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Don't Get Too Hung Up on a Retirement Savings Number

There's tons of advice about how big your nest egg should be for retirement but focusing too much on a single figure can lead to complacency by: Katherine Reynolds Lewis

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The internet abounds with retirement calculators that will help you estimate the size of the nest egg you'll need so that you don't outlive your retirement savings. It makes sense. Business gurus tell us you can't improve what you don't measure.

We set other measurable goals in our lives so what's the problem with aiming for, say, $5 million in savings by age 65? It sets us up for complacency, says Vicki Bogan, associate professor of economics at Cornell University in Ithaca, N.Y. "Anchoring on a specific number -- and saying once you get [to] that number you're done -- is not the best idea," she says. "The calculation of that number is predicated on a lot of assumptions."

Experts generally recommend having enough savings to generate about 80% of your preretirement income annually, after factoring in what you'll get from Social Security and any defined benefit pension. You'll need a larger amount if inflation increases, the stock market falters or your health care costs rise more than expected. Your savings goals can be scaled back if you move to a less expensive area or if inflation stays low.

Right now, a booming stock market is convincing people to retire early because they've already hit "the number," says Allison Schrager, senior fellow at the Manhattan Institute. "I can't blame them. The retirement industry has been really negligent in getting people overly focused on that number."

Meanwhile, that obsession has done nothing to improve retirement security. Only 36% of current retirees say they saved the right amount, compared with 45% who believe they saved too little and 18% who saved more than necessary, according to a 2020 survey by the Employee Benefit Research Institute.

Although having a retirement savings number is important, it's also a moving target and fixating on one number runs the risk that you won't adjust your savings goals to new circumstances, such as additional financial responsibilities, higher health care costs, inflation or the vagaries of the economy. Life isn't stationary and your retirement plan, including any target savings number, shouldn't be either.

Consider the Big Picture

Instead of focusing exclusively on the size of your nest egg, create a comprehensive retirement plan that you'll refine and change over time. It should include your financial goals, a net worth statement, a working budget, debt management strategy, emergency funds and any insurance. "More than a number, every individual should have their own financial plan, which is based on data," says Aradhana Kejriwal, a chartered financial analyst and founder of Practical Investment Consulting in Atlanta. **That data should incorporate estimated day-to-day living expenses in retirement, including medical costs based on your health, taxes and any large purchases you're likely to have, such as a new roof or car.**

Any retirement plan also should reflect your expected retirement lifestyle, investing horizon, risk tolerance, savings goals and estate planning. You'll want to consider how your retirement savings hold up under different scenarios, simulating extreme market conditions or unexpected life events, to be sure your bases are covered. This is known as stress-testing a plan. A financial professional can help you do it, or use Microsoft's free online Retirement Financial Planner template to see how your savings and income are affected when you adjust for inflation, retirement age, health care costs or the rate of return. (At templates.office.com, type "Retirement Financial Planner" in the search bar.)

Revisit the plan every few years while you're accumulating assets and whenever you have a life change, such as switching jobs, losing a family member or moving. When you get into your 60s, revisit your plan more often "because you're in a spending phase, not an accumulation phase," Kejriwal says.

As retirement nears, the plan should factor in your required minimum distribution so that you match your income to your expenses and minimize your tax burden. You want an appropriate mix of taxable and nontaxable investments, such as a Roth IRA combined with a taxable brokerage account, as well as a balance of stocks, bonds, real estate and other assets.

This is not a competition. "You're not in a game to beat your neighbor. You're not collecting money for someone else's retirement," she says.

Understand How Your Spending Might Change

One of the biggest dangers in retirement is losing buying power, not merely having inadequate wealth. "The average person invests to spend," Schrager says. "The number you should be worried about is 'How much can I spend each year?' That's not just a function of the stock market; it's a function of interest rates." Higher interest rates can undermine stocks and raise the costs of any variable-rate debt you owe. On the plus side, rising rates can improve returns on fixed-income investments like bonds. Your retirement savings and expenses must fit into any interest rate scenario.

Many retirement spending models use the 4% rule as the average percentage to withdraw each year from an investment portfolio without dipping into the principal. **Just like "the number," these targets can also be deceptive as well as dependent on market conditions and life expectancy.** The 4% rule originated from an exhaustive 1994 study of historical market conditions, which found that, under every scenario, the withdrawal rate wouldn't deplete a retirement fund for 30 years. But if someone retires at 65 and lives to 100, they could run out of funds under that same

These models also don't account for how your spending might change throughout retirement. "As much as we try to calculate what we'll need for retirement, at the end of the day, we don't really know," says Rich Jones, founder of personal finance podcast Paychecks and Balances in Mountain View, Calif. "A lot of people don't think about the cost of living" where they retire. For Jones, retiring in his current, expensive home city would look very different than hanging his hat in Albany, N.Y., where he grew up.

Similarly, your current spending may be nothing like your retirement expenses because when we have more leisure, we often spend more. "The bigger question you should ask is 'What type of life am I aiming for?'" says Chris Browning, host of the Popcorn Finance podcast. "Do you want to live a simpler life and move somewhere cheaper and slower paced than where you're living? Do you want the ability to give money to family and friends?" That clear vision -- backed up with a written budget -- can guide you in setting and adjusting savings targets as well as motivate you to build wealth.

In retirement, health care costs escalate dramatically. Working households spend about 6% of their annual budget on health expenses, versus 14% for retirees, according to the Kaiser Family Foundation. A heterosexual, 65-year-old married couple spends, on average, about $300,000 on medical expenses in retirement, up 88% since 2002, a Fidelity Investments report found. "You need to allow for flexibility because your life is going to change over time," Browning says. Although you may be perfectly healthy now, "things could happen, and there could be additional costs associated with your care."

Curb Your Impulses

Financial decisions often touch on underlying issues that trigger our deepest fears and dreams. Maybe you grew up financially insecure so that having a healthy savings account gives you peace of mind. Perhaps you don't really enjoy the city and would prefer to retire to a rural, low-cost community. Those feelings can be accounted for using dollars and cents with either a larger buffer of savings for someone who grew up financially insecure or a smaller nest egg for a lower cost of living. That way, you'll keep your emotions in perspective when making decisions.

Be careful with impulsive decisions, like opening a business that you're counting on to make up for a retirement savings shortfall. If you have amassed a healthy nest egg, you may feel hard-hearted turning down a plea for financial assistance from relatives down on their luck. But you worked hard for those funds, and you are relying on them to support you through your old age.

It's fine to overestimate the amount of savings you want if that helps you sleep at night. Similarly, you don't need to aim quite as high if you don't have children or other descendants to inherit your estate.

That brings us back to your retirement savings number because you'll still want one. In fact, if you're the kind of person who's motivated by a concrete and tangible goal, it's OK to set a number in your sights, Browning says. "Having a numerical target is helpful because it gives you something to aim for."