SMS Capital Management, Inc.

High Income Planning (HIP): Retirement

CASE STUDY

Situation

Kevin and Mary Mitchell are a married couple living in Austin, Texas. Their two children are through with college, employed, and financially independent. Now, the Mitchells have shifted their focus to planning for their own retirement. In retirement, they are looking forward to a deeper level of community involvement as well as spending more time travelling and on their hobbies. They do, however, have some concerns about being able to comfortably retire in the next 10 years and outliving their assets given the longevity in their respective families.

MITCHELL FAMILY SNAPSHOT	
Kevin / Mary's Ages	55 / 54
Annual Household Income	$250,000
Investment Assets	$1,800,000
Net Worth	$2,500,000

The Mitchell's objectives include:

- Determine how much income in retirement they will need to maintain their desired lifestyle.
- Evaluate whether they are they on track to retire at 65.
- Determine under what circumstances they can retire earlier.

SMS Retirement Process

Understand Retirement Goals

The first step in SMS' retirement planning process is to understand the non-financial aspects of the Mitchell's retirement goals.

- Do they plan to stay in their current home or are they contemplating a move in retirement?
- What additional expenses will they have in retirement on things like travel or hobbies?
- Do they have any health issues and what is a reasonable estimate of their life expectancies?
- Do their children (or grandchildren) have any special needs they desire to plan for?
- What are their charitable giving expectations?

The answers to these and other questions can significantly impact the Mitchell's finances during retirement and direct which strategies will be most effective in producing a sustainable lifetime income stream.

Determine Target Retirement Spending

Once SMS understands the Mitchell's vision for their retirement, SMS works with the Mitchells to determine a target retirement income in today's dollars. While the Mitchells may save on some work-related expenses in retirement, their desire to travel may drive up their cost of living. Furthermore, the Mitchells may spend more on healthcare and potentially require costly long-term care in their later years. After some collaborative analysis, SMS determines the Mitchells should target spending of $185,000 a year (today's dollars) which should enable them to comfortably support their expected lifestyle.

Evaluate Retirement Resources?

SMS utilizes an advanced, interactive, financial planning program to help evaluate if clients are on track to achieve their future goals. SMS will build a base case that includes the Mitchell's current assets and liabilities as well as various assumptions regarding future investment returns, inflation and tax rates to ascertain if the Mitchells can achieve their desired retirement objectives.

The program runs their situation through 1,000 simulations to determine the probability that the Mitchells can achieve their remaining lifetime goals.

