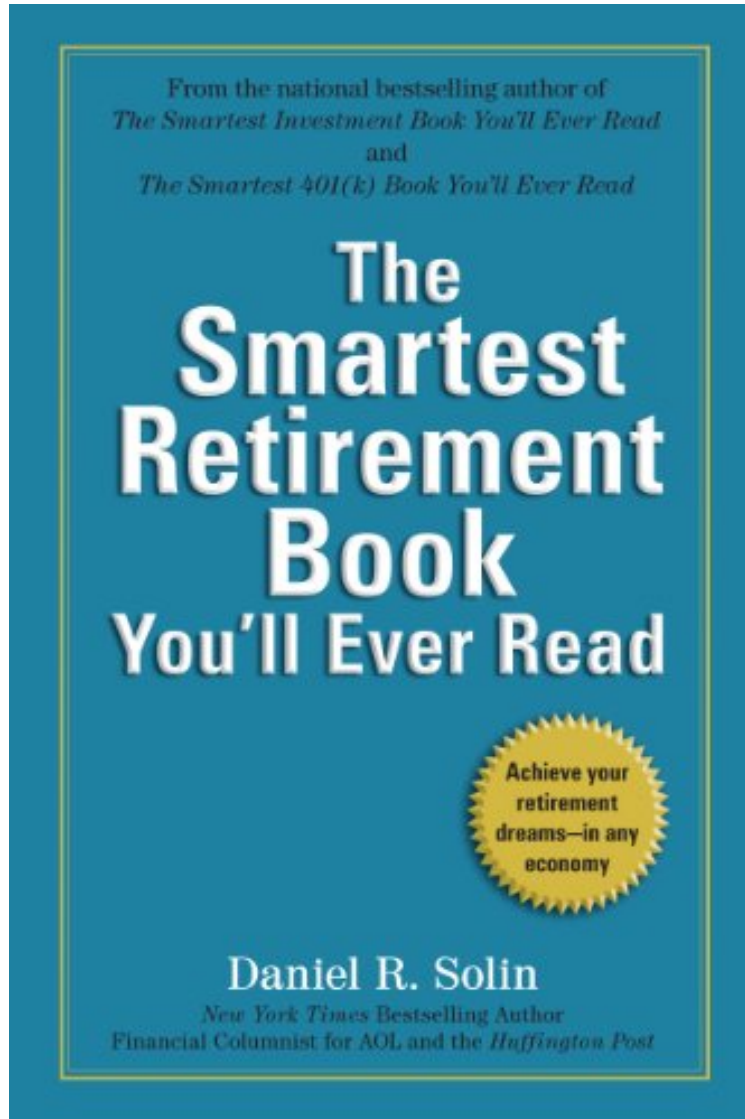


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# The Smartest Retirement Book You'll Ever Read

*Daniel R. Solin*

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Follow the advice in *The Smartest Retirement Book You'll Ever Read* and you will: Find simple strategies to maximize your retirement nest egg. Steer clear of scams that rob you of your hard-earned savings. Ensure that your money lasts longer than you do. Avoid the common mistakes that can leave your spouse impoverished. Discover financial lifelines no matter how desperate the economy. "If you want a handy guide that provides information in small chunks, Solin's book is it." -Newark Star-Ledger

