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Points to Consider When Setting a Retirement Savings Goal

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Many Americans realize the importance of saving for retirement, but knowing exactly how much they need to save is another issue altogether. With all the information available about retirement, it is sometimes difficult to decipher what is appropriate for your specific situation.

How much do you need to save?

One commonly cited guideline is that retirees will need approximately 80% of their pre-retirement salaries to maintain their lifestyles in retirement. However, depending on your own situation and the type of retirement you hope to have, that number may be higher or lower.

Here are some factors to consider when determining a retirement savings goal.

Retirement age

The first factor to consider is the age at which you expect to retire. In reality, many people anticipate that they will retire later than they actually do; unexpected issues, such as health problems or workplace changes (downsizing, etc.), tend to stand in their way. Of course, the earlier you retire, the more money you will need to last throughout retirement. It's important to prepare for unanticipated occurrences that could force you into an early retirement.

Life expectancy

Although you can't know what the duration of your life will be, a few factors may give you a hint.

You should take into account your family history — how long your relatives have lived and diseases that are common in your family — as well as your own past and present health issues. Also consider that life spans are becoming longer with recent medical developments. More people will be living to age 100, or perhaps even longer. When calculating how much you need to save, you should factor in the number of years you expect to spend in retirement.

Future health-care needs

Another factor to consider is the cost of health care. Health-care costs have been rising much faster than general inflation, and fewer employers are offering health benefits to retirees. Long-term care is another consideration. These costs could severely dip into your savings and even result in your filing for bankruptcy if the need for care is prolonged.

Lifestyle

Another important consideration is your desired retirement lifestyle. Do you want to travel? Are you planning to be involved in philanthropic endeavors? Will you have an expensive country club membership? Are there any hobbies you would like to pursue? The answers to these questions can help you decide what additional costs your ideal retirement will require.

Many baby boomers expect that they will work part-time in retirement. However, if this is your intention and you find that working longer becomes impossible, you will still need the appropriate funds to support your retirement lifestyle.

Inflation

If you think you have accounted for every possibility when constructing a savings goal but forget this vital component, your savings could be far from sufficient. Inflation has the potential to lower the value of your savings from year to year, significantly reducing your purchasing power over time. It is important for your savings to keep pace with or exceed inflation.

Social Security

Many retirees believe that they can rely on their future Social Security benefits. However, this may not be true for you. The Social Security system is under increasing strain as more baby boomers are retiring and fewer workers are available to pay their benefits. And the reality is that Social Security replaces about 40% of an average wage earner's income after retiring.[1] That leaves 60% to be covered in other ways.

And the total is…

After considering all these factors, you should have a much better idea of how much you need to save for retirement.

For example, let's assume you will retire when you are 65 and spend a total of 20 years in retirement, living to age 85. Your annual income is currently $80,000, and you think that 75% of your pre-retirement income ($60,000) will be enough to cover the costs of your ideal retirement, including some travel you intend to do and potential health-care expenses. After factoring in the $16,000[2] annual Social Security benefit you expect to receive, a $10,000 annual pension from your employer, and 4% potential inflation, you end up with a total retirement savings amount of about $800,000. (For your own situation, you can use a retirement savings calculator from your retirement plan provider or from a financial site on the Internet.) This hypothetical example is used for illustrative purposes only and does not represent the performance of any specific investment.

The estimated total for this hypothetical example may seem daunting. But after determining your retirement savings goal and factoring in how much you have saved already, you may be able to determine how much you need to save each year to reach your destination. The important thing is to come up with a goal and then develop a strategy to pursue it. You don't want to spend your retirement years wishing you had planned ahead when you had the time. The sooner you start saving and investing to reach your goal, the closer you will be to realizing your retirement dreams.

1) SSA Publication No. 05-10024, March 2016 2) The estimated average annual Social Security benefit payable in January 2016.

IMPORTANT DISCLOSURES

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