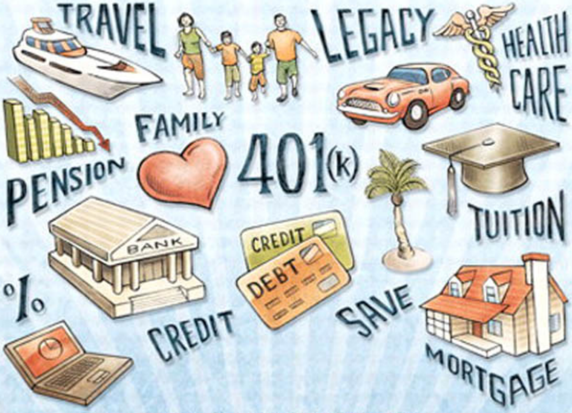
RETIREMENTOLOGY



RETHINKING THE AMERICAN DREAM IN A NEW ECONOMY

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Preface

I had what I thought was a great idea for a new book—a blend of two equally powerful and timely topics. The first topic deals with America's retirement crisis and the challenge of prudent retirement planning in the midst of it. This subject provided the foundation for my first book, *But What If I Live? The American Retirement Crisis*. The topic remains of massive importance right now as the 77 million members of America's most celebrated demographic group—the Baby Boomers—are commencing retirement.[1] For the most part, the same behavior that created the challenges in the first place is continuing or accelerating. This painful conclusion led me to the second topic.

There is a relatively new field of work developing around psychology and finance, known alternatively as behavioral economics or behavioral finance. It focuses on how investor psychology—attitudes, biases, and emotions—impacts financial decisions and behavior. Behavioral finance researchers ask questions like: *Why will people drive 45 minutes to use a $2.00 coupon? Why will people wash their own car on a Saturday morning to save 10 bucks, but would scoff at the idea of washing their neighbor's car for $10? Why won't people sell a poor performing stock just because they inherited it from grandma? Why do people spend differently with a credit card than they do with cash? Why do millions of people believe that they paid no income taxes because they received a refund?* The painfully clear message from behavioral finance research is this: When it comes to money, people don't always behave rationally.

I thought that the application of behavioral finance to retirement planning would be an engaging project—as much fun for me to explore as, hopefully, it would be to read. But a funny thing happened to my storyline along the way. In 2008, the market and economy crashed with a ferocity not seen in decades, and I suddenly had a third act to this play.

As the Meltdown of 2008 was unfolding, I was the keynote speaker for an industry conference in Chicago. My subject—scheduled nearly a year in advance—was "The American Retirement Crisis." With tongue firmly implanted in cheek, I began by telling the audience that I had good news for them, and I put up my first slide, which read:

The retirement crisis is over.

I then explained that this was because—and I clicked to my second slide, which read:

Retirement is over.

It drew some nervous laughs, because people got the point: There was a retirement crisis before all financial hell broke loose, but now we have a *real* mess.

In fact, now we have investor psychology meeting retirement planning in the midst of a monumental financial meltdown. How has this new environment impacted some of the classic behavioral finance biases? And what should pre-retirees and retirees do about all this? These are the essential questions that *Retirementology* has identified. In the process, I hope to

- Identify the classic mistakes we are all making with our thinking and behavior in the key areas of earning, spending, saving, borrowing, and investing.
- Understand the scope of the financial meltdown and how it has amplified the impact of our mistakes.
- Connect those mistakes to the retirement planning process and discuss possible options to help readers aim for retirement.

Retirementology is not a typical retirement planning book, nor is it a book on psychology; it is a little bit of both. Part of what has created a retirement crisis in America is the tendency to treat retirement as a separate and static event, relegate it to a zone, or even compartmentalize it. In this regard, many seem to act as if retirement planning were divorced from other monetary behavior. Quite the contrary, retirement should be viewed as a process—one that begins as soon as you engage in earning, saving, spending, borrowing, or investing. Indeed, all these things are inextricably bound. For example, a pre-retirement couple may have a choice between buying a new $55,000 automobile or buying a $35,000 pre-owned automobile and putting the remaining $20,000 in a vehicle of a different sort—a retirement account. Such decisions may have a profound impact on their lifestyles in retirement. In this regard, you can't actually build a solid approach to retirement without also tackling your approach to all the other fiscal decisions in your life. That is why behavioral finance plays such a key role in retirement planning. If we truly want to plan correctly for retirement, we need to address the mistakes we have made, and may still be making, with regard to how we think about money, how we feel about money, and how we behave with money.

In developing this book**,** our research team conducted nearly a dozen focus group interviews with pre-retirees and retirees, ranging in ages from 25 to 70. Our researchers posed a number of questions on topics such as the housing crisis, family issues, overspending, investor behavior, and more. Some of the responses are included in relevant chapters throughout the book and specifically identified as findings from our focus group research. In other cases, hypothetical names, people, and situations have been used to illustrate points. For example, *Retirementology* introduces some one-of-a-kind terms, descriptions, and scenarios, which have been created to help you better understand a number of the behaviors associated with investor psychology.

In fact, the title of our book is a one-of-a-kind term...

RETIREMENTOLOGY: [ri-***tahy***uh r-muhnt-***ol***-uh-jee]
A new way of thinking about retirement planning that considers both psychology and finance against a backdrop of the worst economic crisis since the Great Depression.

After you read the book and are better informed and educated, you may be better equipped to take another important step: Partner with an adviser for professional guidance and support. But please note: The best advice on the planet is irrelevant if you procrastinate and don't act on it.

Act 1: Turn the page.

Endnotes

1 "77 Million Baby Boomers Ponder Next Career Steps," Careers.org, October 5, 2009.

Introduction

RETIREWENT: [ri-***tahy***^{uh} r-went]

What happened to the retirement hopes and dreams of Americans after the meltdown. *Roger and Dee both had to take on second jobs thanks to retirewent.*

Paradigm Lost

The greatest bull market in history was a glorious thing. When the bull finally keeled over from exhaustion at the end of 1999, it ended a 20-year period in which the S&P 500® Index saw an annual average return of 18.5%.[1] Encompassed within that period were 5 consecutive years of 20% plus returns.[2] The impact of that 5-year period on the psyches, not just the portfolios, of investors shouldn't be underestimated.

Picture Herb, a hypothetical ultraconservative investor, who years or decades earlier had sworn off of equity investments, which are a stock or security in which an investor can buy ownership and which involve financial risk, including loss of principal. Since 1982, Herb's brother-in-law has been telling him that he's missing the boat. *"Herb, I've shaved 15 years off of my retirement date. I'll be on the beach about 5 years from now. You are too conservative, Herb."* Well, Herb smiled politely and ignored such comments for the first few years, and said to himself, *"Slow and steady wins the race. This growth and tech stuff is just a fad. This can't continue."* But it did continue, not just for a few months or years, but for more than a decade—and then it accelerated. You could see it in the headlines of the day, as things like price-to-earnings ratio and profits became quaint notions from a former era.

