Motley Fool's *Rule Your Retirement* Newsletter

5 Retirement Myths ... Debunked!

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Do expenses really go down in retirement? Does owning a home make sense? Can you safely live off 4% of your portfolio each year? We question these and other retirement rules of thumb. Also, retirement account contributions are going up next year, and Alison shares your moving and homebuying/selling advice.

Alison Southwick: This is *Motley Fool Answers*. I'm Alison Southwick and I'm joined, as always, by Robert Brokamp, personal finance expert here at The Motley Fool.

Robert Brokamp: Hi, everybody.

Southwick: In this week's episode of *Motley Fool Answers*, we're going to tackle five money myths with the help of Maurie Backman. She is a writer for Fool.com. I'm also going to share your advice that you sent in for moving, buying, and selling a home. All that and more on this week's episode of *Motley Fool Answers*.

Southwick: Hey, Bro, what's up?

Brokamp: Well, Alison, as I did last week I'm going to highlight three news items, this time, plus one weird fun fact, although this one is weirder and maybe a little sad. Are you ready?

Southwick: Sad facts with Robert Brokamp.

Brokamp: You've got that to look forward to.

Southwick: Here we go. Number one! The IRS announces the retirement account contribution limits for 2019. In our October 17 episode, when we had Megan Brinsfield, one of our Foolish CPAs here, we had mentioned that a few experts were predicting that retirement limits would go up next year. Well, on November 1 the IRS made it official.

So the contribution limits -- IRAs will go up for the first time in six years, increasing from $5,500 a year to $6,000, and then the so-called catch-up contribution for workers 50 and older will remain at $1,000. So for 401(k)s, 403(b)s, most types of 457s and the federal Thrift Savings Plan, that limit will also go up. That's going up $500 to a total of $19,000 and the 50-and-older catch-up contribution remains at $6,000.

And a note to all my fellow babies of 1969, like me who will be turning 50 next year...

Southwick: Aw!

Brokamp: ...you don't have to wait until you turn 50. You can start on January 1. You just have to be 50 by December 31 to be putting that extra money into your retirement accounts.

Also next year, the income limits that determine whether you can contribute to a Roth are going up. They're going up $2,000 for individuals, $4,000 for those who are married and filing jointly. Higher contribution limits are a good thing. It's important to remember that they have nothing to do with how much you should personally be saving for your retirement. A lot of people anchor on these and are like, "Well, if I can put that much in my IRA I'll do that and I must be doing enough." That may not be the case; so regardless of the contribution limits, get either a high-quality retirement calculator or go see a qualified financial planner to find out and make sure you're saving up for retirement.

Item number two. Morningstar releases its latest ratings on 529 college savings plans.

Southwick: Come on, Virginia! Come on, Virginia! Come on, Virginia!

Brokamp: OK, you wait. So using a process that rates plans according to five pillars (process, people, parent, price and performance), Morningstar awards each plan with an Olympic-style medal...

Southwick: Oh!

Brokamp: ...or a neutral rating or a negative rating. So of the 62 plans that they evaluated, only four took home the gold (Illinois, Virginia) ...

Southwick: Yes!

Brokamp: ...Nevada and Utah. Now I should say that those are particular plans. Many states have multiple plans, so it's the Bright Start College Savings for Illinois and Invest529 for Virginia, The Vanguard 529 for Nevada, and My529 for Utah. Nine plans were awarded silver medals. Eighteen bronze. About half won a medal. Most got neutral ratings and five got negative ratings. It's important to remember that you don't have to participate in your own state's plan.

Southwick: Come to Virginia!

Brokamp: You can come to Virginia!

Southwick: It's for lovers. Of 529s.

Brokamp: That's right. Now you might get a benefit by participating in your own state's plan, often in the form of a deduction on the state income tax return, but for most people that's not a good-enough benefit to outweigh being part of a lousy plan. So go read the Morningstar report and also go visit SavingForCollege.com, which is also a great resource. Both of those will rate your state's plan. You can evaluate whether you should stick with your state or maybe move to another state.

And number three. The majority of Americans don't feel they're benefiting from the strong economy. Leading up to the midterm elections, Bankrate did a survey and asked people if they felt like they were doing better since the election of Donald Trump. Only 38% of people thought that they were doing better, 45% said they're about the same, and the rest said that they were doing worse. As you could expect, politics played a part of this, so 60% of Republicans thought they were doing better. Since Donald Trump was elected president, only 29% of Democrats believe that they're doing better.

