

***Economics-Based, Life-Cycle
Personal Financial Planning***

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We all need help with financial planning.

ESPlanner™

The Questions

What is my sustainable living standard?

What must I save to preserve it?

What must I insure to protect it?

How can I raise my living standard?

How do I make life-style choices?

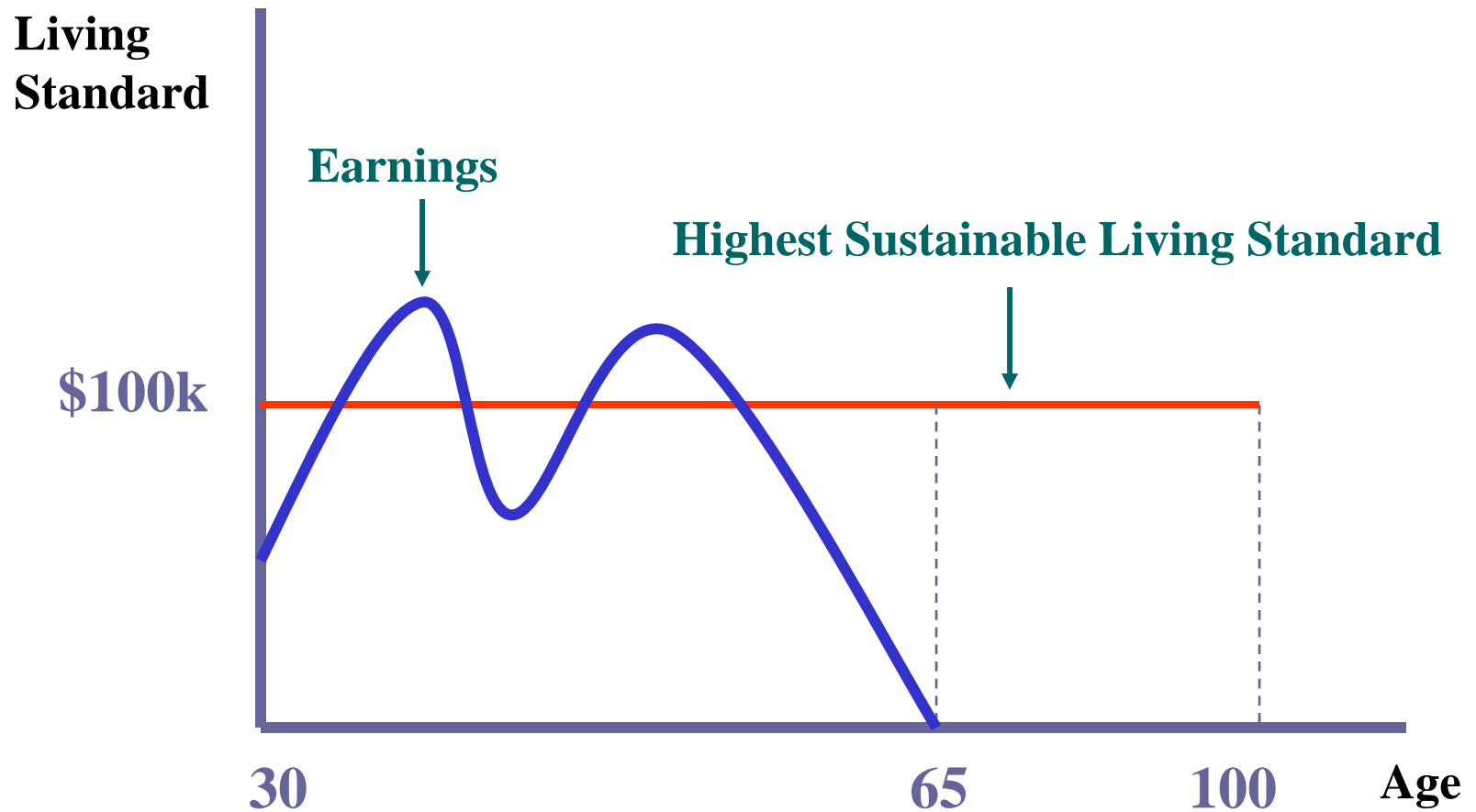
Economics' Approach – Consumption Smoothing

Based on Life-Cycle Model of Saving

Developed by MIT's late Nobel Laureate Franco Modigliani

Goal → a Stable Living Standard

Consumption Smoothing



Conventional “Advice”

Simplistic rules of thumb

Forces you or client to set spending targets.