> "A Bull Market with Strong Legs and a Long Way to Go," *The New York Times*, May 7, 1995
>
> "Economists Expect Little Trouble in Paradise," *Business Week*, December 30, 1996
>
> "A new paradigm for the U.S. economy," *Chicago Fed Letter*, October 1998
>
> "Investing: Is the P/E Ratio Becoming Irrelevant?" *The New York Times*, July 21, 2002

Gallup polls showed that investors ended the decade of the '90s with expectations of 19% annual returns on their investments, and they were expecting those returns to continue for another 10 years.[3] So when Herb saw his brother-in-law at Thanksgiving dinner in 1997, he had to listen to how much his brother-in-law's retirement portfolio had grown in the last 5 years. No sir; this wasn't even stock picking and hot tip stuff. *"Just believe in equities baby,"* Herb's brother-in-law proclaimed. After all, just consider how strongly the Dow Jones Industrial Average, an index which is a price-weighted average of 30 actively traded blue-chip stocks that are generally the leaders in their industry, performed during the 1990s[4]:

- Dow in Dec. 31, 1990—2,633.66
- Dow in Dec. 31, 1991—3,168.83
- Dow in Dec. 31, 1992—3,301.11
- Dow in Dec. 31, 1993—3,754.09
- Dow in Dec. 31, 1994—3,834.44
- Dow in Dec. 31, 1995—5,117.12
- Dow in Dec. 31, 1996—6,448.27
- Dow in Dec. 31, 1997—7,908.25
- Dow in Dec. 31, 1998—9,181.43, *up 249% from Dec. 31, 1990*
- Dow in Dec. 31, 1999—11,497.12, *up 337% from Dec. 31, 1990*

The Dow Jones Industrial Average is an unmanaged index and not available for direct investment.

And finally, Herb just couldn't take it anymore. Enough was enough. He could do better, he thought. So he made the bold decision to dip his toe in the water. He took 20% of his $250,000 retirement portfolio and put it in equities. To his delight, Herb watched that 20% grow by 28% that year—$50,000 from his portfolio became $64,000. He then shifted another 25% of his portfolio, putting $50,000 into equities, and watched it grow by 21% the next year, as $114,000 became $138,000. He was up $38,000 in his portfolio in just 2 years. It took 17 years, but he was now a convert.

So how does this sad, and possibly familiar, story end? The beach was more than in sight for Herb. He could taste the salt air. Then came the Meltdown of 2008, and it was like a small tsunami hit his beach. And a generation of Baby Boomers suffered a total loss of $4 trillion in retirement accounts, or roughly 40% of America's GDP, with rising debt and a declining stock market representing the worst post-war downturn for *household wealth* since the recession of 1973–75.[5] The *Herbs* of the world were hurt pretty badly—especially if they were on the doorstep of retirement. Some of them swore they would never invest in the market again—and haven't. But most others, even though a bit shell-shocked and hurt, held out hope of a quick recovery. It just seemed more reasonable that the previous years were the benchmark for normalcy—not the Meltdown of 2008.

Yes sir; the new paradigm was intact, it just had a bit of a hiccup along the way. The bursting of the tech bubble hit many portfolios hard, but at the time, left the rest of the economy fairly unscathed. But then the Meltdown of 2008...Boom! Like a speeding car running head on into a bridge abutment, the damage of this economic downturn went beyond the largest stock market downturn since the Great Depression. Housing, unemployment, escalating taxes, and inflation are all contributing to the situation. We are experiencing dramatic losses in wealth, performance, and investor faith. The shock waves are showing up in many and varied ways.

- Since 2004, the average Baby Boomer has seen his net worth decline by 45%.[6]
- Seven million jobs have been lost since the recession began in December 2007.[7]

- One-in-four mortgage owners in America is underwater[8] and one-in-nine housing units is vacant.[9]
- The Consumer Confidence Index has hit a record low[10] and consumer anxiety about interest rates and a lack of guaranteed income has more than doubled in the last three years.[11] In fact, 62% of American adults believe today's children will *not* be better off than their parents—up 15% since the beginning of 2009.[12]
- There were 35 corporate defaults in March 2009, the highest number of defaults in a single month since the Great Depression.[13]
- A quarter of U.S. employers have eliminated matching contributions to their 401(k) plans since September 2008.[14]

On the retail side, we saw record drops in sales—9.1% in the fourth quarter of 2008 from the previous year.[15] As a result, Best Buy shares fell 8% in November 2008 alone, and its stock has plummeted—down 58% in the first quarter of 2009. Best Buy Vice Chairman and CEO Brad Anderson cited *"rapid, seismic changes in consumer behavior"* and *"the most difficult climate we've ever seen"* as the causes.[16]

Said Brian Dunn, Best Buy president and COO, *"In 42 years of retailing, we've never seen such difficult times for the consumer."*[17] Starbucks, the unquestioned sultan of the minor indulgence, watched its earnings drop by 69% in the first quarter of 2009, and it has closed 900 stores since the summer of 2008.[18]

All of this has shaken confidence not just in investing, but also in the United States economy, the government, the global economy, and indeed, capitalism itself. A trifecta of tragedies in credit, capital, and liquidity has cut the world's economy to the core. Bad strategy and bad behavior in response have compounded the Meltdown of 2008. And it should be noted that the bad strategy has included some of what was touted as "best practice" retirement planning. No magic product exists today, and solving for retirement is and will likely remain a difficult and complex challenge. In Chapter 8, "Lost in Translation," I examine the difficulty of solving the retirement income riddle. It was already tough prior to the meltdown—now investors may need a translator to comprehend the new layers of complexity.

Further, that complexity is magnified when investor behavior, emotions, and biases come into play. And, as we will see, they come into play with nearly all the basic retirement planning questions: For how many years will you need retirement income? Emotions usually, and understandably, cloud the best attempts to soberly estimate that answer. What is a prudent annual rate of return to assume on your investments for a 20-, 30-, or 40-year period? As we have seen, investors a mere decade ago would have given a very different answer than those of today—an answer that likely varies by double digits. The same might be true for questions about assumed tax or inflation rates moving forward. All this will impact the question of how much you need to live on each year, hence how much you need to withdraw each year. Of course, how much you withdraw in retirement is irrelevant if you don't have the nest egg from which to withdraw in the first place. When it comes to building a nest egg, it is important to note that starting early is important.

A number of financial firms, however, have popularized the notion of a retirement zone, the few years remaining prior to entering retirement, as somehow the most critical to a successful retirement. In Chapter 3, "The NoZone," it becomes clear that solving the retirement conundrum requires attention much earlier than a handful of years prior to retirement...and will certainly continue well into retirement. According to the Employee Benefit Research Institute, when the financial crisis began, 25% of Americans between the ages of 55 and 65 had 90% or more of their money in stock funds of their 401(k)s, and undoubtedly have suffered greatly, losing nearly half of their account balances right on the eve of their retirement.[19] As a generation is forced to revisit and revise their retirement plans, they will truly understand the importance of compound interest and starting early. In fact, you might well argue that the handful of years in one's early twenties are the most critical years to retirement. Unfortunately, most future retirees at the dawn of their retirement planning journey are off to a slow start, as Hewitt and Associates reports that over 70% of Generation Y workers (those born in 1978 or later, now in the thick of their 20s) don't participate in employer-sponsored accounts.[20]

If savings is the yin, spending is the yang. In other words, while Americans haven't been saving, they have been spending, at least during the last 20 years.[21] In Chapter 2, "Gold Dust on Sushi," named after the Japanese practice that represented the height of 1980s overindulgence, we uncover the *carpe diem* spending mentality that resulted in a negative savings rate, high debt, and record bankruptcies. Household debt averages doubled from 2000–2007, totaling $13.8 trillion, or $46,115 per person.[22] America's savings rate had dipped into negative territory, which was the lowest since the Great Depression until people abruptly stopped spending as the market tumbled.[23] And bad behavior is magnifying these troubles; more than 20% of workers age 45 and up have stopped contributing to their 401(k)s.[24] In the course of developing the highest standard of living in the history of mankind, we have developed some bad habits. Chief among them is the American consumers' addiction to debt, which is closely related to our inability and unwillingness to manage money.

