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Planning for Retirement: Taxes, Health Care Costs, and Longevity

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In a March 2006 report Fidelity estimated that a 65-year old couple retiring today will need \$200,000 to cover medical costs in retirement. More alarming is the fact that since Fidelity's initial estimate of \$160,000 in 2002, this number has increased an average 5.8 percent per year. The report assumes that the retiree couple does not possess employer-sponsored retiree health insurance coverage, but that they will enroll in Medicare Parts B and D. Somewhat disconcerting is the fact that the report does not include other health care expenses, such as over-the-counter medications, most dental services, and expenses associated with long-term care (either in a skilled nursing facility, assisted care living facility, or through receipt of assistance at home).

On the heels of the foregoing report comes new research from biomedical gerontologists at several prestigious American and British universities. Life expectancy in wealthy countries will be 112 within the next few decades and could go much higher, said Richard Miller, a researcher from the University of Michigan in Ann Arbor. People will live to an average of about 100 by 2030, according to Shripad Tuljapurkar, a biology and demographics professor at Stanford University in California. The first person who will live to age 1,000 already has been born, according to Aubrey de Grey, a biomedical gerontologist from Cambridge University in England.

Think the foregoing is scary? What about expected future rates of return from the stock market? Before fees, costs, and taxes, many researchers are predicting (due to relatively high stock market index valuation levels at the current time) that stock market returns over the next 10 years may range from a high of an average annualized 9% rate of return to as low as zero. This all assumes "reversion to the mean," which one researcher notes is a prevalent

phenomenon in the capital markets. Even assuming 9% gross returns, fees and costs can often consume 3% (or much more) of an investor's returns, and taxes can easily consume another 2% annually if not managed properly.

With inflation projected at 3% (or higher), and longevity potentially increasing significantly, many retirees are struggling to make their investment portfolio "nest egg" last. Here's a few helpful hints: (1) Keep taxes down by investing tax-efficiently. There are many ways to achieve this, including allocating investments correctly between taxable, tax-deferred and tax-free accounts, using low-cost and tax-efficient stock mutual funds in taxable accounts, planning out withdrawals from retirement accounts, bunching itemized deductions, and much more. (2) Keep your total fees and costs relating to investments and for the receipt of investment advice below 1.85%, and preferably even lower. There are a lot of hidden costs relating to investing which investors don't see, but which nevertheless drag down returns. Consider obtaining a second opinion on your investment portfolio from an objective advisory firm and ask about the "hidden costs" found in many investment products.

The challenge for retirees of today is far different than that of the prior generation. Academic research reveals those very few strategies which effectively work to maximize after-tax returns and hence enhance annual withdrawals from a retiree's investment portfolio. Faced with the necessity of managing a nest egg over an ever-increasing lifespans, in a world perhaps more complicated from a tax and financial perspective, the retiree of today should consider obtaining truly objective advice from knowledgeable professionals (not product salespersons). Reading to keep abreast of the latest developments as to investment portfolio theory, investments and their structure, and the taxation of investment returns is also a necessity, if not for retirees then for their advisors.

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