The Retirement Mirage
Why Investors Should Focus Less on Timing and More on Saving
Expect the Unexpected

Choosing when to retire is one of the single most important financial decisions we make in our lives. The decision has a lasting impact on our ability to have a comfortable retirement, and, less obviously, it shapes our pre-retirement behavior long in advance of retirement itself. Knowing when we plan to retire helps determine how much money we need to save and our standard of living in the meantime.

Unfortunately, our retirement plans are often wrong, and that can wreak havoc on our finances. Despite our intentions, many Americans retire earlier than planned: For example, someone who expects to retire at 65 may be more likely to actually retire at 63. This happens for a variety of reasons—including health issues and job changes—but the impact can be severe: fewer years of saving combined with a greater need in retirement.

There is another challenge as well. When people have insufficient retirement savings, delaying retirement has become the standard solution. But planning to delay retirement may not be the life raft it seems to be, because it doesn’t always translate into reality. It’s not a straightforward calculation either—it is difficult to predict when a specific person will actually retire.

Our findings suggest that given this uncertainty around retirement age, some investors may need double their current savings to achieve their retirement targets. A person’s retirement age is simply too unpredictable, and we must plan accordingly to help avoid negative surprises.

“Planning to delay retirement may not be the life raft it seems to be, because it doesn’t always translate into reality.”
Powerful Tools, Unrealistic Planning

Retirement-planning tools can help people estimate the likelihood of reaching their desired retirement income. Based on information such as current salary, accumulated savings, savings rate, years to retirement, and projected investment returns, these tools can simply and powerfully illustrate the levers that investors can pull to help improve their chances of retirement success, which we define in this research as reaching a desired retirement income or investment goal.

In many cases, these tools have been shown to help people better prepare for retirement. A 2014 Morningstar Investment Management white paper¹ showed that defined-contribution plan participants on average increased their deferral rates by 28% after using such online tools—an increase of about two percentage points to about 10% of income, on average.²

Unfortunately, these tools miss an essential piece of the puzzle. Using 12 waves (or survey years) of data from the University of Michigan’s Health and Retirement Study, we’ve recently completed research that suggests individuals and their advisors should consider changing how they project retirement savings.

The challenge is twofold. First, researchers are increasingly finding that people underestimate the age they will—or will need to—retire. If an investor’s retirement age is uncertain, planning for retirement must take this into account. Retiring earlier than planned likely means cutting short the savings and investment period, lowering the Social Security benefit, and possibly extending the payout period. Second, when one plans to delay retirement in order to fix a savings shortfall—it may not help one’s finances in the way we would expect.

Retirement Expectations, Meet Reality

Workers often have an idea of when they would like to retire, especially the older they get. But how much control do people have on when they retire?

Research increasingly shows that many people retire earlier than they expect. In Exhibit 1, Gallup surveys³ show that people on average retire about four years earlier than expected (Panel A), and about 48% of people retire earlier than expected based on the latest survey⁴ from the Employee Benefits Research Institute (Panel B). The median expected retirement age measured in the EBRI survey was 65 compared with an actual retirement age of 62, not far from the four-year difference Gallup found in its surveys.

2 A total of 58,444 participants were included in the study based on available participant information and various filters and included those that used Morningstar Investment Management’s Morningstar® Retirement Manager™ Managed Accounts or Advice service between the dates of January 2006 and February 2014. The average increase in saving deferral rates is determined by analyzing each participant’s savings deferral rate prior to using and after using the Morningstar Retirement Manager service. The result is the average across all participants included in the study. Morningstar Retirement Manager is offered by Morningstar Investment Management and is intended for citizens or legal residents of the United States or its territories. The investment advice delivered through Morningstar Retirement Manager is provided by Morningstar Investment Management LLC.
61: The ‘Magic’ Retirement Age

According to the Health and Retirement Study data, planned and actual retirement ages align at 61, with those planning to retire earlier than that tending to retire later than expected, and those planning to retire after 61 tending to retire earlier than expected. In other words, actual retirement ages pull toward 61, with each retirement year planned before or after age 61 resulting in a half-year’s difference in actual retirement age. For example, someone who plans to retire at age 69 will likely retire at age 65 (69 – 61 = 8 × 0.5 = 4; 69 – 4 = 65). This is illustrated in Exhibit 2.

Exhibit 1: Surveys show people retire earlier than planned

Exhibit 2: The difference in planned and actual retirement ages traces a nonlinear path

Exhibit 3: The Retirement Mirage: Why Investors Should Focus Less on Timing and More on Saving

Source: Gallup 2014.