What’s the right spending target --

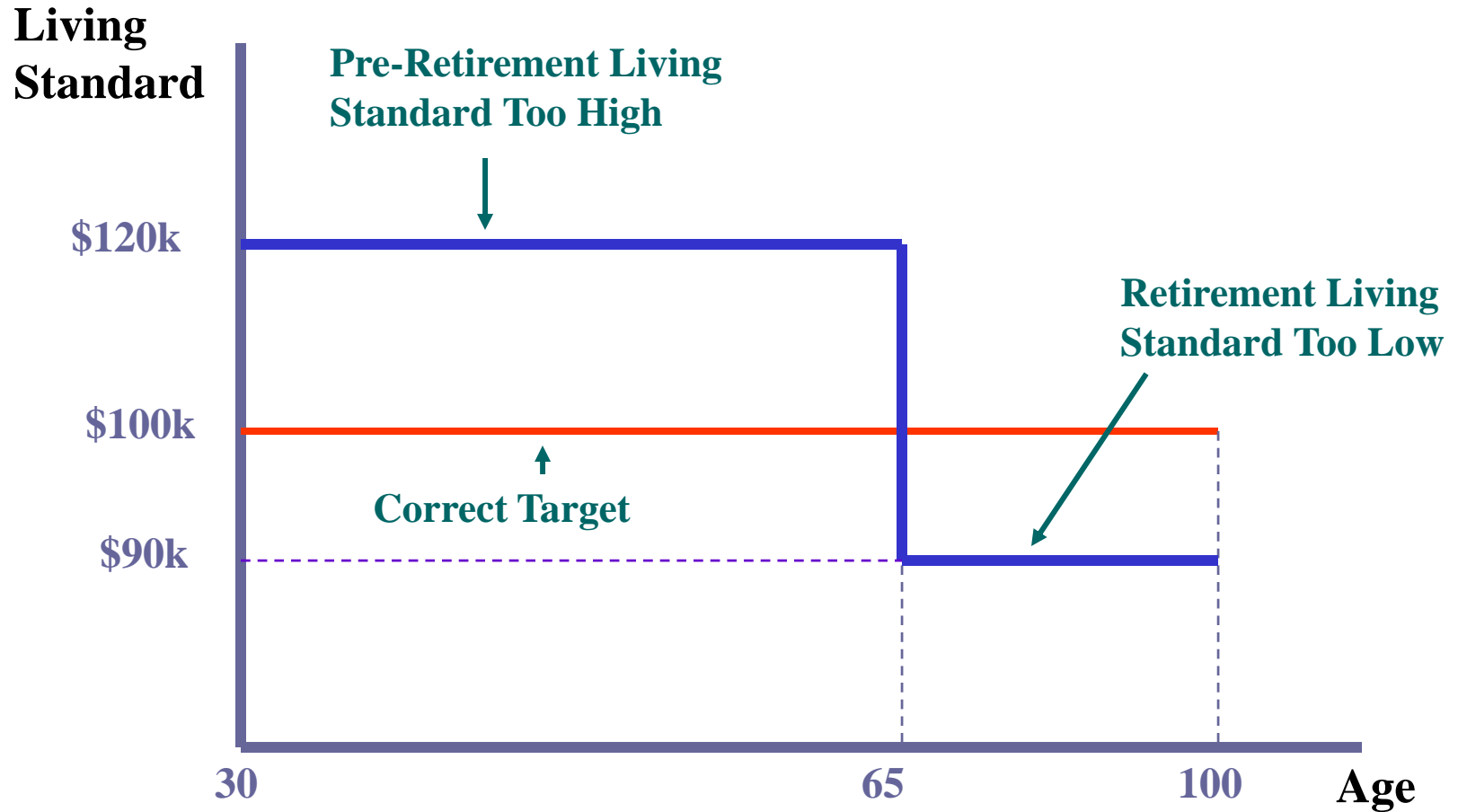
100%, 70%, or 30% of pre-retirement income?

