

Couple wonders whether they can retire early

Money Manager/by Karin Price Mueller – www.businessstoday.com

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Problem:

Early retirement is on the menu for John and Helen, who live in the Merrimack Valley. They've been saving steadily for this goal for years, but they're not sure if they've been doing enough to allow them to leave the working world by age 60. The couple, whose names have been changed for publication, came to the Herald to figure out if they'd make it in time.

"I haven't made too many smart decisions for our investments," says John, 38, a community development officer for a local municipality. "I need a plan."

John and his wife Helen, 39, an accountant, aren't looking for a lavish lifestyle in their golden years. They're interested in moving to a warmer climate, and taking the time to enjoy outdoor sports and other activities while they're still young.

To reach that goal, they've built up about \$120,000 in retirement savings. And until a few years ago, they thought they'd have to use some of that money to pay for their 18-year-old daughter Amy's college education.

"We had no college planning," John says. "We got started saving for college late, and by the time we started she was much older."

But Amy was named as a beneficiary in the wills of a great aunt and uncle, and when they died four years ago, Amy received about \$70,000. The family earmarked the funds for college, and Amy started classes in September, so far debt-free. Amy will probably take loans for remaining college expenses.

That windfall left the couple free to focus on their retirement goal.

John has a deferred compensation plan from his employer, to which he contributes about \$8,000 of his \$57,000 annual salary. The funds are divided among Aetna Active Small Cap Portfolio, Fidelity Fund, Fidelity Growth Company Fund and The Aetna Income Fund, totaling about \$13,450. He also has an employer pension plan worth \$45,500.

Helen earns \$41,200 a year, and she also contributes to her 401(k) plan. The plan is invested with the AIM family of funds. The assets, worth about \$12,000, are split among AIM Large Cap Growth, AIM Large Cap Basic Value, AIM Mid Cap Equity, AIM Select Equity and AIM Blue Chip funds.

She also has a few plans from previous employers. One, worth about \$18,000, is invested in various Scudder funds. The other, worth \$3,500, is in a money market fund. Helen also has an annuity inside of an individual retirement account worth \$12,000.

The couple has saved for retirement outside of tax-deferred plans. They have \$5,385 in Putnam Health Sciences, \$3,600 in Putnam Voyager Fund II and \$600 in IPOSX Renaissance IPO Plus Aftermarket Fund. They also have two brokerage accounts, worth \$5,500, invested in stocks, including Cisco Systems, Genzyme Corp. and Interneuron Pharmaceuticals.

Their cash emergency fund is healthy in size. They have \$21,350 spread among several money market and bank savings accounts. John wonders if the money would be better off invested in funds or a higher-paying investment.

John and Helen feel comfortable with their monthly budget, which includes a mortgage payment of \$1,333 and a home-equity loan for \$118. They try to pay extra principal toward their mortgage each month because

they'd like to own their home by the time they retire. Other bills include utilities for \$279 a month, food bills of \$435 and car payments, insurance and auto maintenance, which runs \$975 per month.

"We've basically paid attention to what we spend and we don't waste what's left over," says John. "We just need to keep preserving the extra money."

Solution:

Tweaking asset allocations, increasing savings helps plan

John and Helen are close to reaching their early retirement goal. They can get there by stepping up some of their savings - for which they should have cash available after they pay the bills each month - and redirecting their asset allocation.

"For a couple in their late 30s with college at the threshold, they're doing well," says Matt Fitzpatrick, a certified financial planner and assistant vice president of financial planning at Enterprise Bank & Trust in Lowell.

One huge financial benefit to the couple was the inheritance their daughter received, Fitzpatrick says. That has taken a gigantic burden off their shoulders, and they can fully direct their money toward their early retirement goal of having \$50,000 in income in today's dollars by the time John is age 60.

Fitzpatrick says the couple's savings is a little short, not counting whatever benefit they may receive from Social Security. But because the couple's goal of \$50,000 per year is a modest one, Fitzpatrick says the couple can get there.

"Lifestyle dictates your financial success," Fitzpatrick says. "If they wanted \$100,000 in today's dollars they would be way off."

After examining John's and Helen's cash flow, he has found they have an extra \$1,200 in discretionary income each month. He'd like to see them take \$300 a month and each open up a Roth IRA.

"There would be an immediate tax benefit, and great long-term growth," he says.

As long as the couple's investments earn 8 percent a year until John retires, and 7 percent after that, they'll hit the numbers they need.

The bigger problem the couple needs to correct soon is their asset allocation, Fitzpatrick says.

"They're guilty of portfolio overlap," he says. "It's very common for people who have collections of investments, a little here and there, and there's no method to the madness."

Though the couple appears to have a lot of different mutual funds in their portfolio, many of them are invested in the same types of stocks. About 75 percent of their assets are in large-cap growth stocks, Fitzpatrick says, and that's what's gotten hammered in the past 18 months.

"Your actual selection of funds or hot stocks or the fund de jour isn't as important as the asset class," he says. "I don't care which large-cap growth fund you're in, it's gotten spanked, so you need to diversify across asset classes."

So for all of their retirement and non-retirement accounts, Fitzpatrick says the couple should pare back their large-cap holdings so that only 30 percent of their assets are in that class, with another 10 percent in large-cap value. Then, he'd like to see 20 percent in mid-cap growth, 20 percent in mid-cap value, 10 percent in small-cap growth and the final 10 percent in small-cap value. Within the large- and mid-cap investments, some should be allocated to international investments.

“But invest internationally with caution,” he warns. “Many large cap international funds also invest in a lot of domestic stocks and are actually 60 percent in the U.S.”

Another area the couple has to watch is one of Helen's former 401(k) plans, which is 15 percent invested in company stock. Fitzpatrick says no matter how good the stock, 15 percent leaves too much of your fate hinging on the success or failure of one company. He'd like to see that holding pared to 5 percent.

He also recommends some changes for Helen's IRA, which is invested in an annuity. Because the IRA already offers tax benefits, the annuity inside the IRA adds no extra tax protections, but it has extra fees. The annuity was purchased in 1993, so its surrender charges should expire over the next few years. When the charges no longer apply, he recommends she roll over those funds to a regular mutual fund.

After opening Roth IRAs, the couple will still have some \$900 per month to allocate. Fitzpatrick says the couple should continue paying down their mortgage, but try to fix the amount at \$500 extra a month. That would take years off the mortgage, save the couple thousands of dollars in interest, and get them closer to their goal of being mortgage-free when they retire.

“If they look for a market equivalent they'd need to earn 8.2 percent, and that doesn't count management fees or a risk premium,” he says. “The 5.4 percent on the mortgage is guaranteed.”

Fitzpatrick says the couple's \$21,350 cash funds should remain liquid. Those funds would cover about 5 months worth of expenses should the couple lose their jobs.

“It's a solid piece of their financial puzzle,” he says.