"Reading this book is smart. Solin's previous entries in this series were clever, breezy guides to navigating through the financial morass without getting hurt... This new book gets into the basics of investment in context with the present economic scene, so reading the earlier volumes doesn't mean that you won't get anything out of this one. ...Solin casts his wise eye and sharp pen on other important subjects like reverse mortgages, age of social security distribution, prenuptial agreements for seniors, options and implications of delaying retirement... The best thing that Solin brings to the party is his shrewd and skeptical approach to the art and science of investing. ...there's no question that his focus is on what's best for individuals, not institutions. Throughout, Solin writes clearly with style and humor but stays on topic and doesn't bloviate or pontificate excessively. He includes a number of charts and other tools to figure out what to do with your money so it grows into the amount you will need to live on for the rest of your days." --Richard Pachter, Miami Herald "These two books are very different in format-Solin (*The Smartest Investment Book You'll Ever Read*) offers short chapters on a variety of retirement subjects, each concluding with a pithy summarization, while Jason (principal, Jackson, Grant Investment Advisers, Inc.) gives a more explanatory dissertation. But both are clearly written and easy to understand, tackling such topics as stocks, bonds, annuities, pensions, and cash withdrawal strategies (although Solin's book offers a handy section on care costs, Jason's does not). Jason's will be better for readers not as familiar with basic finance concepts, while Solin's may appeal to a more financially literate crowd." --Library Journal About the Author Dan Solin, a wealth advisor to high net worth investors and retirement plans for Buckingham Asset Management and The BAM ALLIANCE Director of Investor Advocacy, is the author of *The Smartest Retirement Book You'll Ever Read*, *Does Your Broker Owe You Money?*, and *New York Times* bestseller *The Smartest Investment Book You'll Ever Read* and *The Smartest 401(k) Book You'll Ever Read*. His award-winning books have been widely praised by *The New York Times*, *The Wall Street Journal*, *The Library Journal*, and many financial writers, leading economists, and others. Solin is one of the most popular financial bloggers on The Huffington Post. A frequent guest on national television and radio shows, Solin has addressed professional organizations of accountants, advisors and financial planners and has testified before Congress on investor issues. Excerpt. copy; Reprinted by permission. All rights reserved. Chapter 1 Deflating Inflation Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair. — Sam Ewing, humorist Retirees should be as concerned about investing their retirement nest eggs as they are about withdrawing from them; the 2008 market crash exacerbated these concerns and makes this issue even more critical. Fortunately, Smart Investing before or during retirement is not difficult. While you'll hear lots of ballyhoo about the special investment needs of retirees, the basic investment rules; the Smart Investing rules; are the same for everyone, no matter what their age or stage of their investing lives. In Chapter 5 and Appendix B, I provide recommended portfolios that will take the mystery out of this process. Before jumping in, we'll review in the chapters ahead some basic investing principles you need to understand. Let's start with the most commonly overlooked one: inflation. Inflation: The Natural Predator of Your Nest Egg Retirees understandably worry about the stock market's gyrations. Who wouldn't, especially given the current unprecedented financial meltdown? But they don't spend nearly as much time fretting about inflation. In recent years, inflation doesn't seem to have been much of an issue. For more than a decade, the nation's annual inflation rate has rarely inched above 3 percent. As 2009 began, economists were far more worried about deflation. Yet even a seemingly innocuous inflation rate can flatten the cushion of a retiree's otherwise solid budget. When inflation is running at 3 percent, the value of \$100 will plummet to \$76 in just ten years. If you wait two decades, the value of that \$100 is worth no more than \$56. It's easy to illustrate how destructive inflation can be if you look at hypothetical portfolios of retirees from twenty or thirty years ago. Today's retirees can easily live that long; longer. I used the inflation calculator from the federal Bureau of Labor Statistics to see how much money a retiree would need today to

match the buying power of an American who retired with a \$500,000 nest egg twenty years ago. Thanks to inflation, today's retiree would require \$924,695. (You can play with your own numbers at [www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm).) The current crop of retirees will likely feel the pinch of inflation more acutely because it is likely they will have to spend more on medical costs, which have been rising faster than inflation. Unfortunately, the only inflation indexing that most retirees can count on today is their Social Security checks, which provide an annual cost of living allowance. Countless research has illustrated that conservative portfolios run the risk of running on fumes. One landmark study examined what would happen if an investor withdrew 6 percent a year from an all-bond portfolio. The study concluded that the investor had only a 27 percent chance of having anything left after thirty years. As you contemplate how you're going to structure your portfolio in retirement, you'll want to plan to deal with inflation. The solution— as hard as this might be to swallow today's volatile markets— involves adding stocks to your portfolio. I'll discuss exactly how you should do that in Part Two.

### What's the Point?

If you don't fortify your portfolio against inflation, you're likely to outlive your money. Chapter 7

### The Investing Secret Your Broker Won't Tell You

Index funds have a large following among institutional investors such as pension funds and insurance companies. Ironically, one of the most vocal advocates of index funds for individual investors is Warren Buffett, self-made billionaire and chairman of Berkshire Hathaway Inc. [who] made his fortune through individual stock selection— Richard A. Ferri, CFA, author of *All About Asset Allocation* indexing can make you feel like an investing genius. Here are the major benefits of indexing:

- Market returns (which are superior returns)
- Low cost
- Broad diversification
- Tax efficiency
- Minimal cash holdings

Let's take a look at these more closely.

### Market Returns

Index funds make a simple promise: Everybody who indexes will earn market returns minus low transaction costs. Here's an example: If the SP 500 index (the popular benchmark for blue chip stocks) generated a yearly return of 9 percent, you could count on the Vanguard 500 Index Fund, the Fidelity Spartan 500 Index Fund, or some other large-cap index fund to produce a return that's almost identical. The goal of an index fund manager is to be a clone of a corresponding index. When an index stumbles, so will its index fund. When the index is doing well, so will the index fund. Over time, stocks and bonds of every size and category have grown, which means index funds have too. It is perfectly understandable if you're not impressed by "average" market returns. After all, it's far easier to tout the stellar returns of carefully selected actively managed funds. Unfortunately, these returns are almost always ephemeral. An actively managed fund can enjoy a streak of phenomenal luck— but nearly all actively managed funds eventually stumble. Their long-term (and even shorter-term) performance returns lag behind comparable index funds. Why do proponents of actively managed funds struggle so much against those average returns? These stock jockeys eventually smack into a brick wall called the "efficient market." Think about it this way: Wall Street is transparent— any news about any stock quickly makes the rounds, and the stock is adjusted accordingly. Consequently, it's almost impossible for professionals to outsmart all the other investors trying to beat the markets. The difficulty of surpassing index returns on a sustained basis is even harder than it appears, thanks to something called "survivor bias." Every year, a huge number of actively managed funds go out of business. During one recent five-year period, according to Standard Poor's, more than one in four stock funds vanished. The funds that disappear are typically the ones with terrible performance statistics. Fund companies will often get rid of the embarrassing funds by merging them into more successful ones. With the dead bodies hidden away, the remaining actively managed funds look better than they deserve.