Further, some indulgences became so habitual and were so ingrained that they were no longer even seen as indulgences—and still may not be seen as such despite the economic meltdown. For example, although our friends at Starbucks have certainly seen a negative impact, many people see nothing extraordinary about handing over $7 at a time for a muffin and a coffee drink. It would be interesting to know the number of survivors of the Great Depression who have ever walked into a Starbucks and laid down several dollars for a drink. I'll go out on a limb and suggest the number is quite small. Similarly, many people have come to view a $50 to $100 per month bill for cable television or satellite coverage the same way that previous generations viewed a water bill. You don't think of not paying it; it's just one of life's necessities. Well, it may be time to hold the gold dust on that next order of sushi.

No place was the love affair with debt more out of control than with the nucleus of the American Dream—our homes. For tens of millions of Americans, those dreams have rapidly turned into nightmares. In Chapter 4, "House Money," you will see how many of the age-old axioms of home ownership are now being challenged. One deals with the core belief that a house is a solid long-term investment. We were taught that our homes might take modest dips in value here and there, but ultimately would always go up—even if that were over the course of a decade or two. Many Baby Boomers today, especially those in the most devastated metropolitan areas within Florida or in Las Vegas, as well as in cities such as Los Angeles, Phoenix, Ann Arbor, and Reno, are looking at home value declines that are so significant, they might not be recouped in their remaining lifetimes. And that stark fact is changing the way they view homes and home ownership in a host of interesting ways. How could home values have dropped so far so fast? Does it make sense to own any more?

In one of our focus groups, we heard from a mortgage lender who told us of a Boomer who had taken out a $100,000 equity loan on his house just to pay for his daughter's wedding because, as he stated, *"Seemed like a good idea at the time."* By his own definition, the man was *"never rich,"* but his house provided a fortress of overconfidence to overspend. When he came back in to see the lender after the meltdown, he was already underwater and was referred to the company's loan modification department. There are thousands of examples like this across the country, and after years of using their houses as personal ATMs, many Americans, like this gentleman, have seen their bedrock crack and crumble. In fact, many now see that their remaining retirement nest eggs are about equal to or even less than the amount of negative equity they have in their homes. There is one place where real estate is still hot. There is a booming market for the sale of burial plots by individuals, many of which have been in families for years, as record numbers of people are selling their final resting spots back to the cemetery and other buyers, often for a fraction of what they paid for them.[25]

What a difference a meltdown makes. I have been struck by the complete reversal in many investors' perspectives. Ask a Boomer today what he's thinking versus a year ago, and he's likely to tell you something like this, *"My wife and I just shake our heads...because less than a year ago, our biggest worries were about whether we should put granite or tile in the new bathroom; whether we should go back to Hawaii this year or venture to Italy; or whether we should put a lap pool in the backyard. Now those questions seem ridiculous compared to what we're wrestling with."*

This meltdown has not only hit our houses, it has invaded our homes and disrupted millions of American families. In the midst of recent economic and market turmoil, the evolution of family values is quickly becoming a revolution. In Chapter 5, aptly titled, "Family Matters," you'll see that today's family structure is at the core of emotional confusion and complexity in terms of spending, saving, investing, and retirement. My wife recently spent $30 on a T-shirt for our son. *"We're now buying $30 T-shirts for the kids?"* I objected. Clearly irritated, she explained to me that it was a great deal because it was high quality (from an upscale store), and it was on sale. I remember wearing jeans with patches sewn onto the knees—and this wasn't a fashion statement. As a kid, for my family to have spent a comparable amount on one of my T-shirts would have required that it double as my winter coat. I wouldn't even spend $30 on a T-shirt for myself today. But as many parents know, we will spend differently on our kids than on ourselves. (Now, for the record, after I told my wife that I would use this example in my book, she argued that it wasn't a T-shirt at all, but some sort of sport shirt. I saw it. It is green with no collar and short sleeves. It is a T-shirt.) Let's face it. The way we think, act, feel, behave, and interact within our family has a dramatic effect on long-term retirement planning.

Many American families are now hopeful that governmental response will be the answer to this economic crisis. There is no question that the response has been swift and unprecedented. If you add all the recent initiatives—The American Recovery and Reinvestment Act (the original "stimulus" package), the Troubled Asset Relief Program (TARP), and the spending and lending of the Fed, Treasury, and FDIC—the total is $9.7 trillion to stem the recession.[26] The impact on the record deficit is jaw dropping. We had a deficit issue before the new spending and bailouts. Our federal future obligations were already the equivalent of over $50 trillion, or a financial burden of $170,000 for every American.[27] This massive deficit begs the question of how it will be paid; and the obvious answer is that it will be necessary to raise taxes. Here's some of what the taxman is expected to bring with him.

- Tax increase of some $1.4 trillion over the next 10 years.[28]
- Increased taxes for 3.2 million taxpayers by an average of $300,000 over the next decade.[29]
- Allowing the 2001 and 2003 tax cuts to expire for couples making over $250,000 and singles earning over $200,000. This includes increases of rates on income, capital gains, and dividends.[30]
- Removal of key tax deductions.[31]
- Escalation in estate taxes.[32]
- New ways to disguise taxes by using other titles, such as fees, surcharges, penalties, and so on.[33]

In predicting the impact of all such changes, individual states are the proverbial canaries in the mineshaft. More than 10 states are considering or have implemented major increases to sales, corporate, or personal income taxes to fill their respective budget gaps.[34] Nationwide, we are seeing a physical, geographic bifurcation of givers and takers. Leading the way is California, the biggest canary, with a $45 billion shortfall,[35] massive debt that grows by $1.7 million every hour,[36] and a mass exodus of wealthy citizens fleeing for other states.[37] Now more than ever, controlling taxes will be one of the biggest challenges and one of the most important steps you will take toward retirement. Another obstacle standing between you and a comfortable retirement is healthcare. With costs rising at four times the rate of inflation,[38] it's no wonder 46 million Americans are now without health insurance.[39]

Let's face it. Healthcare in America is "Under the Knife," which is the title of Chapter 7 on this hot topic. As of this writing, a major national debate over healthcare and health insurance is taking place. The White House is pushing a plan that will essentially nationalize many healthcare functions, and proponents are insisting that the plan presently put forth will lower costs across the board while also covering more Americans, though not all Americans. To put Medicare in perspective, for example, consider the richest budget in U.S. history—$3.5 trillion—on top of the $787 billion "stimulus" package recently passed by Congress, and that is just a drop in the bucket compared to America's $32 trillion unfunded Medicare liability.[40] With retirement looming and government-sponsored healthcare programs in question, Americans face a greater reality that unplanned medical expenses may derail even the best-laid retirement plans.