Setting Your Own Targets is Dangerous

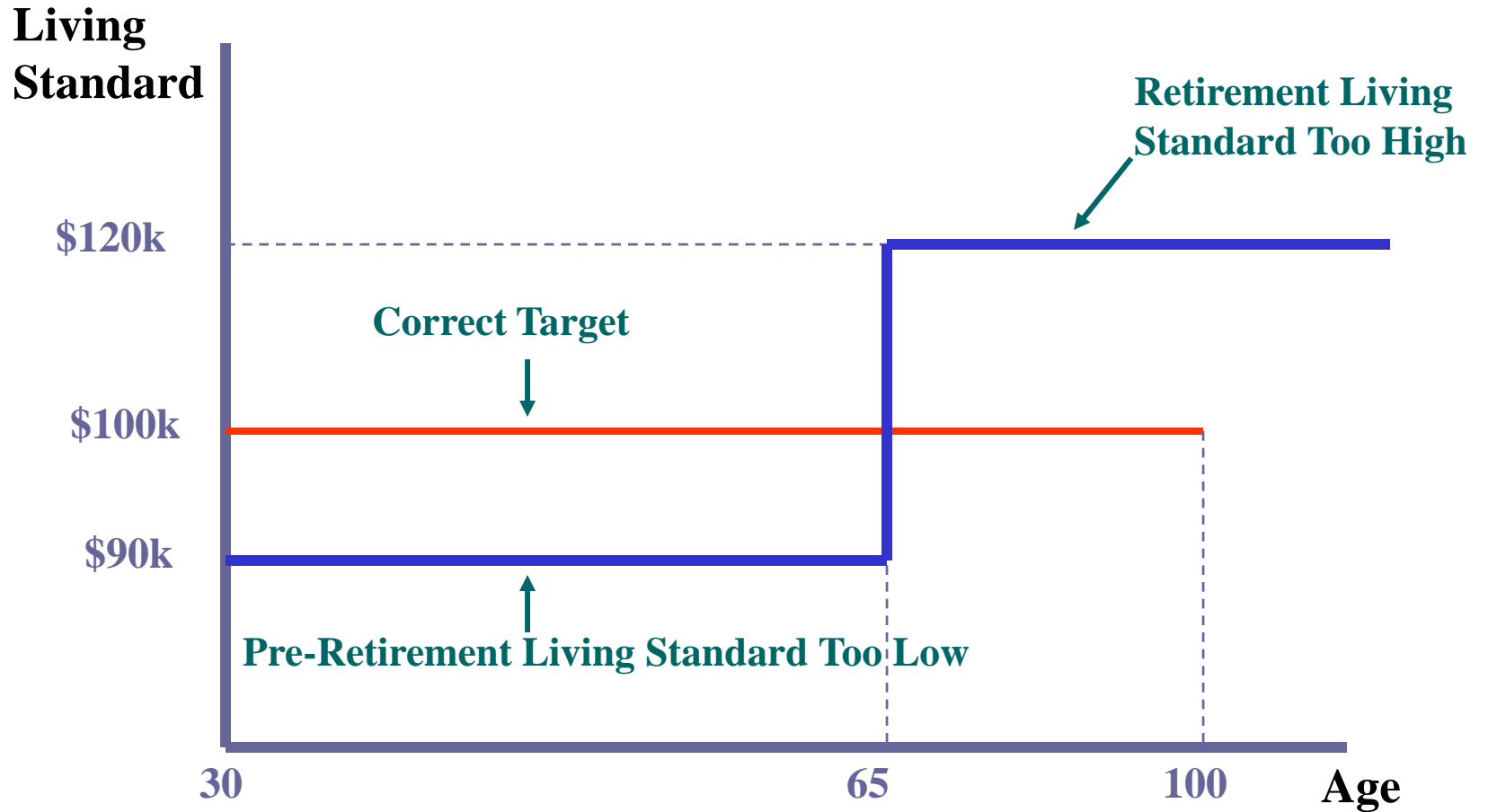
Target to spend too little → under-save, under-insure

Target to spend too much → over-save, over-insure

Retirement Spending Target Too Low



Retirement Spending Target Too High



Even Small Targeting Mistakes

- Major Consumption Disruption
- Very Bad Saving Advice
- Very Bad Insurance Advice
- Very Bad Investment Advice

Finding the Right Target On One's
Own is Impossible.

Factors to Consider

Wages

Special Expenditures

Estate Plans

Regular Assets

Retirement Accounts

Primary Home

Changes in Primary Home

Real Estate

Pensions

Reserve Fund

Changes in Social Security

Contingent Plans

Self-Employment Earnings

Special Receipts

Life Insurance Holdings

Current Saving

Retirement Contributions

Vacation Home

Changes in Vacation Home

Retirement Account Annuitization Plans

Annuities

Changes in Taxes

Portfolio Allocations

Economic and Demographic Assumptions

Tax and Social Security Provisions

TAX CALCULATIONS

Federal Income Tax
State Income Taxes
FICA
EITC
Exemptions
Child Tax Credit
Saver Credit
Alternate Minimum Tax
Standard Deduction Decision
Retirement Account Taxation
Real Estate Depreciation
Capital Gains and Dividend Taxes
Sales of Homes

SOCIAL SECURITY CALCULATIONS

Retiree
Survivor
Parent
Spousal
Child
Divorcee
Family Benefit Maximums
Earnings History
Earnings Test
Early Retirement Reductions
Delayed Retirement Credit
Re-computation of Benefits
Offset and Windfall Elimination

How Economics-Based Planning Can Safely Raise Your Clients' Living Standards

Illustration Based on
ESPlannerPRO

Available at www.esplanner.com

Maximizing your Clients' Living Standards

Let's begin with a middle-aged couple, Jack and Jill Sprat.

Basic Profile

Jack is 51, Jill is 49

Their children have already graduated from college.

Housing: 25 years remain on mortgage; \$350K value and balance; \$2K property tax; \$1.5K insurance; monthly pmt: \$2255 (Last house payment is year 2033).