### Low Cost and Lovin' It

Index funds are the cheapest game in town. The Vanguard 500 Index Fund, which is the nation's most popular index fund, charges shareholders just 0.15 percent to manage their assets. That means if you had \$10,000 invested in the fund, your tab for the year would be a paltry \$15. There are even cheaper class shares for larger investors. For a new shareholder who invests at least \$100,000 in the Vanguard 500 Index, the cost would drop to 0.07 percent, or only \$70 a year. The typical mutual fund can easily charge ten times more than a comparable index fund. People don't appreciate that price gap, because the difference doesn't seem wide. A fund that charges 1.7 percent doesn't seem like a porker compared to one that charges 0.07 percent. In reality, the gulf is huge. Let's suppose you invested \$50,000 in a stock index fund that charges 0.20 percent in expenses, and your neighbor invested the same amount in an actively managed stock fund that charges 2 percent. Let's assume you both earned an annual 8 percent return before expenses. A decade later, your index fund would be worth \$105,964. The fund of the poor guy next door would be worth \$89,542. Your neighbor's cost for holding this fund would have been \$16,422.

### Broad Diversification

Index funds hold more securities than actively managed funds. By diversifying the number of holdings, index funds reduce the risk of having a concentrated position in a smaller number of stocks.

### Tax Efficiency

When judging mutual funds, investors look at total returns. But performance statistics can be misleading. When investments aren't sheltered in retirement accounts, after-tax returns are the key feature. Taxes can mangle the returns of actively managed funds. Too many portfolio managers trade stocks with little regard for the tax consequences that are borne by the investor. Index funds are considered paragons of tax efficiency because there is little turnover in their portfolios. John Bogle, the former head of the Vanguard Group, conducted a study that illustrated how devastating the tax bite can be for actively managed funds. Over a sixteen-year period, Bogle concluded that investors kept only 47 percent of the cumulative return of the average actively

managed stock fund. Indexers kept 87%.

Can you afford to leave that much of your money on the table?

**Minimal Cash Holdings** Large cash holdings reduce returns in a rising market. Index funds typically have less cash holdings than actively managed funds because they don't have to keep cash on hand to time the market. Index fund portfolios stay focused on meeting the returns of the index.

**What's the Point?** Investors who index achieve superior returns.

**Chapter 58 Ten Golden Rules** Practicing the Golden Rule is not a sacrifice; it is an investment.

Author unknown The Ten Golden Rules that I've put forth here won't work for everyone, but they should be considered by all investors, regardless of your age, whether you are currently planning for retirement or are already retired. If you have an account with a brokerage firm, close it. I can't think of any reason to do business with a broker. They can't pick out performing stocks or mutual funds. They can't time the markets. They are expensive. They are not fiduciaries. Never buy an individual stock or an individual bond, with the exception of Treasury bills. Your expected return with individual stocks and bonds is the same as an index of comparable stocks or bonds, but your risk is vastly increased. If you need help coming up with a financial plan, use a fee-only financial planner (or a certified public accountant) who charges an hourly or a flat fee and who limits advice to preparing a plan and answering your questions. If you need assistance in making investment decisions, use a registered investment advisor who focuses on your asset allocation and who recommends investing only in a globally diversified portfolio of low-cost index, passively managed stock and bond funds, or in an immediate annuity, where appropriate. Ask the advisor to confirm in writing that she will act as a fiduciary in all her dealings with you. Be sure your funds are held at an independent, well-known custodian, like Charles Schwab, Fidelity Investments, or TD Ameritrade. Make all checks payable only to the custodian and ensure that you receive account statements directly from the custodian. If you are investing on your own, use a well-known fund family, such as Vanguard, Fidelity, T. Rowe Price, or Charles Schwab. Consider one of my recommended portfolios (see Appendix B). Avoid alternative investments like hedge funds, limited partnerships, and private equity deals. Add up your monthly expenses. Deduct the amount of your Social Security and other income you can count on. Consider purchasing an immediate annuity directly from a low-cost provider such as Vanguard or TIAA-CREF for the difference. You can now sleep well knowing that you have enough money to meet your monthly expenses. Keep funds sufficient to meet two years of living expenses in an FDIC-insured savings account, a certificate of deposit, Treasury bills, or a money market fund from a major fund family. Prepare a will. A will is the first important step in estate planning. Sometimes intelligent retirement planning can seem overwhelming. However, these basic rules are really quite easy to implement. You now have the knowledge to do it. Don't let anyone cause you to stray from the path toward a successful retirement.