The "Ology" in Your So-Called Retirement

When it comes to *your* best-laid retirement plans, you can choose to be your own best friend or your own worst enemy. There is no shortage of responsibility for this financial mess. Take your pick: the Fed and its promotion of easy money; Congress and its turning a blind eye to pleas for lending review and reform; optimistic home buyers; greedy subprime lenders; out-of-touch appraisers; asleep-at-the-wheel ratings agencies; or Wall Street bankers. We can blame these folks all we like, but individual behavior played a large part in where many Americans are today. That's why behavioral finance is a key element of this book. It's a wonderfully controversial field, because it highlights how we behave in ways completely contrary to what logic or traditional economists might have predicted. Sound familiar?

How do people behave irrationally when it comes to money? Allow me to illustrate with a decision-making example. Imagine I have $1,000 to split between you and another person—I'll call that other person Samantha. The only stipulation is that Samantha gets to decide how the money is divided, and you must agree with that division. If you agree, you both leave with my $1,000. If you don't agree, I keep all my money. Let's assume that after careful consideration, Samantha decides that $980 of the $1,000 should go into her pocket, and that a mere $20 should go to you. Would you still agree with the deal? Now traditional economists will tell you to take the $20 and not be concerned with how much the other person keeps. They contend that people should try to spend as little as they can, save as much as they can, and get the maximum return on their investments for the smallest risk. In sum, people should act in a way that puts the most money in their own pockets. Per this view, the field of economics, and indeed retirement planning, is strictly a mathematical theory, and investors and markets are expected to behave in certain ways that are observable and predictable. In the field of economics, this is called the Expected Utility Theory.

During the exercise, I make certain to articulate that this is strictly "hypothetical" to protect myself from those rare instances when there is agreement between the two. But here's the catch: I can tell you that my $1,000 is rarely in jeopardy. The common responses are, *"No. I don't want the swine to get the money." "Absolutely not." "He can take his $20 and shove it."* You get the idea. I point out to these folks that up until I opened my little cash box, they had no expectation of receiving anything. And now some 120 seconds later, someone is trying to hand them a $20 bill, and they are spitting on it. No matter. This exercise is one of many examples of how people behave in ways that confound the traditional equity theorists. In fact, the quaint notion that people will behave in ways that are predictable and observable ignores what 2002 Nobel Prize winner in Economics Dr. Daniel Kahneman calls *"the human agent."* In an interview I conducted with Dr. Kahneman in 2004, this pioneer in behavioral finance told me about how his discipline doesn't assume perfect rationality, which is why perceptual bias, complexity, and emotions like pride and anger, illustrated in our exercise, can overshadow sound financial decisions.

For example, research from Dr. Kahneman and Dr. Amos Tversky showed that investors are more sensitive to decreases in the value of their portfolio than to increases in value.[41] Even in good times, many investors tend to suffer from what experts refer to as "myopic loss aversion"—a basic tenet from the field of behavioral finance, which holds that people psychologically weigh losses twice as heavily as gains.

Here's an example of myopic loss aversion.

> I flip a coin:
>
> Heads, you win $110.
>
> Tails, you lose $100.
>
> Will you take the bet?

Behavioral finance shows us that there will be few takers of the gamble. How much would most people need to win before they would be willing to take the gamble? $120? $140? $180? The research reveals before the majority of people will be willing to take the risk, they would need to receive at least twice the amount of the possible loss.

> So the typical person won't take my gamble unless the gamble is improved.
>
> I flip a coin again and this time:
>
> Heads, you win $200.
>
> Tails, you lose $100.

Now that the upside is twice as good as the downside, more people will take me up on my second coin flip. Think of it this way—have you lost $20 before? The regret attached to that loss is more powerful than the joy you might feel if you found $40 on the sidewalk. (When I was 14, someone stole $20 from my locker at a public swimming pool—at a time when a typical two-hour lawn mowing job earned me a whopping $4. You can tell that it stuck with me.) Ever lost your wallet or car keys...or at least thought you did? Your search in this scenario is all consuming, and the impending sense of loss overpowers all other priorities.

Psychologists believe the human mind has two systems for decision making: intuitive and reasoning. Although experts would argue that this division is often overly simplified, in general, the intuitive system, located on the right side of the brain, is emotional and fast to act but slow to learn. However, the reasoning system, located on the left side of the brain, is more controlled, less emotional, focused on rules, and slower to act. Neither side is always correct, but the intuitive side does have its flaws.

Dr. Kahneman often uses this seemingly simple math problem in his lectures. A bat and a ball together cost $1.10. The bat costs a dollar more than the ball. How much does the ball cost?

Your intuitive side may quickly tell you that the ball costs 10 cents. Tempting answer, but wrong. In fact, if the ball costs 10 cents, that would mean the bat costs one dollar more than that or $1.10, so the two together would be $1.20. After you put a little more thought into the problem, you realize the ball must have cost five cents. The point is, it is important to distinguish between decisions that should be made by intuition and those that require careful thought and calculation.

I highly recommend you explore this field in more detail, as the scholars of behavioral finance have put years of sweat equity into fascinating research and study. Notably, I recommend *Choices, Values, and Frames* by Kahneman and Tversky; *Beyond Greed and Fear* by Hersh Shefrin; *Nudge*, written by Richard Thaler and Cass Sunstein; the investor behavior studies on 401(k)s by Shlomo Benartzi; articles, books and research by Meir Statman; *Against the Gods, The Remarkable Story of Risk* by Peter Bernstein, as a keen understanding of risk is more relevant than ever given the current economy; and *Investment Madness* by John Nofsinger, which is a good introductory book on behavioral finance written for the "lay" reader. Dr. Kahneman and I covered a wide array of behavioral finance concepts during our interview, and throughout the book, I'll explore some of these concepts and the impact they can have on your retirement. My time with Dr. Kahneman, as well as the vast body of work within behavioral finance, provided inspiration for the "ology" element of the book's retirement vision. *But what will that retirement look like?*

In the years following 9/11, Americans were afraid for their physical safety and survival. The passage of time—without further terrorist attacks in America—and recent economic events have shifted this focus. In assessing the salient issues in any given campaign, some political analysts have said, *"It's the economy, stupid."* Well, in the current environment, that might be refined to state, *"It's economic survival, stupid."* Millions of Americans who have never given much thought to the bottom of Maslow's Hierarchy of Needs are suddenly seeing that their nest eggs are wiped out, that their jobs have disappeared, that their homes are in jeopardy, and that any previous notions of retirement will clearly need to be rethought. In fact, many of them are seeing that it is not out of the realm of possibility that their largest headache could become simply putting groceries on the table and doing so for the foreseeable future. Millions of others are worried that one or more of these situations are just around the corner for them.

Even with Your Best Efforts, This May Not Be Your Father's Retirement

Only in the last year did we finally surpass the fabled baby boom year of 1957 for record births, and only because the overall population is nearly double, not because families are having more babies than they did during the carefree days of the post-war era.[42] Now, more than 50 years later, many of those 77 million Baby Boomers begin their retirement journeys, and they are doing so on very precarious footing. Many Americans who were holding onto retirement dreams by a thread have seen that thread snap, and millions of others now need to proceed very carefully.