Retirement Dates: Jack 65, Jill 63 (year 2023)

Income Jack: 130K in today's dollars, steady through age 65

Income Jill: 100K in today's dollars, steady through age 63

401(k) Contributions Jack: 3K / Employer 3K

401(k) Contributions Jill: 3K / Employer 3K

401(k) Retirement Balance Jack: 500K

401(k) Retirement Balance Jill: 500K

Inflation is set at 3%.

Nominal return on retirement assets: 6%

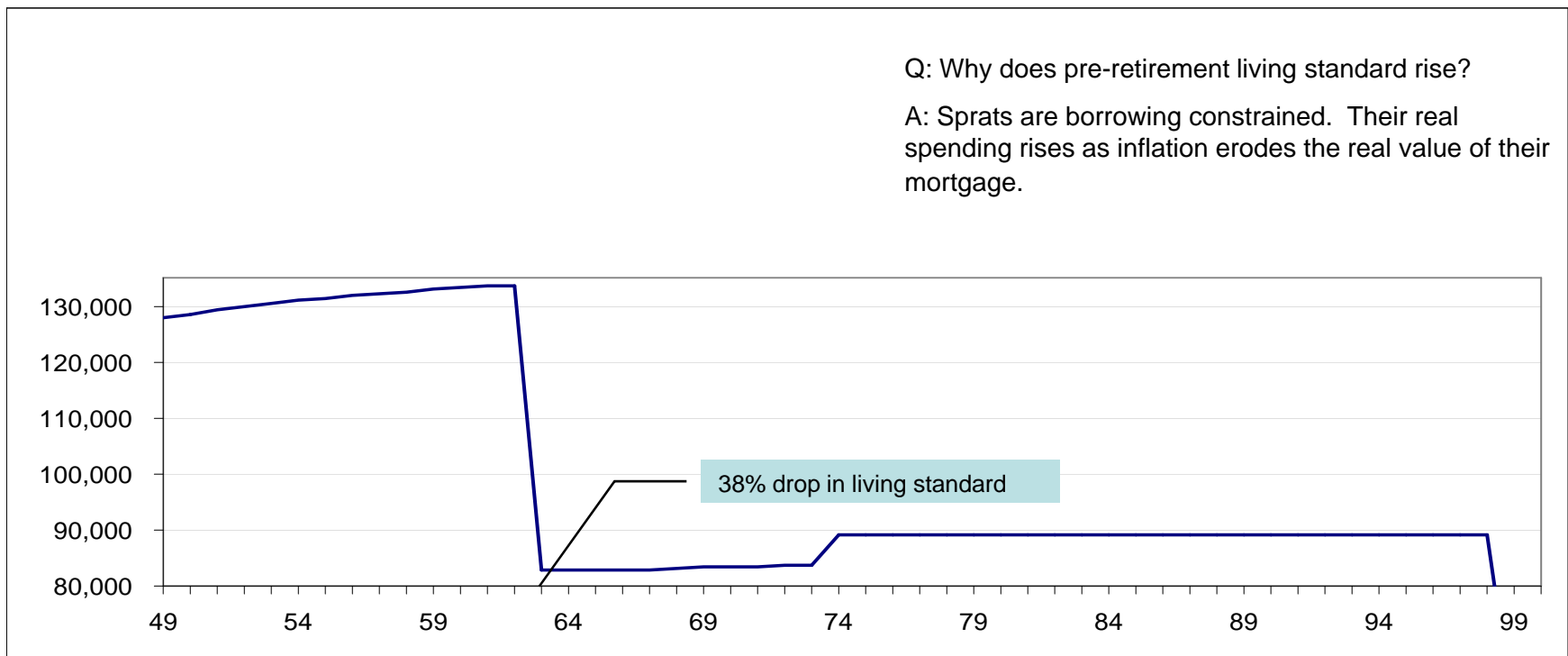
Nominal return on regular assets: 5%

Tax Tables: Michigan

The Implications of Not Saving

If the Sprats don't save beyond contributing to their 401(k)s, their living standard plunges 38% at retirement.

