Why Are Retirement Plans Failing?

After doing my "Fire Your Financial Adviser" workshop and our Producer Power Hour podcast, I wanted to address a topic that I feel is grossly misunderstood. When I was a traditional financial adviser, I would rattle off some assumed 2000 Bureau of Labor Statistics that came out with a longitudinal report that studied where 25 yr olds in 1960 were in 2000. It showed 29% of 65 year olds deceased, 66% totally dependent on others or still working, 4% financially independent, and 1% wealthy. I have never seen any government source confirm these numbers, but I have seen many financial institutions and network marketing companies quote it. In fact, in my presentation, I would have a tagline that said "People don't plan to fail, they only fail to plan." This was what I used to convince others to take action and do business with me. However, even if those numbers were accurate, hadn't more than 5% of Americans implemented some sort of retirement products during their life, like 401(k) and IRA's, some with financial advisers? Weren't many of these "Prime lifers" born in 1935 strict savers because of the influence of the Great Depression?

The Tragic Truth

The reality is much worse. According to the National Centre for Health Statistics, a 25-year old only has a 16% chance of death before age 65, not 29%. Of the surviving, the 2000 Bureau of Labor Statistics says that 24.4% of 65-69 year olds were still working and 66% of them depend on Social Security to provide at least 50% of their income (22% are totally dependent). The median household income for those 65 and older was only $33,802 in 2002. In addition, the 2000 U.S. Census said that this aging population had a net worth of $108,885. However, $85,516 was home equity leaving a measly $23,369 for retirement. If you read my blog on hidden 401(k) fees (August 8th), you would also notice that the average balance in a 401(k) for 65 year olds is only about $60,000. Could you live like that for one year? Two years? Ten years? How about 25 more years?

The Cause

There are many factors contributing to this, but let's address some of the most overlooked. First, most financial planners will quote some "average" return in the markets that someone can likely count on for the long haul. However, the "actual" return often is different. See diagram below.

This is a pretty drastic example, but it proves the point that the number an adviser or planner puts in the calculator will never match up to reality. From 1965 to 2004, the S&P 500's (stock market) performance was an 11.74% "average" rate of return but the "actual" return was 10.4% per year. You may think that 1.34% makes little difference; however, after 40 years, your money is less by about 38%! This doesn't even include fees that they never factor into your rate of return. If your fees totaled about 1.25% per year, you would see that number cut by another 36%! This would mean that you would actually only have about 39% compared to what a financial calculator would tell you based on the average rate of return! Therefore, in this S&P 500 example, if you were expecting $1 million when you retire, even if it performs how it is supposed to, you would only have about $390,000. Would you be disappointed? How would that affect the income you were hoping for? What if you had to pay taxes on that disappointing figure as well? How much would $390,000 really be worth in 40 years given the actual inflation rates, including health care, as well as keeping up with certain technological changes and so forth? To see what other factors do to your money, and to watch how a positive ACTUAL rate of return of 12% could become a negative return in reality, check this out!

The SolutionIt's simple. Get further educated on leveraging the assets you have. One cannot expect to get different results by believing the same things about investing as everyone else. Misunderstood concepts, like some that were previously mentioned, are contributing to the dilemmas and drain on Social Security. To hear more on this subject, check out this blog on FireYourFinancialAdviser.com.