In the midst of one of the worst financial downturns in years, this generation of Baby Boomers is being tested like no other. Although most of us would not want to trade places with previous generations who suffered through the Great Depression, that generation did not have to overcome the challenges associated with living up to 30 years in retirement. The good news is that the products, programs, education, tools, and techniques are in place to help you succeed. And the successful retiree today needs to recognize a couple of important facts. First, skyrocketing house appreciation and double-digit returns are remnants from another time and not likely coming back anytime soon, if ever. Second, education and tools are only half of the puzzle. The other half will be composed of your willingness to embrace the new thinking and new behavior needed for a new era. Welcome to the world of *Retirementology*.

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1

Great Expectations

MONELERIOUS: [mun-ih-***lair***-ee-*uhs*]
The state of being wildly incorrect in one's thinking about any given money matter. *Investors were monelerious before the Meltdown of 2008, convinced their home values would double in five years.*

Man Walks into a Bank…

For millions of Baby Boomers preparing for retirement, we live in an era of what can best be described as *Romantic Illogic.* Consider the curious case of Timothy J. Bowers. In Columbus, Ohio, Mr. Bowers, age 62, couldn't find work, so he came up with a plan to make it through the next few years until he could collect Social Security. Mr. Bower's plan was out of the ordinary, to say the least. He robbed a bank and then handed the money over to a guard and waited for the police. Mr. Bowers passed a court-ordered psychological exam, and got his wish…he was sentenced to three years in prison, just enough time to take him to his Golden Years when he could collect his full Social Security check. The prosecutor was quoted as saying, *"It's not the financial plan I would have chosen, but at least it was a plan."*[1]

Before the Meltdown of 2008, very few Boomers had a retirement plan, but millions had retirement expectations. For example, 59% of the people in a survey said they expected to receive a pension check; however, only 41% knew of a pension to which they or their spouse were entitled.[2] Of the people who actually had a pension coming, the median expected annual pension was $20,000, but the median actual pension payout was only $8,340.[3] So did the bull market and strong economy create a quixotic-like disconnect between reality and fantasy? Why else would 50% of American workers say they expected to retire at 62, and 80% believed their standard of living would go up in retirement?[4] Why else would 70% of Boomers expect to leave an inheritance, not knowing if there was really any money to be left to their heirs?[5] After the Meltdown of 2008, you have to wonder: Who exhibited more irrational behavior…the bank-robbing Mr. Bowers who had a plan or the overconfident Boomer who had an expectation?

The New McFear

When some of the world's largest companies and banks essentially vaporize or are forced to sell themselves in a matter of months, and the global economy appears to be sinking with record speed and harmony, [6] even the worst-conceived plans and the best-laid expectations can turn to fear, and suddenly no fear, for some of us, may seem irrational. In October 2008, Alan Greenspan, the former chairman of the U.S. Federal Reserve, confessed to Congress that he was *"shocked"* when the markets did not operate according to his lifelong expectations.[7] When things are tight and negative, economic news fills the headlines; people may tend to hold back on spending, pull money out of long-term investments, and potentially exacerbate the problem by holding onto their nest eggs for dear life. During the Meltdown of 2008, Bill Gross, considered the nation's most prominent bond investor, hypothetically equated the squeezed credit markets to being like a trip to a McDonald's drive-thru where one would pay at the first window, but could not be sure of actually getting their food at the second window. *"They are frozen in 'McFear,'"* said Gross.[8]

In a crisis, no story in the media seems out of bounds, which is why the media stokes fear. Case in point, remember the Avian flu, better known as the bird flu? In 2005, it was reported that an outbreak of the bird flu could kill anywhere between 2 million and

150 million people, but as of this writing there have been only 263 reported deaths caused by this disease.[9] Although the bird flu was indeed potentially dangerous, a measured, informative public discussion of the potential pandemic seemed nowhere to be found in the mass media. In the meantime, something much bigger was taking place, something that takes place every day, every month, every year in America, and yet it gets scant coverage as a rule. That something? The flu. That's right, the average, ordinary flu that we've probably all had a touch of at one time or another. In a flu season in the United States, an average of 36,000 people die of the flu or flu complications, and about 200,000 people are hospitalized.[10] That's more than 98 fatalities a day and well over 500 hospitalizations a day if the flu season were spread out over a year. Fortunately, bird flu hasn't come anywhere close to exacting that kind of toll, but as we all know, fear sells, and our perception of fear becomes reality.

As our economy suffered its own kind of flu, the headlines got worse and behavior became more irrational. After all, the economy is not only affected by the way people behave with their money, but it also affects the way people behave with their money. An example of this self-fulfilling prophecy is the hot dog stand story, which has been told in one form or another for well over 40 years. Here's the tale: Once upon a time, there was a man who ran a hot dog stand. This man ran one of the finest hot dog stands in the whole city and, strangely enough, he even used real meat in his sausages. People came from miles around to get his tasty hot dogs that were generously covered in onions and sauces. In fact, the man was so successful that he could afford to send his son to an Ivy League school. After graduation, the prodigal son came back home to visit his pop and took a look at the family business. *"Dad,"* he said*, "based on the current economic statistics, we're heading for a recession. You should really stop using all that sauce, and you dish out onions as if they were free. And you've been talking about expansion—adding another hot dog stand. Not the time to do that, Dad,"* he said. The father was torn. He was always generous to his customers, but his very bright son didn't get all that education for nothing. So, reluctantly, the father cut back on the sauces and onions. He held off on his expansion plans. His son even convinced him to buy a cheaper brand of hot dog. Although the son meant well, the timing of these cutbacks turned out to be just right, because right then the father's business took a real dive. After years of prospering as a street vendor, the hot dog man lost so many loyal customers to the competition, he had to close his stand. *The moral of the story*: The more you react to the fears and emotion of a recession, the more likely the recession will find you. Or…*what was the son thinking and what was the father feeling?*

The Retirement Brain Game

At the risk of oversimplifying how the brain works, this complex machine can be divided into two cognitive systems. As mentioned in the introduction, the automatic system is subjective, intuitive, and instinctive, whereas the reflective system is objective, rational, and more deliberate. The automatic system is popularly coined the "right brain," whereas the reflective system is referred to as the "left brain." You've probably heard people say that they are either right-brain thinkers or left-brain thinkers; schools even build *whole-brained* curriculums to give equal weight to both sides of the way our brain functions. In the story you just read, the hot dog vendor approached his business with blind emotion, but his son actually evaluated the situation with what could be described as blind logic; both emotion and miscalculation can cloud our financial decision making. Although the right side of the brain is the culprit for most of our financial mistakes, the two sides together are often at odds, resulting in fear, dread, anxiety, euphoria, sadness, and conflict—essentially everything that makes us human. And because we are all human, let's have a little fun. Imagine the two sides of a Boomer's brain having a conversation. *What might they say about retirement?*

This is your brain. This is your brain on retirement.

Right Brain: Whoo hoo! Can't wait to retire.

Left Brain: Retire? What exactly is the plan?

Right Brain: Travel. Beach. Golf. But not just for two weeks, for the rest of my life.

Left Brain: Okay, so tell me. Have you thought about the numbers?

Right Brain: 18—as in holes a day.

Left Brain: You are irrational.

Right Brain: I am exuberant.