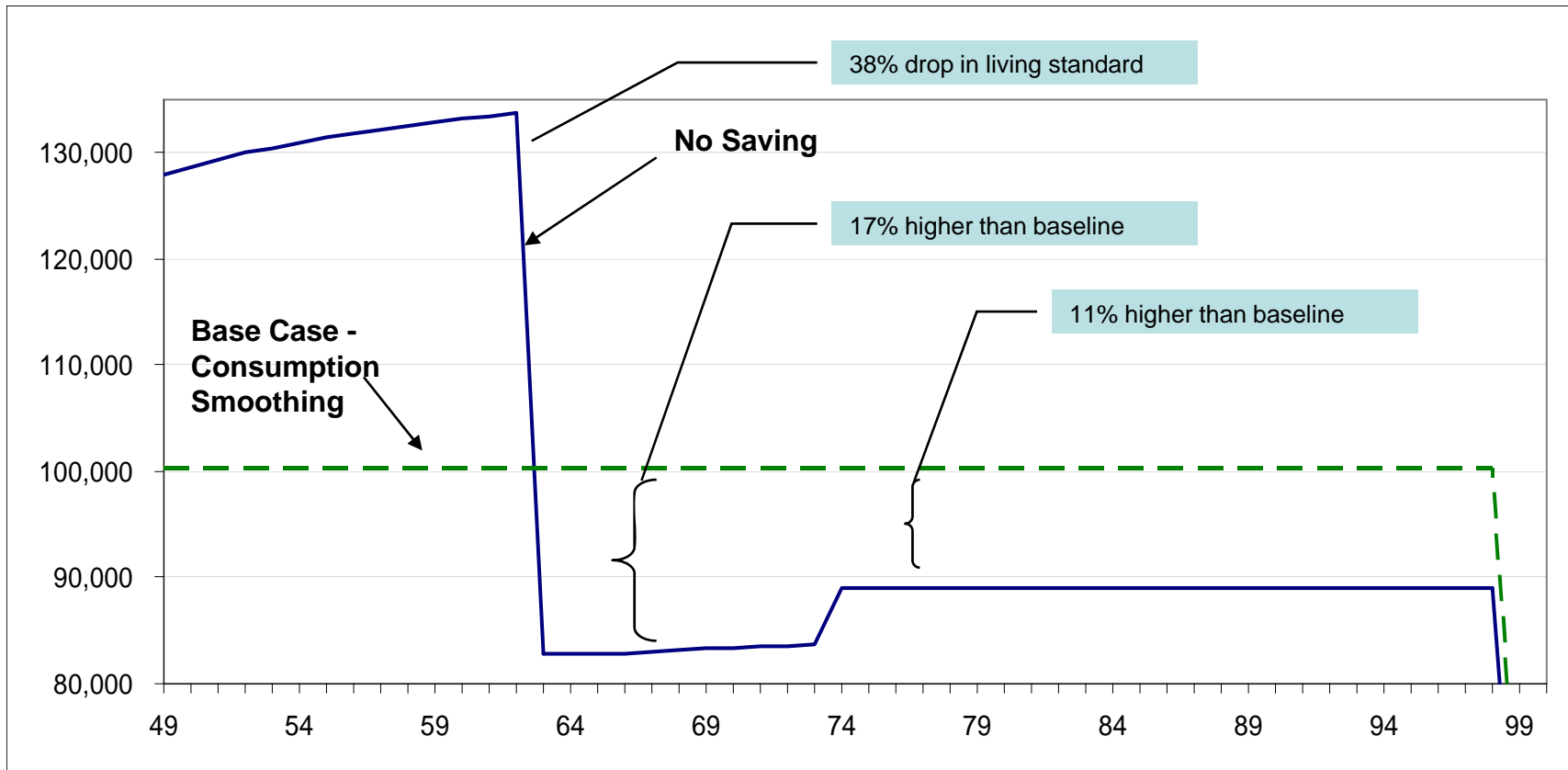
The Living Standard Implications of Not Saving



Consumption Smoothing

Their living standard is now stable. They spend less when young, but more when old.

