SMART INSIGHTS FROM FINANCIAL PROFESSIONALS

Is Inflation a Big Retirement Worry? How to Protect Savings

Concerns about how inflation eats into your resources or limits your ability to save sufficiently for retirement are real, but there are four things you can do to cope.

By JASON "JB" BECKETT
Beckett Financial Group | April 25, 2023

If you ask a retiree, someone who's getting close to retirement or even a person who's planning to work an additional 10 to 20 years what their main retirement worry is, chances are good that many will say inflation.

Inflation[1] has risen significantly in recent months and is top of mind for adults of all ages as it continues to affect households throughout the U.S. According to Fidelity's 2022 State of Retirement Planning Study[2], more than 70% of Americans say they are very concerned about the impact of inflation on their retirement savings plan. Nearly one-third admit they don't know how to make sure their retirement savings keep up.

Inflation prompted the Social Security Administration to give a cost-of-living adjustment (COLA)[3] of 5.9% in January 2022, at the time the highest rate of increase in the last 40 years. The latest COLA, announced in October, was substantially higher — an 8.7% increase for 2023. Though the increased benefits are helpful, retirees relying solely on Social Security[4] can struggle when prices continue to rise.

And for retirees with other sources of income, such as a 401(k), traditional IRA or Roth IRA, inflation can make it tricky in terms of how much money a person should withdraw annually. The 4% withdrawal rate rule[5], which many people applied in the past, has been debunked by numerous experts because it was created in the mid-1990s when bond rates were high, inflation was relatively low, and the markets were roaring. The rules have changed in 2023.

Meanwhile, those who are either a long way from retiring or nearing it and have saved consistently have concerns about how inflation can eat into their resources or limit their ability to keep saving sufficiently for retirement. There's increasing talk of a recession[6], and there's uncertainty about how long high inflation will be with us as well as what it will look like in retirement. But whether you're still working, already retired or getting close it, there are steps you can take to protect your finances both in the present and for the future:

1. DO A DEEP-DIVE BUDGET ANALYSIS.

High inflation means you're spending more for goods and services. With purchasing power in decline, look for spending patterns. Go through your credit card and bank statements over the past year. That process will provide a clear picture of your average monthly expenditures and whether they have trended upward while inflation has risen.

Make a T chart, with variable expenses on one side for things like eating out, entertainment, etc. – all the nonessentials. The other side shows your fixed monthly expenses – costs that are the same or close to the same every month, like rent or mortgage, cable, phone bill, groceries, utilities, subscriptions and insurance.

Add up your fixed and variable expenses for an average month and subtract them from your monthly income. If the remainder is a negative number or near it, look at your variable expenses and see where you can make cuts. On the other hand, a decent surplus allows you the opportunity to pay down debts or add to an emergency fund[7].

2. STRESS-TEST YOUR RETIREMENT PLAN.

The stock market has been volatile in 2023, and higher interest rates[8] imposed by the Fed to fight inflation are a factor. How would your retirement income plan hold up if the market went into a prolonged period of low returns or went through another major recession or bear market? Or, what would the effect on your retirement be if you or your spouse lives well past life expectancy?

You can get an idea of the impact of those worst-case scenarios by running a stress test on your retirement plan[9].

Some financial pros do this by posing different scenarios in software applications. For example, the "Monte Carlo test" runs many randomly generated returns for each asset class.

Another method is to test your portfolio's ability to survive actual past market returns for all asset classes you may invest in.

The general rule of thumb is that you pass these tests when there's a 90% likelihood you won't outlive your money. If the tests indicate your plan may be vulnerable to certain scenarios, your planner can go over options to strengthen your plan, such as the benefits of a Roth IRA[10] to defend against taxes, annuities[11] to provide guaranteed lifetime income and hard assets like real estate to protect against inflation.

3. KEEP SAVING.

High inflation is a time to cut some expenses, but don't let reduced purchasing power convince you to greatly reduce your 401(k) contributions[12] or the amounts you put toward general savings. If you aren't experiencing a reduction in income, keep contributing to your employer-sponsored retirement plan up to the maximum that is matched.

If you can afford to save more, consider an individual account such as an IRA or Roth IRA if you qualify. At minimum, always try to maximize your employer's matching contributions. Get into their pockets as much as possible to help you save. Perhaps pulling back a little on what you put away is understandable until the economy improves, but the point is to stay on track as much as possible so that your retirement goals aren't adversely affected. And when things are better, get back to where you were in terms of percentage saved or contributed.

If you are over the age of 50 and can take advantage of a Roth 401(k)[13], Roth 403(b) or Roth TSP (thrift savings plan), consider directing catch-up contributions into the account. In 2023, that's a maximum of $6,500. Though you pay tax on the contributions, you don't pay tax when withdrawing the money.

4. BE DIVERSIFIED.

Your portfolio should be a mix of different assets, such as stocks and bonds, and the allocation should always be determined by your current risk tolerance. Growth and value stocks as well as mutual funds or exchange-traded funds (ETFs)[14] should also be included in your portfolio. Companies that pay dividends regularly can help weather volatility. And commodities like gold and real estate investment trusts (REITs)[15] have traditionally been considered inflation hedges.

Financial planning for retirement is a work in progress. It's never one-and-done, and high inflationary times demonstrate the importance of adjusting your retirement plan – whether you're still working or retired. When the future seems unclear, being flexible to change leads to progress and financial stability.

SOURCES

1 https://www.kiplinger.com/economic-forecasts/inflation

2 https://newsroom.fidelity.com/press-releases/news-details/2022/Fidelity-Study-Most-Americans-Hope-to-Put-Pandemic-Behind-Them-and-Reclaim-Strong-Financial-Grounding-but-Retirement-Concerns-Abound/default.aspx

3 https://www.kiplinger.com/article/retirement/t051-c000-s010-what-is-the-social-security-cola.html

4 https://www.kiplinger.com/retirement/social-security

5 https://www.kiplinger.com/retirement/retirement-planning/the-4-rule-gets-a-closer-look

6 https://www.kiplinger.com/slideshow/investing/t038-s001-recessions-10-facts-you-must-know/index.html

7 https://www.kiplinger.com/personal-finance/how-to-save-money/family-savings/601120/emergency-funds-how-to-get-started

8 https://www.kiplinger.com/economic-forecasts/interest-rates

9 https://www.kiplinger.com/retirement/retirement-planning/603455/how-exactly-do-you-stress-test-your-financial-plan

10 https://www.kiplinger.com/retirement/retirement-plans/roth-iras

11 https://www.kiplinger.com/retirement/annuities

12 https://www.kiplinger.com/retirement/higher-ira-and-401k-contribution-limits

13 https://www.kiplinger.com/retirement/retirement-plans/603953/roth-401k-contribution-limits-for-2022'

14 https://www.kiplinger.com/investing/etfs

15 https://www.kiplinger.com/investing/reits

Dan Dunkin contributed to this article.

Investment advisory services offered through Brookstone Wealth Advisors, LLC (BWA), a registered investment advisor and an affiliate of Brookstone Capital Management, LLC. BWA and Beckett Financial Group are independent of each other. Insurance products and services are not offered through BWA but are offered and sold through individually licensed and appointed agents.

The appearances in Kiplinger were obtained through a PR program. The columnist received assistance from a public relations firm in preparing this piece for submission to Kiplinger.com. Kiplinger was not compensated in any way.

This article was written by and presents the views of our contributing adviser, not the Kiplinger editorial staff. You can check adviser records with the SEC (https://adviserinfo.sec.gov/) or with FINRA (https://brokercheck.finra.org/)