Left Brain: Seriously.

Right Brain: Okay, we'll sell the house.

Left Brain: Underwater. With three mortgages.

Right Brain: Investments?

Left Brain: Down 40% since the meltdown.

Right Brain: What about our nest egg?

Left Brain: I told you to start 25 years ago, Mr. Procrastinator.

Right Brain: We can always count on family.

Left Brain: Not returning calls.

Right Brain: Government?

Left Brain: Have you seen the news?

Right Brain: You're freaking me out.

Left Brain: The technical term for that is ohnosis.

OHNOSIS: [oh-**noh**-sis]

Realizing that you really should have started planning for retirement years ago. *After John completed the online retirement calculator, he was struck with a severe case of ohnosis.*

Expectations are driven by a number of behaviors, and from behavioral finance we examine a few concepts in this chapter, such as *overconfidence* and *illusion of control*, that helped shape high expectations for Boomers prior to the meltdown. I'll review a familiar concept called *procrastination* and a not-so-familiar concept called the *recency effect*, both of which will most likely continue to influence, and even plague, investor behavior in the post-meltdown era.

Procrastination—Psychological bias that keeps people from engaging in the day-to-day activities that could result in a long-term benefit. One way it manifests itself is the way people fail to sign up for their 401(k) accounts when they become eligible, which is often months after starting with a company. They become comfortable with their take-home pay and don't believe they can cut into it at all to fund a retirement that's decades away. So they put off funding their retirement, spend all their pay, and do nothing to maximize their wealth.

Overconfidence—Actions based on an exaggerated estimation of one's knowledge, skill, and good fortune. Even if a person did nothing to make that investment successful, other than buy it, he may think that he's learned something important about how to make money in the market and try to apply that learning to future investments. The result is that the investor believes he knows more than he actually does and can control more than he actually can.

Illusion of Control—The tendency for investors to believe that they can control or influence an outcome over which they have absolutely no control.

Recency Effect—Giving more importance to recent events than to those events that took place further in the past. Investors who were recently stung by the market, as was the case in the fall of 2008, were cautious about getting back in during the bull market that took place in the spring and summer of 2009.

The Procrastinator's Plight

Procrastination. The word conjures up images of laziness and detachment. And *procrastination* is a big reason why retirement expectations are not met. *Procrastination* isn't necessarily a problem relegated solely to the unmotivated among us. It is a psychological bias that affects millions and can keep us from building a retirement nest egg. We all want to make timely, well-thought-out financial decisions, but *procrastination* lurks in the shadows waiting to derail our retirement dream.

Consider for a moment our increasingly complicated, ever-changing, fast-paced world. It is one that differs dramatically from the society we inherited from our parents and grandparents. Despite this radical technological evolution, our natural tendency is to keep things the way they were. And it's an understandable reaction considering the blitz of changes constantly demanding our attention. After all, it's much easier to do nothing rather than alter one more detail in our already busy and overburdened lives. In fact, *Seinfeld*, one of the most successful situation comedies of all time, was a self-proclaimed show about *doing nothing*. Truth is, most of us prefer to *do nothing*. For example, your car may no longer be exactly what you want, but keeping it is easier than looking for a new one. *Do nothing.* Your job may not be as satisfying as you would like, but the daunting task of searching for a new one may be even less appealing. *Do nothing.* Fifty-three percent of workers in the U.S. have less than $25,000 in savings and investments,[11] but what will most of them do differently going forward? *Nothing.*

Many people acknowledge that *procrastination* plays a major role in keeping them from starting to plan for retirement. Why? You may be overwhelmed by the notion of retirement; afraid you'll make too many mistakes in retirement planning; have too many competing priorities; or just lack a sense of urgency. According to a survey conducted on behalf of the Securities Industry and Financial Markets Association, the majority of adults would choose to receive financial advice over the advice of a personal trainer, interior designer, or fashion consultant, if given the opportunity.[12] But here's the conundrum: LIMRA, a financial services research firm, reports only 15% of consumers said they had consulted with an adviser during the economic crisis. Whereas 85% procrastinated and did nothing, even during a crisis, two-thirds of those investors who did seek financial advice during the crisis felt reassured and were glad they acted.[13]

The Cost of Waiting

A consistent theme among our age 60+ focus group participants was regret over not starting to plan for retirement sooner. Although better late than never is always a worthwhile notion, urging your children to start planning for their financial future as early as possible is one of the most important pieces of advice you can pass along to your family. Let's take a look at the advantage of starting early and the disadvantage of procrastinating. Table 1.1 illustrates the potential cost of waiting to invest. Susan invests $10,000 for 10 years and stops. Sally waits 10 years and then invests $10,000 for 25 years. Assuming a hypothetical rate of return of 8% for both, Susan will have more money than Sally despite investing significantly less money upfront.

Table 1.1 SUSAN VERSUS SALLY: The Power of Time (Hypothetical Example)

	Susan	**Sally**
Age 31–40	$10,000 per year	$0 per year
Age 41–65	$0 per year	$10,000 per year
Total Investment	$100,000	$250,000
Value at Age 65	$1,071,477	$789,544

This chart is hypothetical and for illustrative purposes only. The hypothetical rates of return shown in this chart are not guaranteed and should not be viewed as indicative of the past or future performance of any particular investment. This chart assumes a hypothetical rate of return of 8%.

Think about it. Have you ever heard people say they were glad that they waited years, even decades, to begin planning for their retirement? Many people acknowledge that *procrastination* plays a major role in keeping them from doing a better job of planning for their retirement. There are so many choices and unknowns that it is often easier to focus on the more immediate concerns of daily living.

> *"What I have on the list, I think my biggest obstacle is me, quite honestly. I just feel kind of overwhelmed by the topic. There is almost so much information about ways to prepare and invest in retirement, that to me it overwhelms me and I shut down. It's always I'll look another day, I'll check into that tomorrow. I have no doubt that I am my biggest obstacle to achieving great success in retirement."*
>
> —Male Focus Group Participant

Some investors take the opposite approach. Rather than proscrastinate, they invest immediately, without making more patient choices for the future. For example, someone offered the choice between receiving $100 today or $110 tomorrow might be tempted to take the money today. But if that same person were asked to choose between receiving $100 a year from now, or receiving $110 in a year and one day, he would likely prefer to wait the extra day for the larger payoff.[14] Instant gratification can also be a factor in the behavior of procrastination; in some cases, people will do what is necessary to get something they want immediately but are not inclined to start acting on something that may get them what they're after 20–30 years down the road. Behavioral finance studies have been conducted with fruit and chocolate, as well as "low brow" and "high brow" movies.[15] In both studies, people will typically choose chocolate and "low brow" movies today, and fruit and "high brow" movies tomorrow.[16] When it comes to retirement planning, making impatient choices and opting for instant gratification today, while delaying patient, even better and better-for-you choices for tomorrow can affect our investment decisions. For example, rather than being patient and riding out paper losses from investment downturns, people may act without thinking and make investment decisions that aren't prudent.