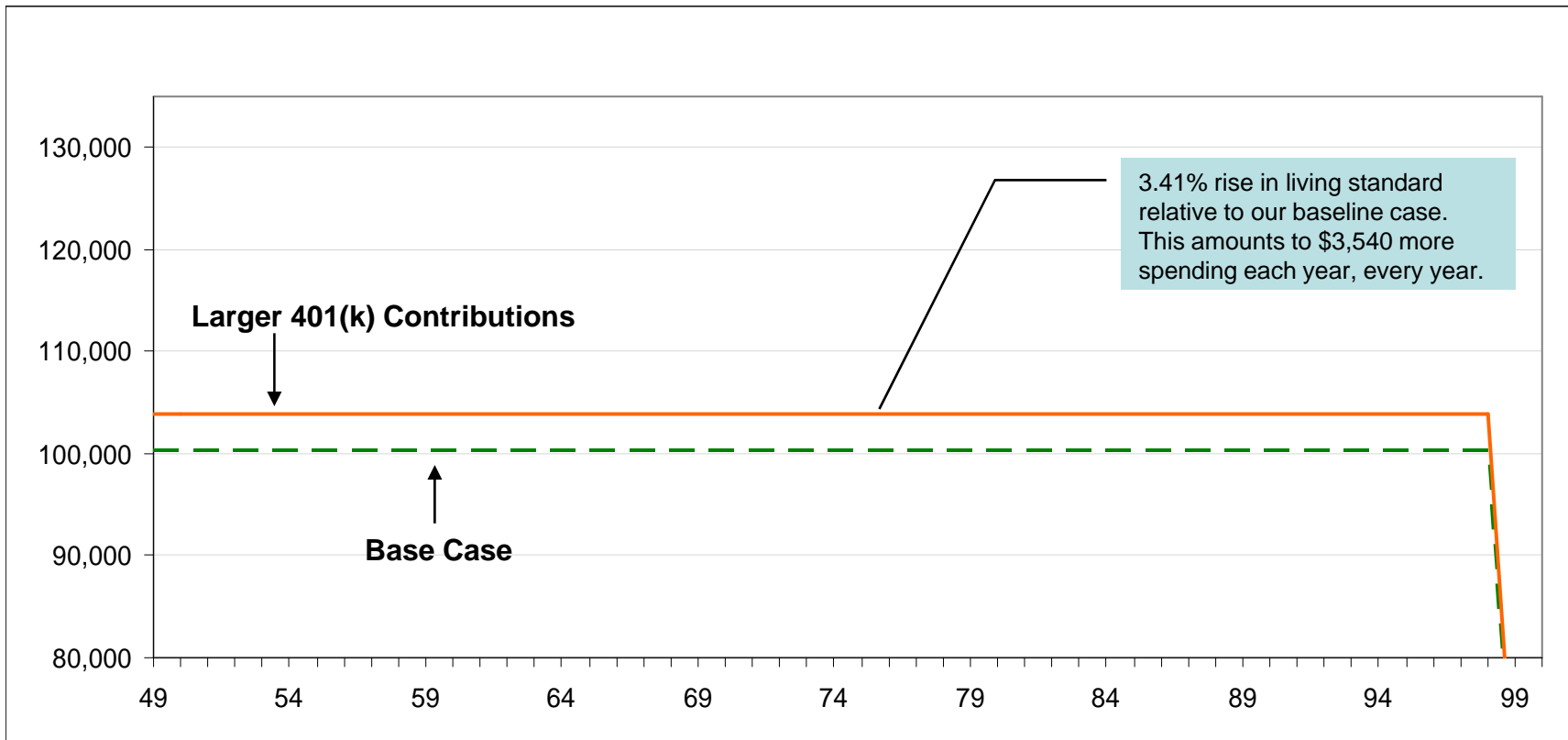
Achieving a Stable Living Standard



Raising the Sprats' Living Standard – Larger 401(k) Contributions!

Here the Sprats contribute an extra \$9,000 each to their 401(k). This raises their lifetime living standard 3.41% above our baseline consumption-smoothing case.

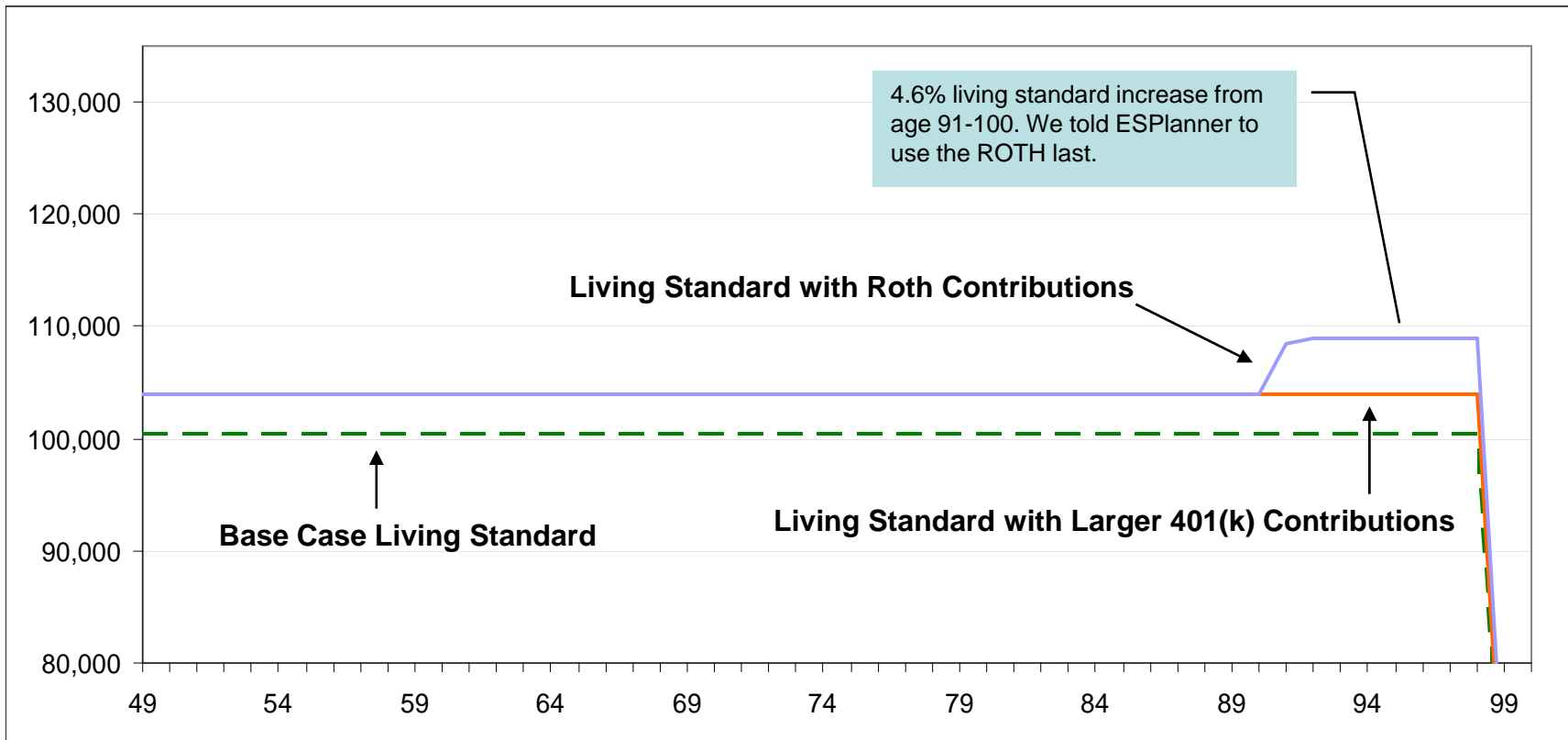
Contributing More to a 401(k)



