

KEYSTONE FINANCIAL PLANNING
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The real keys to retirement planning

Retirement planning is not just about amassing as much money as possible. Why? Because that isn't what life is about, and retirement is just another stage in life. Although how much to sock away and how to invest it are critical retirement planning questions, there are others that are just as—or possibly more—important.

Perhaps it is worth repeating an old saying as a way of putting retirement planning in the proper context: “Money is unlimited; time is limited.” Think about it: you can keep earning as much money as you want, plus add to it inheritances or gambling windfalls, and you can get huge returns on stocks and real estate over long periods. You cannot, however, buy more time. That makes time more precious than money.

You may help yourself change your thinking by asking yourself a simple question: If you had six months to live, what would you do? Would you spend more time or less at a job you hated? Would you spend more time with family, helping others, studying physics or philosophy? The answers to questions like this are as important to your planning as the answers to investment questions.

For instance, you may feel trapped in a job or profession that is stressful, boring, or unrewarding. Yet you continue to work to support your current lifestyle and to make sure you can continue that lifestyle in retirement. After asking the six-months-to-live question, does this still make sense? Is it worth putting your health and happiness on the line for another 20 years so that you can maintain a large home, an SUV, and a place in the country? If not, your retirement planning takes on a new dimension other than figuring out how to put together a portfolio big enough to replace your current income.

Remember, time is limited and precious. It may be time to consider a change in lifestyle. You can downsize your home, buy smaller, used vehicles, sell the summer home and take cheaper (yet still fun) tent-camping vacations. The question is whether you have reached the point in life where you value leisure time more than an increased standard of living. Everyone reaches this point at some time: on our deathbeds, we don't ask for money, but many of us ask for just one day more.

Retirement can mean stopping work altogether or switching to another job that is more enjoyable and less stressful. Reaching for investment returns will rarely get you to that point sooner. The markets have provided returns in the 10% range over the last two centuries and have rarely given investors more during any shorter period. You can have more impact on your retirement success by reducing debt and spending and increasing retirement savings contributions. Spending is critical: for every \$1,000 you eliminate in annual spending, someone facing 25 years in retirement will need \$25,000 less in savings. If you can cut \$10,000 in annual spending from your lifestyle you can eliminate the need to amass \$250,000 in savings.

With this type of information you can begin to make intelligent spending decisions. You may find that paying off a loan rather than buying a theater-size television make sense, or that a modest home suits you better than a McMansion.

How ‘confirmation bias’ clouds your judgment

First impressions count, but, unfortunately for many investors, they may count too much. The human tendency to rely on first impressions and stick with them despite later evidence to the contrary has been dubbed “confirmation bias” by cognitive researchers. It is a form of mental shortcut that allows us to make decisions when faced with a lot of information. However, it also may force us to rely on the wrong information and to ignore good information that may help us later.

Many psychological experiments have identified confirmation bias as being widely held. They found that as soon as someone develops a preference they would filter new information in a way to support that preference. New information that contradicts the preference will be ignored or discounted. They also found that once someone has developed a *feeling* about something it becomes much harder to overcome the bias created by that feeling. Marketers and advertisers use this bias as the cornerstone of selling: if they can make a positive first impression, they are more likely to make a sale.

How does this affect investors? Suppose you buy a stock for whatever reason—a tip, research you have done, or you just like the company’s products. Immediately the stock starts going up and has a great run for six months. Such action would “confirm” your decision. What if negative information started coming in, such as critical analyst reports, an accounting scandal, or a decline in your stock’s industry? For investors already confirmed in their beliefs in the stock, the new information most likely would be discounted: they would continue holding the stock because it was “good.”

Sound outrageous? Then consider the millions of investors who stuck with Internet and communications stocks from the late 1990s through the bear market. Many saw gigantic leaps in value in 1998 and 1999, only to see the stocks go into a freefall in the 2000-02 bear. Unfortunately, their early good experiences clouded their judgment and they couldn’t bring themselves to sell their stocks. Many held on until their stocks were worthless or nearly worthless because they discounted the price declines as temporary.

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