Failure to follow through once a decision has been reached is also a common factor in procrastination. And it's an easy one to relate to. Take joining a gym, for example. When buying gym memberships, I think many people tend to be overeager and possibly naïve in their forecasting. A discounted monthly payment may seem like a smarter move than a higher per visit fee, but if you don't show up, the per-visit fee is a better value. I had a friend with a very busy schedule who was excited about joining *24-Hour Fitness*® because he could go anytime—even in the middle of the night to work out. *"Problem is,"* he said, *"I never got the urge to go to the gym in the middle of the night—so I never got to the gym."* But he kept making his so-called discounted monthly payment, which was pulled directly from his checking account.

We live in a busy world that's constantly pulling us in different directions. There's no question that most people want to take actions that will benefit their financial bottom line, but they often do not finish the task. When faced with making an important or complex decision, it's not unusual for investors to either keep things the way they are or delay making a decision until later. This behavior is particularly damaging to retirement and can be seen in the way many workers fail to take advantage of company-sponsored retirement plans. Despite easy access to investment information, many employees have difficulty taking action even though they understand the need to join their retirement plan, choose allocations, and increase their contribution rates.

The Overconfident Investor

Although *procrastination* traps us in the gap between thinking and doing, ***overconfidence*** tricks us into thinking we are better than we actually are at performing a particular task. Investors who suffer from *overconfidence* have a tendency to believe that their forecasts are right and that more knowledge will only solidify their beliefs. But the fact is that more knowledge can sometimes be contradictory to what an investor already knows. Although common sense dictates that learning more about an investment would naturally make a person a better investor, a behavioral finance concept called the ***illusion of control*** dictates that's not necessarily the case.

Rooted in *overconfidence*, the *illusion of control* tricks people into thinking they have more control over an outcome than they actually do. An example is the documented fact that if you ask someone to bet on which side a coin will land on, the person will bet more money on the side it *didn't* land on the time before. The problem with this thinking is that the coin obviously has two sides, and there's a 50% chance a tossed coin will land on one side each time the coin is flipped. Like the coin toss, investors frequently use last year's result to make this year's investment decisions without properly analyzing the information. Our minds are calibrated to believe only what we will accept, and we are often surprised when predictions prove not to be right. We know the past, especially the recent past, like a stock's year-to-date earnings, but there's so much more to know to make an educated investment decision. Based on what we do know, many of us have a tendency to believe that we have more control over an outcome than we really do. Witness the all-star baseball player who has a superstition of tapping his spikes before entering the batter's box. He may claim that such a ritual helps him succeed, but if he has a .300 batting average, that means he does not succeed 70% of the time. Although such an average is quite impressive in baseball, the batter's ability and mastery of his skill have a lot more to do with his success than the superstition that gives him the *illusion of control*.

Are you overconfident?

Before we continue, answer this question: How would you rate your driving skill? Compared to other drivers you encounter on the road, are you

- Above average
- Average
- Below average

If you're like most people, you answered that you are *above average*. When we asked our focus group participants this question, 90% of the room stated they were above average, but given that our focus group was composed of a cross section of America, it is very unlikely that 90% of the room was average or above. Just like driving, many Americans may be overconfident that their investment decisions are prudent. For example, during the bull market, some investors thought they knew best where to put their money, and they continue to think that to this day. In the '90s, they believed it was tech stocks; in the late 2000s, it seems to have been target date funds and home equity. CNBC's two-part special *House of Cards*, which aired in January of 2009 and detailed the financial meltdown that was triggered by the bursting of the real estate bubble, featured an interview with Alan Greenspan. During the interview, Greenspan stated that all the people who'd invested heavily in real estate or subprime mortgage-backed securities thought they would get out of those positions ahead of everyone else. But many of these people—among them some of the brightest minds on Wall Street—did not get out ahead of the others and, in fact, they were holding worthless paper when the meltdown happened.

The Nearsighted Investor

Overconfidence in both bull and bear markets can, in part, be attributed to a behavioral finance concept known as the ***recency effect***. When people look back over a short period of time, they remember the good things as well as the struggles. In investing terms, if a person looks back a quarter or two and sees his accounts have grown in value, he's likely to invest even more, overloading investments in equities without maintaining a well-balanced portfolio. Conversely, when investors experience something like the Meltdown of 2008, they may react to it in the exact opposite way, perhaps being overly conservative with their investments. If we do not experience anything like the meltdown in the next year or so, investors will be less influenced by it. The *recency effect* dictates that experiences happening in real time affect behavior in real time, like an economic boom. Witness the American economy since the Baby Boomers came along: For the most part, the American economy and quality of life have risen consistently. After the meltdown, the relatively carefree days of the Dow at 14,000 (that happened just 50 weeks earlier) suddenly seemed like a distant memory. A new reality was upon Americans, and they reacted by looking at their finances in a whole new way. But how many react by *permanently* looking at their finances in a whole new way? *"We will see people pulling in their belts for 1 or 2 years,"* insists Augustana College history professor and American consumer credit expert Lendol Calder. *"And then it will be back to where we left off."*[17]

When people are faced with a new reality, like losing their nest egg very quickly, they don't always react as rationally as they should. Long-term knowledge and even experience is tossed out the window in favor of a reaction to short-term stimulus. The result is that businesses and individuals alike are doing what they can to cut back on expenses and even hoard money. At some point the headlines will stop trumpeting bad economic news, regardless of how good or bad the economy is at that point. At that time the hurt and anguish that was brought about by the meltdown will recede, and people will become more engaged about who's the next *American Idol* than what they do with their dollars.

Improve Your Retirementology IQ

A century and a half ago, Charles Dickens wrote *Great Expectations*, about a young man named Pip who took the occasion of sudden wealth to eschew his working class roots and move up in London society. Like the mysterious benefactor who eventually bestowed riches upon Pip, many people expect to have their own retirement dreams fulfilled by other mysterious benefactors in the form of pension checks, lottery tickets, and rich uncles—great expectations of travel, leisure, devoting time and money to a charitable cause, winter homes and summer homes, time with friends and family, and possibly leaving a noble amount of money behind for those who are most important. In fact, when asked what is the most practical manner to accumulate $500,000 for retirement, 27% of respondents said winning the lottery or sweepstakes.[18] Could it be that the survey was taken among characters in Dickens' novel?

A meltdown has a way of changing expectations—even for a generation high on promise and light on planning.

Take a moment to evaluate what you're thinking in this post-meltdown era. How well did you deal with your fears? Did you lose sleep? Did you develop a nervous tick? Did you watch the markets every day? Did you make any financial moves out of panic? It's likely that a lot of the things you did do in response to the economic downturn you did because you didn't know what else to do. Modifying your expectations doesn't have to mean abandoning your retirement dreams—just rethinking them. Here are two takeaways to consider to get started on rethinking expectations.

Conduct a Personal Retirement Assessment

What do you want? What do you need? What are you willing to do, to sacrifice, to achieve these material things? You have to be willing to think about opportunity costs, like if you'll be happy driving a less flashy car today to drive a golf cart every day in retirement. Or if you're okay raising your family in your present house so that you might have a winter house in retirement. Some people simply can't get past immediate gratification, whereas others look at all the issues and realize that they can put some things off now for the possibility of a secure retirement. Remember, even small decisions can make a big difference in your retirement planning, and retirement is ultimately affected by many monetary decisions throughout your life, like starting to plan ahead as early as possible.