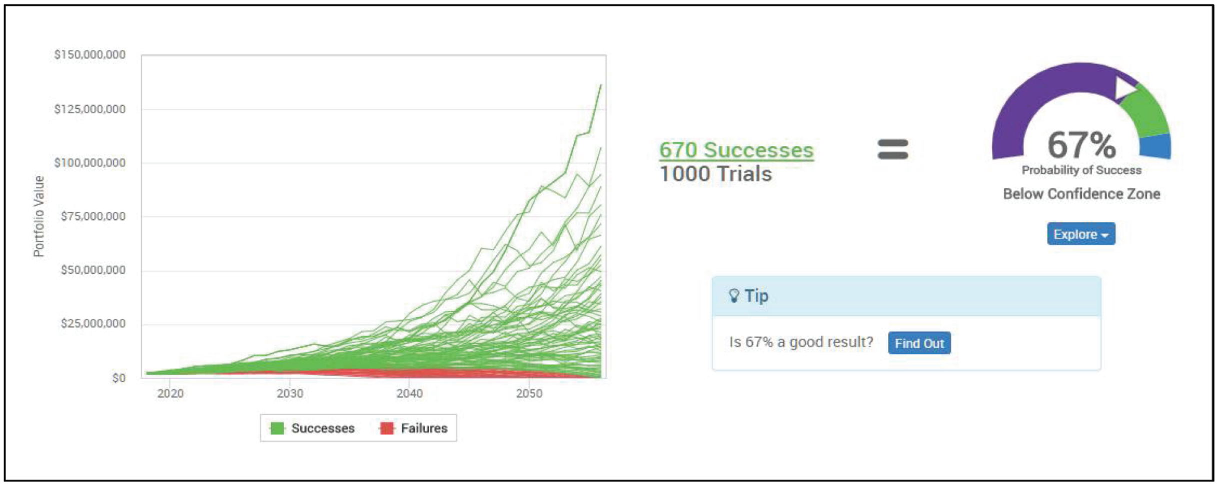

Figure 1. Retirement Simulation Results

Starting with their current situation and targeting retirement at age 65, in this example, the results show a undesirable 67% probability of success. SMS works with the Mitchells to reevaluate their assumptions to get their plan on the right course. In the Mitchell's case, there are three main levers to adjust their retirement plan: working longer, saving more, or spending less in retirement. With the big college bills over with, the Mitchells decide they can direct more resources towards aggressively saving over the next few years. Increasing their savings by $40,000/year improves their probability of success to 80% with retirement at age 65, which is within their desired zone of confidence.

What If Scenarios

The Mitchells would also like to know what they can do to retire earlier than 65. Given that the increase in savings is about all they can handle with their budget, there are a few more levers they can explore. SMS runs a case where their annual spending drops to $150,000 from the original $185,000/year in addition to their extra $40,000 of savings. In this scenario, the Mitchells can retire a full three years earlier at age 62 with an even higher probability of success of 82%.

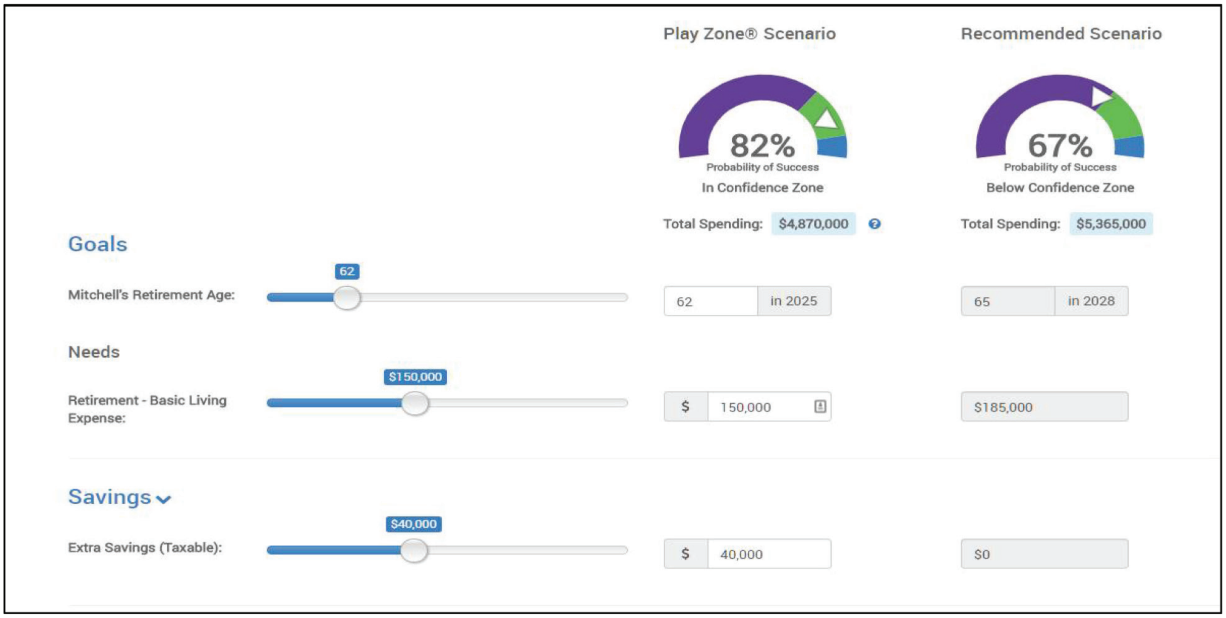

Figure 2. "What If" Retirement Simulation Results

Planning Impact Summary

- The Mitchells have a defined vision for retirement and a detailed financial plan to achieve their goals.
- The Mitchells have a base case plan to follow as well as an interactive planning tool to revisit as they make progress towards their retirement objectives.