Would Contributing the \$9K Each to a Roth Be Even Better?

The living standard difference is slightly higher except at the very end of life. But using a Roth hedges future increases in tax rates.

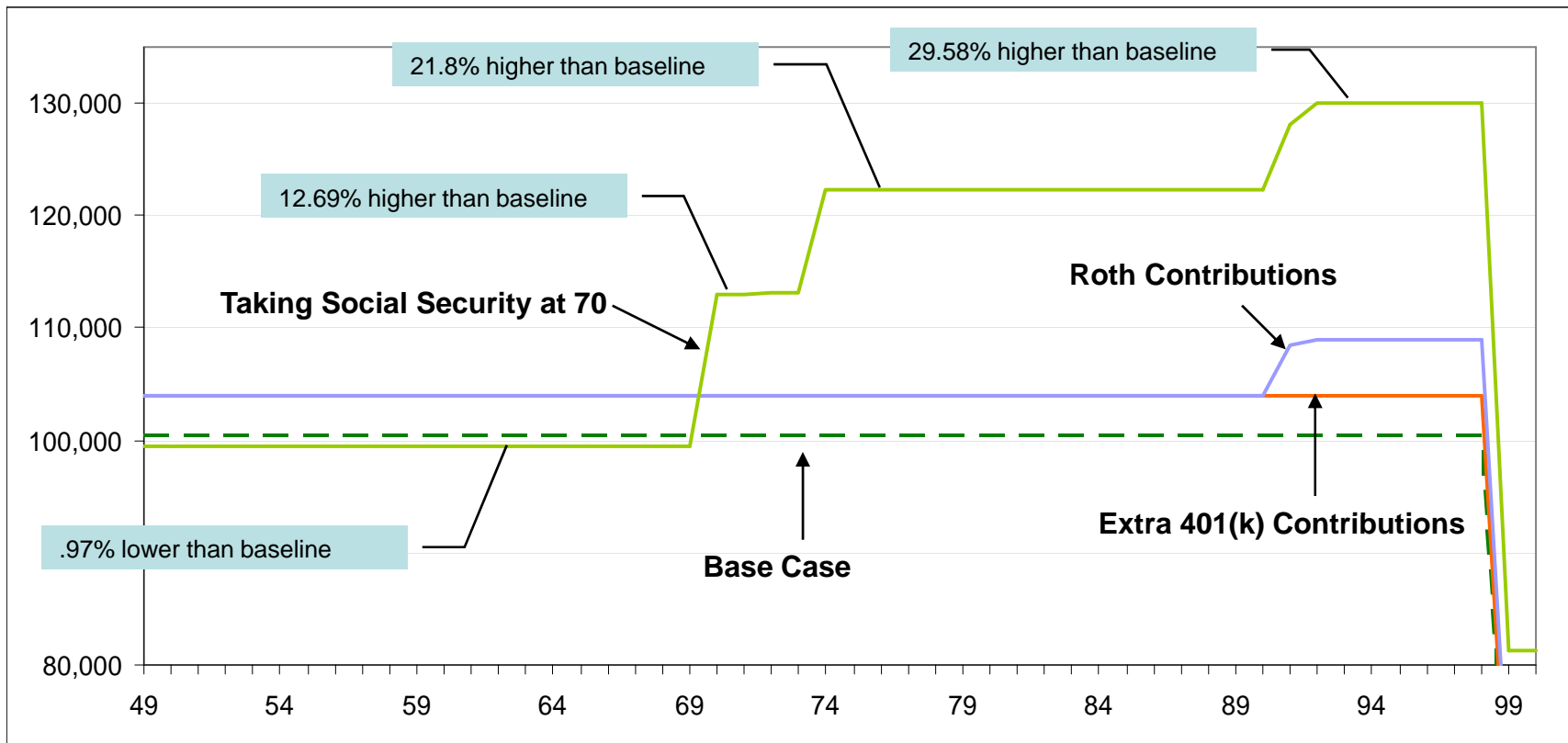
Contributing the \$9K Each to a Roth



Taking Social Security at Age 70

By collecting at age 70, the Sprats raise their living standard dramatically after age 70, with little sacrifice before age 70 thanks, in large part, to Jill's receiving free spousal benefits.