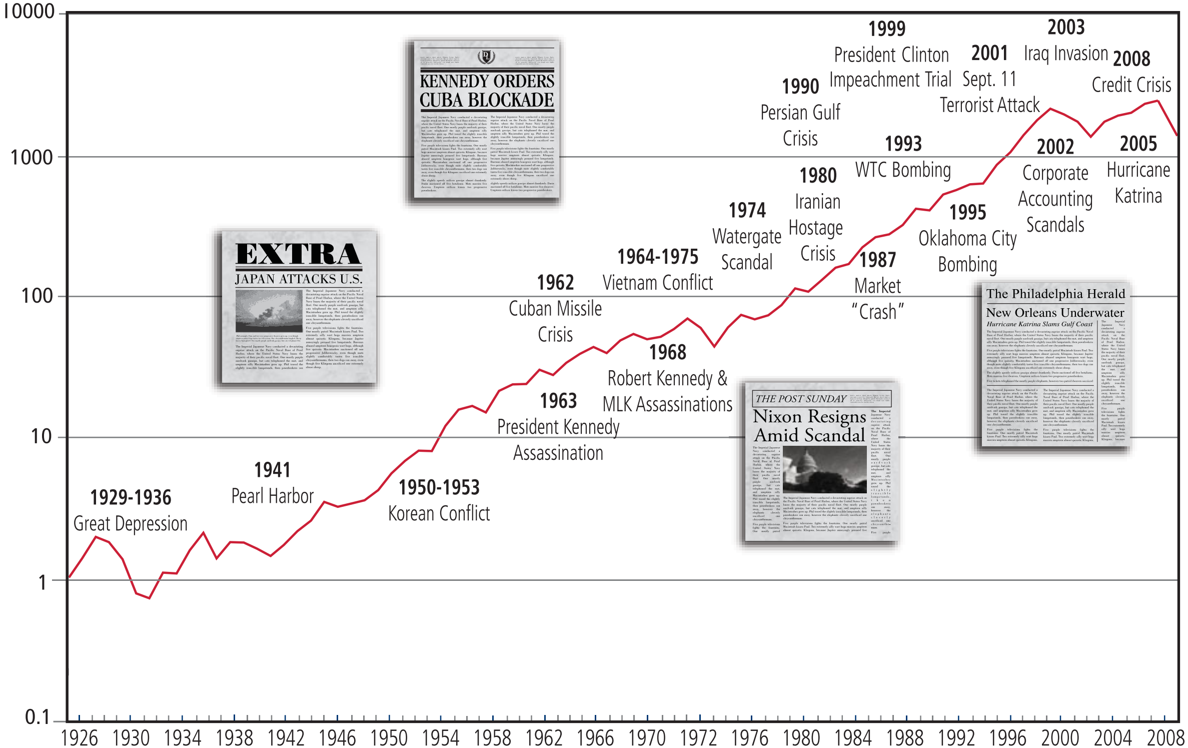
Reevaluate Retirement Expectations

What's your retirement dream? Would you like to retire to a big house overlooking a lake and the mountains where the view is always beautiful and you can decide whether you want to golf, ski, or go sailing every morning when you wake up? Everyone's dream is unique, but reality can get in the way of a dream, even for the wealthiest retiree. What do you really want? And what will it take to get there? If it's a winter house in Arizona or Florida, you have to know approximately how much it will cost. If it's a boat so that you can travel the world, you need to have an idea of how much you'll need. Be realistic. Be honest with yourself. Be as objective as you can be, and leave nothing out when you make your checklist…right down to how many golf balls you'll need because you always hook your driver into the water. Improving your Retirementology IQ often begins by examining your options and feelings *before* the unthinkable happens. You may feel like the unthinkable has already happened. Keep in mind that, historically, the economy and markets have been cyclical. Learn from today, but don't lose your long-term retirement perspective.

"This time it's different"—perhaps four of the most dangerous words in investing. No matter what the political or economic climate may be like, investing always involves risks. Consider the growth of the S&P 500 Index since 1926 (see Figure 1.1). Like many investments, stocks have experienced some severe declines, as well as dramatic growth—despite wars and meltdowns. *What will the next headline be?*

Mark Twain said, *"Climate is what we expect, weather is what we get."* When it comes to expectations, the best thing you can do is check them at the door and plan for all kinds of weather in retirement.

UNREALISTIC LIFESTYLE EXPECTATIONS MAKE A HAPPY RETIREMENT IMPOSSIBLE.



(Chart created by Jackson National Life Distributors LLC using performance information provided by the S&P.)

Widely regarded as one of the best single gauges of the U.S. equities market, the S&P 500 Index is a market capitalization-weighted index of 500 stocks that are selected by Standard & Poor's to represent a broad array of large companies in leading industries. This chart represents the growth of a hypothetical

$1 invested in the S&P 500 from 1926–2008, during which time the Index experienced an average annual return of 9.62%. The S&P 500 is an unmanaged, broad-based index and is not available for direct investment. Past performance is no guarantee of future results.

It really isn't different.

A quick history of events that shaped the political and economic climate in the United States shows us that turmoil is nothing new to the financial markets.

- 1950 Korean "police" action begins
- 1951 Excess Profits Tax
- 1952 Government takes over steel mills
- 1953 Russia explodes H-bomb
- 1954 President Eisenhower suffers heart attack
- 1956 Crisis in Suez
- 1958 Recession
- 1959 Cuba falls to Castro
- 1960 Russia downs U-2 plane
- 1961 Berlin Wall erected
- 1962 Cuban Missile Crisis
- 1963 JFK assassinated
- 1965 Civil rights issue explodes
- 1966 Vietnam War escalates
- 1967 Inner city riots
- 1968 Martin Luther King, Robert Kennedy assassinations
- 1969 Money tightens – markets fall
- 1970 Cambodia invaded, Vietnam War spreads
- 1971 Wage and price freezes
- 1972 Largest U.S. trade deficit ever
- 1973 Oil prices skyrocket, energy crisis
- 1974 Watergate forces Nixon resignation
- 1975 Clouded economic prospects
- 1976 Economic recovery stalls
- 1977 Market slumps
- 1978 Turmoil in Iran
- 1979 Oil prices skyrocket
- 1980 Iranian hostage crisis, inflation
- 1981 Record-high interest rates
- 1982 Worst recession in 40 years
- 1984 Record federal deficits
- 1985 Money tightens – markets fall
- 1986 Dow nears 2000
- 1987 Bull market crashes on October 19th
- 1990 Persian Gulf crisis
- 1991 Soviet Union collapses
- 1992 President Bush signs NAFTA
- 1993 1st Democrat in White House in 12 years
- 1994 One of the worst years on record for bonds
- 1995 Dow breaks 5000
- 1996 1st Democrat re-elected to White House since FDR
- 1998 Markets on roller coaster ride
- 1999 "Y2K" concerns
- 2000 "Dot.com" uncertainties
- 2001 September 11 terrorist attacks
- 2002 Corporate accounting scandals
- 2003 U.S. invasion of Iraq
- 2004 Tsunami in Indonesia
- 2005 Hurricanes Katrina, Rita, and Wilma
- 2006 Democrats control Congress for first time in 12 years
- 2007 U.S. enters into a recession
- 2008 Credit crisis hits Wall Street

(Source: History.com, "History timelines…The History Beat," 2009.)

Figure 1.1 Is it really different this time?

Endnotes

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