot outlive. These annuities are simple to understand and are generally lower cost when compared to their variable and indexed brethren. Deferred income products where owners and/or annuitants can wait at least 5 years before withdrawals, may participate in market index gains (subject to caps) and have an opportunity to receive higher non-guaranteed annual income withdrawals depending on market performance. Withdrawals can never be less than the guaranteed withdrawal benefit established by the insurance company but may be higher depending on annual market returns. As with most annuities, there is never market downside risk. In other words, Millennials are going to be responsible for creating their own pensions. Income annuities are a vehicle to accomplish the task. The objective is to ensure that fixed expenses like rents, mortgages, insurance, are covered by a lifetime income option especially until full retirement age is reached, and Social Security can be incorporated to boost guaranteed lifetime income. Retiring at 56 can be doable for Millennials. However, most of mainstream financial information is not going to assist in the effort. Next week, I?ll outline additional action steps that should be taken including rules to manage debt and several lifestyle or qualitative initiatives to consider.