Source: EBRI 2017.
Impact of Retirement Age Uncertainty on Retirement Success

Next, we studied how the probability of retiring early—or, more broadly, retirement age uncertainty—might affect retirement success estimation. Using certain assumptions⁵ we tested the traditional approach financial planners use to generate a client plan (which assumes retirement age is certain) against approaches that incorporate the probability of retiring earlier than expected (following the nonlinear path discussed previously).

Exhibit 3 shows that delaying retirement can have a significantly positive effect on the probability of an investor achieving retirement success. However, the uncertainty around retiring earlier than expected results in much lower probabilities of success for people planning to retire after age 61, dragging down the probability by about 40 percentage points for some ages.

In other words, retirement savers who think they have a 90%-plus chance at meeting their goals might actually have more like a 65% probability of success, something they and their advisors won’t likely be comfortable with. So, we used stochastic simulation to calculate the additional savings needed at retirement to get those probabilities back to where they were before we incorporated the uncertainty of retiring early.

The results were stark. The assumptions people use to improve their probability of success actually work against them, by considerable margins in some cases. As Exhibit 4 displays, saving more is needed—more than double in some situations—as the target retirement age increases and as the withdrawal rate decreases.

⁵ For a complete description of assumptions, see David Blanchett’s full paper, “The Impact of Retirement Age Uncertainty on Retirement Outcomes,” slated for publication in 2018.
This finding may surprise investors and their advisors, as the very steps taken to improve the retirement picture may lead to higher savings rates. This is explained by the fact that the benefits of retiring later and planning to spend less would be nullified by retiring earlier than expected.

Is Retiring Early Predictable?

If roughly half of the population will retire earlier than expected, what factors might predict who is at greater risk for not reaching their retirement income goals? We set out to answer that question in our latest research project. We investigated whether certain worker characteristics foretold unexpected early retirement. The rich HRS data set allowed us to test more than a dozen factors, including general personal characteristics such as gender, marital status, and education, along with factors that might be expected to lead to retiring early, such as job stress level, how physical a job is, and whether health problems limit someone’s work.

However, these factors had little or no predictive power on retiring early. The only factor that appeared to tell us much about when someone might retire was their planned retirement age and its distance from the previously noted “magic” retirement age of 61.
The Primacy of Saving

This study shows that a person’s retirement age is unpredictable on a couple of accounts. Not only do many people retire earlier than expected, but it’s nearly impossible to predict who will be part of this group. Retiring early can present a series of obstacles by reducing saving and investing time, lowering the potential Social Security benefit, and potentially increasing time spent in drawdown, making it harder to reach retirement success.

To offset this risk, individuals and their advisors must incorporate retirement age uncertainty in their retirement planning by focusing on saving. Buying guaranteed income when appropriate, derisking investment portfolios, working in retirement, and a host of other factors still apply. But they should not distract individuals and their advisors from setting aside enough income throughout their working lives to reach their retirement goals.

Our new research analyzes eight changes individuals and their advisors can make to build a better financial future. We found that for both the general public and mass affluent households, it’s the basics that matter the most.

Easing the Retirement Crisis by Steve Wendel

Our analysis found that:

▶ About 25% of working American households are on track to have what they need for retirement
▶ While people think that their retirement shortfalls can only be resolved by extreme austerity, a combination of more moderate interventions can significantly improve retirement outcomes
▶ Since every investor faces unique circumstances, personalized advice is key to identifying the most effective interventions

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About David Blanchett

David M. Blanchett, Ph.D., CFA, CFP® is head of retirement research for Morningstar Investment Management LLC. In this role, he helps develop and maintain methodologies relating to wealth forecasting, general financial planning, automated investment selection, and portfolio assignment for Morningstar Investment Management LLC. Prior to joining Morningstar, he was the Director of Consulting and Investment Research for the Retirement Plan Consulting Group at Unified Trust Company. He has published over 100 papers in a variety of industry and academic journals. His research has received best paper awards from the Academy of Financial Services (2017), the CFP Board (2017), the Financial Analysts Journal (2015), and the Journal of Financial Planning (2007, 2014, 2015). He is currently an Expert Panelist for the Wall Street Journal, an Adjunct professor of Wealth Management at The American College, a member of the Executive Committee for the Defined Contribution Institutional Investment Association (DCIIA), and a member of the ERISA Advisory Council. He holds a bachelor’s degree in Finance and Economics from the University of Kentucky, a master’s degree in financial services from the American College, a master’s degree in business administration from the University of Chicago Booth School of Business, and a doctorate in personal financial planning program from Texas Tech University. When David isn’t working, he’s probably out for a jog, playing with his three kids, or rooting for the Kentucky Wildcats.

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