There's definitely some evidence [why] people, despite the strong economy, may not feel like they're doing all that much better. Wages have begun moving up, but so has inflation, so while you're getting paid more, you're also spending more on various things. Also, the tax cuts were not evenly distributed. In fact, some people will hear about this new tax cut law, but in fact they're actually ending up paying more in taxes.

But what was most fascinating to me is that politics played a part in this. There is a bottom-line answer to this. You're either doing better or you are not. So hopefully if you don't really know whether you're doing better or not, figure it out. Either use something like Mint, Personal Capital, create your own spreadsheet, or something. It is important to know how your finances are doing and whether they're getting better or not.

And then finally, the fun/weird fact comes straight from a headline of *Bloomberg Businessweek*. Crash test dummies are getting fatter because we are, too.

Southwick: Oh ho ho ho!

Brokamp: It was actually a long, fascinating article about a company called Humanetics Innovative Solutions that makes crash test dummies. It turns out they're pretty pricey. They range in price from $250,000 each to $1 million.

Southwick: What?

Brokamp: Yeah! And the article went into the history of testing. So back in the '50s they would have to use cadavers or like hogs and things like that.

Southwick: Ooh!

Brokamp: Some people started to use live human test subjects until their blood vessels would burst and their eyes and stuff like that. It's a fascinating article. But the point being back in the day, they would make what would be the size of a typical man (which was 5'9" and a 172 pounds). Now the typical man is 200 pounds, so they have to make bigger crash test dummies and this relatedly comes on the heels of another report from *Scienmag* (which surprisingly is a science magazine), which highlighted a report that put a dollar figure on the cost of the US economy of excess weight. That figure -- more than $1.7 trillion according to the Milken Institute.

So in previous episodes we have discussed the evidence that healthier people actually are wealthier. So Fools, take care of yourselves, eat right, and exercise regularly and your bottom line will be better off because of it.

Southwick: Bottom line and waistline.

Brokamp: That's right.

Southwick: Why haven't we made that pun already?

Southwick: Hey, we have a special guest in the studio today. It's Maurie Backman and she is a writer for Fool.com. She's a great writer for Fool.com.

Maurie Backman: Thank you.

Brokamp: Perhaps one of my favorite writers for Fool.com.

Backman: Oh, you're too kind.

Southwick: So I often get reporters contacting me saying they saw your article, or you get quoted, so it's really great to actually meet you because we've exchanged a lot of emails.

Backman: Yes, we have.

Southwick: So it's so great to meet you in person. Thanks for coming into the studio.

Backman: Thanks for having me.

Southwick: So you are here for the Fool.com Writer's Conference. Can you tell us maybe just a little bit about your story and how you came to be a writer for Fool.com?

Backman: You know, it's funny. I was writing for a lot of different personal finance sites. I was on the job boards one day and I saw an application for a contract writer or for a freelancer for Fool.com and I said, "You know what? I'm going to apply." And it was this gauntlet of an application. You had to submit samples. You had to answer a million questions ranging from what's your favorite personal finance tip to what your biggest pet peeves are in life and I'm like, "Oh, I have so many of these."

If I'm honest, this could go very poorly or very well depending on the people reading my answers. Somehow they didn't think I was too weird, and they gave me a shot. Fast forward to today and we're rockin' it.

Southwick: I feel like that should be a motto of Motley Fool hiring. *We didn't think you were too weird.* At The Motley Fool you can never be too weird. So you've joined us today to share five retirement myths that you are on a crusade to debunk.

Backman: Yes, we're going to do some serious debunking today, folks.

Southwick: Let's get to it. The first one is that *your daily lattes will kill your retirement.*

Backman: Right. One of my favorite things is when I'm talking to people and they say, "Oh, I'm spending three bucks a day at Starbucks. I really shouldn't because if I put that money aside instead, I could retire on it." And my answer is no.

Southwick: Sorry.

Backman: No, sorry. Fifteen bucks a week, $60 a month. No. This is my take on retirement. If you're smart about saving for retirement, life's little luxuries will not get in your way from meeting your goals, so this is what I do personally. I've got a certain amount that I set aside for retirement. I aim for at least 20% of my earnings just because I know that with the way inflation is going I'm going to need some serious cash when I'm older, especially if I have health issues and all that.

So I basically put that aside from the start. And then, frankly, I don't worry about the little purchases because, hey, they're what get me through my day. My morning coffee -- you do not want to see me without my morning coffee.

Southwick: It's an investment in a happy family.