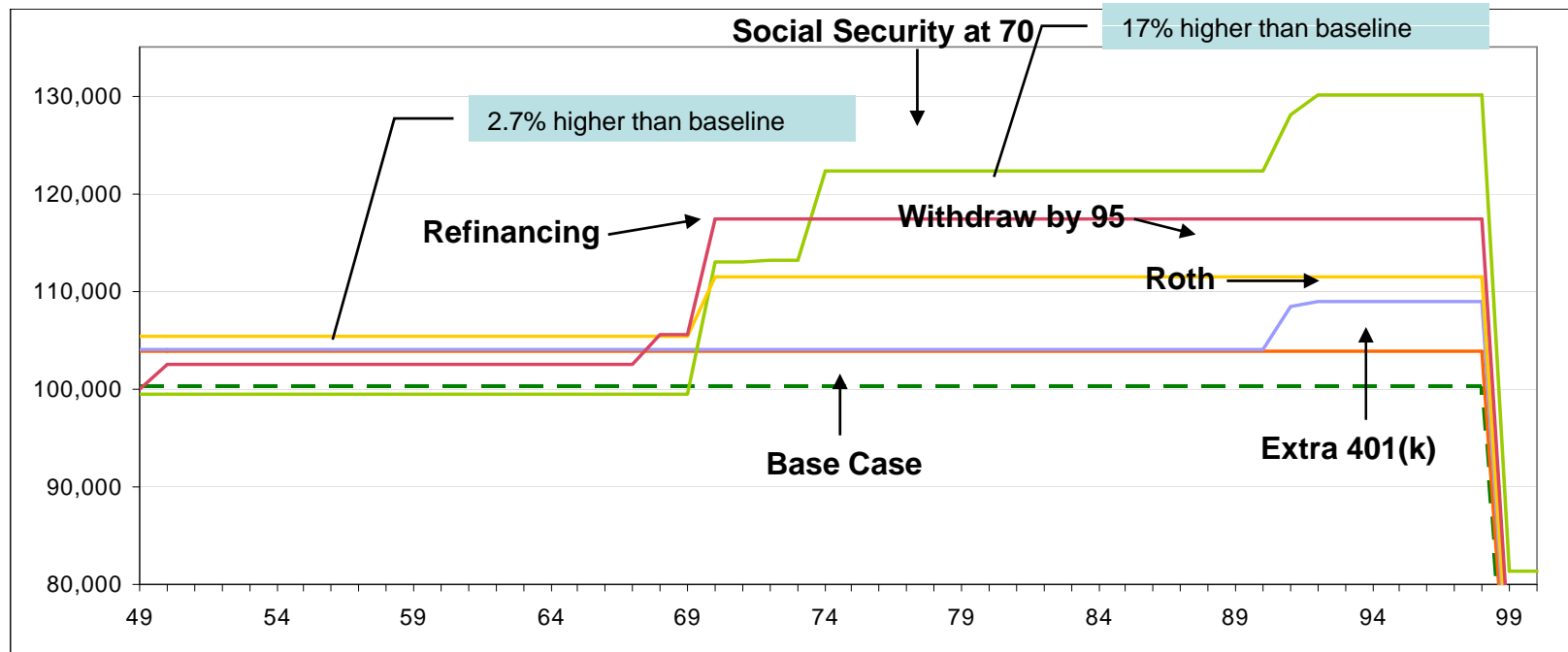
The Living Standard Gains to Delaying Social Security Collection



Refinancing the Sprat's Mortgage

Refinancing by paying points to get a low rate raises the Sprat's living standard by 2.7% before retirement and 17 percent after relative to the base case.

Refinancing the Sprat's Mortgage Can Matter



Economics Approach to Evaluating Risky Investments

The Living Standard Risk-Reward Diagram for a Single Age-60 Individual with \$1 Million Invested Solely in Stock.

