Retirement Countdown

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Five key questions to ask yourself, roughly five years before retirement.

Chances are you've thought about retirement quite a bit over the years, whether you've fantasized about how you'll spend your time or fretted about your 401(k) balance. If you're like most, though, you may be a little fuzzy about what your retirement will really look like.

At some point, however, you'll need to bring your retirement into focus. Ideally, that's about five—or more—years before you hope to retire, when retirement is close enough to know what you want it to look like, and yet far enough away that there's still time to hone your strategy to help meet those goals or alter your plans.

This is harder than it sounds. "Assessing your retirement—especially years before you actually retire—is not unlike going to the dentist when you suspect a problem," says John Sweeney, executive vice president of Retirement and Investing Strategies at Fidelity Investments. "You may be afraid and procrastinate. But waiting can make the ultimate fix more painful. Better to act early. Take it a step at a time."

Here are five questions to ask—and begin answering—before you start planning your retirement party.

1. What are your expectations?

It seems like a simple question. But a 2013 Fidelity survey of 808 couples showed that 38% of preretiree couples don't agree on their anticipated retirement ages, and 35% have different lifestyle expectations once they are no longer working.

Such differences may affect more than your marital happiness; they may affect when and how you'll be able to retire. Five years before you plan to retire may be a good time to start thinking through the details and prioritizing your goals. "You need to do as accurate and realistic a projection as you can," says Sweeney.

Where do you plan to live?

If you plan to move, make sure you also consider how that will impact your cost of living, access to health care, and, if you have your eyes on another state, your tax obligations. If you plan to stay put, you'll want to consider how your home equity factors into your plans.

What do you want to do?

The early stages of retirement can be a costly time in one's life. Many people overestimate how much they'll be able to work in retirement, and underestimate how much they'll spend. Take a hard look at both fronts.

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How will you pay for health care?

After food, health care is likely to be your second largest expense in retirement. According to the latest retiree health care costs estimate calculated by Fidelity Benefits Consulting, a 65-year-old couple retiring this year is estimated to need $220,000[1] to cover medical expenses throughout retirement.

A recent Fidelity study[2] suggests that many consumers greatly underestimate the amount of savings they may need to cover health care costs in retirement. The poll of preretirees (aged 55–64) found that nearly half (48%) of respondents believe they will need only $50,000 to pay for health care costs in retirement.

If you've relied on your employer to pick up most of this tab, retirement could be a rude awakening: Only 26% of large companies offer health care benefits to retirees, according to a 2011 employer survey by the Kaiser Family Foundation. Although Medicare kicks in at age 65, you may need to buy supplemental insurance or, at the very least, budget for the expense. Read *Viewpoints:* "How to tame health care costs when you retire. " You'll also want to think about long-term care.

2. Will you have enough?

This question nags many preretirees. According to Fidelity Investments' latest Retirement Savings Assessment (RSA), [3] the median baby boomer is on track to meet 81% of estimated retirement expenses, enough to cover the basics but not sufficient to cover discretionary expenses like travel.

With five years to go, you'll want to run some real numbers, either with help from an advisor or with a comprehensive tool. If the numbers aren't encouraging, you may need to rethink your plans, step up your savings, or both. The good news: If you're age 50 or older, you may be able to make up to an additional $5,500 in catch-up contributions, before taxes, in 2013 and another $5,500 in 2014 to your 401(k), and an additional $1,000 in catch-up contributions to your IRA.

"We generally suggest a total annual savings goal of at least 10% to 15% or more, including 401(k) and other workplace plans, IRAs, and other savings. That's a total of your savings and any employer match," says Steven Feinschreiber, senior vice president, Financial Solutions, at Fidelity Strategic Advisers. "But that's only a rough guideline, and assumes continuous savings for 40 years of work and an age-appropriate asset allocation."

For baby boomers who are nearing retirement, saving more and adjusting their asset mix has less impact for the simple reason that they have less time to accumulate wealth—though it may still help. For them, postponing retirement is generally the most effective step. Delaying retirement from 64.5—the average age people planned to retire, according to the RSA study—to their full Social Security retirement age boosted baby boomers' median retirement readiness.

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3. Are you invested properly?

As you round the bend toward retirement, you may not want to take on any more investment risk than necessary. But the consequences of being too conservative can be just as worrisome when you account for inflation and the possibility that you could outlive your savings. Part of the solution is appropriate asset allocation.

Although you can't control market behavior, you can affect its long-term effect on your portfolio through investment choices and by replacing portfolios that are either too conservative or too aggressive with an age-appropriate allocation. According to the RSA survey, 48% of baby boomers have 50% or less of their investment in stocks—still conservative for their age.

Your ideal investment mix will depend on a number of factors, including your age, time horizon, financial situation, and risk tolerance. "Retirement is often the time to take some risk off the table," notes Sweeney, "but some people are tempted to become too conservative when they have a 30-plus-year retirement time horizon in front of them." A financial advisor can help you rebalance your portfolio to get the appropriate asset mix to help you meet your needs. Together, you can formulate a plan for gradually shifting your assets toward more conservative investments as you age.

4. Where will your retirement "paycheck" come from?

At the same time you think about shoring up your nest egg, you need to begin thinking about how you'll convert some of your savings into income. For many people, it's helpful to start by grouping potential sources of income into three or four categories, such as income from a part-time job, current investment income, pension income (from a defined benefit plan or Social Security), annuity income, and income from any other assets, such as rental real estate. It's important to understand the nature of one's expenses (discretionary/non-discretionary) and income sources (guaranteed/non-guaranteed).

Next, you'll want to develop a plan to meet essential expenses with guaranteed income sources. If you plan to work a bit during retirement, that may provide your "first" income, but be conservative: You might not work as long as you expect. Next, account for any pension income and Social Security. Before you rush out to file for your Social Security benefits at age 62, however, consider the big picture: Generally, the longer you wait, the higher the potential lifetime benefits.

If these sources aren't sufficient to cover your needs, you may want to consider liquidating assets. Or you could look at ways to shift a portion of your investment portfolio into income-producing assets, such as bonds or dividend-paying stocks.

A guaranteed income annuity[4] is another option to consider if you're interested in converting your assets to income. Generally, the older you are when you buy an annuity, the better the

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benefits, but there may be advantages to thinking about an annuity before you reach retirement age. "If you're concerned that the market will go down in five years, using a portion of your portfolio to purchase a guaranteed annuity to lock in income is something to consider," adds Sweeney.

5. How does your home factor into your retirement?

Don't neglect what is likely one of your largest assets: your home.

If either downsizing or relocating is in your plans you may want to start plotting the move. With home prices in many parts of the country still depressed and mortgage rates near historic lows, it may behoove you to consider getting your foot in the door of your retirement home sooner than you might have otherwise. And there are steps you can take to get your current house ready for sale when the time is right.

If moving isn't in the cards, you may still want to think through whether it makes sense to pay down your mortgage faster—thereby saving on interest payments and improving cash flow in retirement.

Alternatively, consider how to use some of your home equity to help finance your retirement. If tapping home equity is only a temporary solution (e.g., you don't want to sell an investment prematurely), consider applying for a home equity line of credit while you're still employed and more likely to qualify for the best rates. If home equity factors into your long-term planning, you may consider a reverse mortgage. Before considering any of these ideas, however, make sure you consult a tax professional or attorney.

Get started

Between your investment portfolio, your home, and your lifestyle, there's a lot to cover between now and your retirement. Moreover, you'll likely revisit these topics several times over the next several years, as you well should. The point isn't to have all the answers right away but to start asking the kinds of questions that will shape some of the big-picture decisions you'll soon face.

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Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

In general, the bond market is volatile, and bond funds entail interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longerterm securities.) Bond funds also entail the risk of issuer or counterparty default, issuer credit risk, and inflation risk.

1. Source: Fidelity Benefits Consulting, 2013. Based on a hypothetical couple retiring in 2012, 65 years or older, with average (82 male, 85 female) life expectancies. Estimates are calculated for "average" retirees, but may be more or less depending on actual health status, area of residence, and longevity. Assumes individuals do not have employer-provided retiree health care coverage, but do qualify for Medicare. The calculation takes into account cost sharing provisions (such as deductibles and coinsurance) associated with Medicare Part A and Part B (inpatient and outpatient medical insurance). It also considers Medicare Part D (prescription drug coverage) premiums and out-of-pocket costs, as well as certain services excluded by Medicare. The estimate does not include other health-related expenses, such as over-the-counter medications, most dental services, and long-term care.

2. Fidelity survey conducted by GfK Public Affairs and Corporate Communications from Feb. 4 to Feb. 20, 2013. The study was conducted among a nationally representative sample of 1,836 U.S. adults aged 25–64, with a household income of $25,000 or more. Respondents also have primary or shared responsibility for household financial decisions and receive health care benefits through their own or their spouse's employer.

3. **About the Fidelity Retirement Savings Assessment**
These findings are the culmination of a yearlong research project with Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company, which analyzed the overall retirement readiness of American households based on data such as workplace and individual savings accounts, projected Social Security benefits, and home equity and pension benefits. The analysis for working Americans projects the income replacement rate for the average household, compared with preretirement income, and modeled the estimated effect of specific steps to help improve readiness based on the anticipated length of retirement.

Data for the Fidelity Investments Retirement Savings Assessment (RSA) was collected through a national online survey of 2,265 working households earning at least $20,000 annually with respondents aged 25–73 from June through October. Data collection was completed by GfK Public Affairs and Corporate Communications using GfK's KnowledgePanel,® a nationally representative online panel. Fidelity Investments was not identified as the survey sponsor. GfK Public Affairs and Corporate Communications is an independent research firm not affiliated with Fidelity Investments.

4. Guarantees are subject to the claims-paying ability of the issuing insurance company.