Backman: It's an investment in my ability to work and function as a human and that's the case for a lot of people, so I always say whether it's your coffee or the fact that you love buying lunch or ordering takeout, those little things aren't going to stop you from retiring if you have an overarching goal of saving for retirement and you're actually committing to it.

So the easiest thing to do, if you work for a company that has a 401(k), is just allocate enough of your paycheck to automatically land in your 401(k) before you even touch it. Before you even see that money.

Southwick: Pay yourself first. Pay your future self, first.

Backman: Exactly. Pay your old and gray self, first, and then buy your coffee.

Brokamp: Especially goals-based budgeting. As long as you figure out, "OK, this is what I need for college. For retirement. If I want to buy a house. If I set that all aside and get that out of my bank account, whatever is left over I can spend however I want."

Backman: Exactly. Obviously you have to keep in mind the bills that are going to come up. You've got your cable bill due at the end of the month. Don't overspend on coffee and then owe Cablevision. You're going to be in the red and you're going to have to pay interest on that silly bill. That's why I'm a big fan of automating your savings, because that way, like you said, you get it out of the way and then you don't have to worry about those little purchases.

Southwick: Let's move on to the second myth. *Your expenses will go down in retirement*.

Backman: Right. So a lot of people think, "OK, I'm going to retire and instead of spending what I'm spending today, my expenses are going to get cut in half." And in fact I have a relative who's close to retirement who said this to me recently. He said, "Yeah, I think I'll probably spend about half as much in retirement as I am now."

And I said, "Why?"

He said, "I won't be commuting. I won't be paying for dry cleaning."

I said, "Well, what are you paying now to commute to work and to dry clean your suits? A couple of hundred bucks a month?"

He was like, "Yeah."

I said, "Does that represent 50% of your spending?"

And he's like, "Oh, no."

The thing about retirement is that, yes, you'll kill a couple of costs. You'll kill your commuting costs and maybe some other incidentals that we all incur by having an office job to go to. I wouldn't know something about that. You guys who actually report to an office every day probably know a little more than I do.

But generally speaking, I like to tell people that you'll probably need about 70-80% of your former paycheck to cover your expenses in retirement because most of them are probably going to stay the same. You might even have some that go up, like healthcare or entertainment because when you think about it, you're not working. You don't have a job to go to. You're not going to sit in your house all day.

So that's the rule that I like to follow. The only thing that's really going to go away -- the only major expense -- is your retirement plan contribution because obviously you're not saving for retirement when you're in retirement. But when you think about the things that you're spending money on right now, there's really no reason to think that they're going to drastically drop just because you're a little bit older and not reporting into an office.

Southwick: Unless you're going to make major life decisions like downsizing or moving someplace cheaper.

Backman: And I've heard people say, "Well, what about your mortgage because you might pay it off in time for retirement?" And my answer to that is you might, but keep in mind that if you're hanging on to an older home, as that home ages, your maintenance and repair costs are going to go up. They might go up enough to offset that mortgage payment, especially if it was on the lower side. And property taxes also have a tendency to go up over time. There's that to consider, too. So don't expect to pay like 50% of what you're paying now to live just because you're old.

Southwick: How often do you have the random relative or uncle or friend coming up to you and offering their thoughts on their own retirement and then you have to be like, "Well, actually..." Does it happen a lot?

Backman: Pretty often. And I feel bad because basically my family members call me the "dream dasher."

Southwick: Oh!

Backman: I'm that person who dashes dreams, but I'd rather give someone a reality check than have to help them pay for their nursing home.

Southwick: That's true.

Brokamp: *The Wall Street Journal* recently published the results of a study from Dan Ariely and Aline Holzwarth who work at the Center for Advanced Hindsight at Duke University.

Southwick: Advanced hindsight.

Brokamp: I'm going to summarize it very basically. They asked people how much of your pre-retirement income are you going to need in retirement and most people thought 70-80%. And then when they asked another group to actually break it out into specific categories, some groups had as much 130% because, as one quote in the article said, working is a very cheap activity. And once you stop working you start doing all these things that you've always wanted to do and it turned out you spend much more, at least in the first five to 10 years of retirement.

So the bottom line is you have to figure out what your situation is and what you're really planning to do in retirement before you just rely on a rule of thumb.

Southwick: The next myth. *Social Security will cover the bills in retirement*.

Backman: It won't.

Southwick: Oh!

Backman: No, no.

Brokamp: That's all you need to say. It won't!

Southwick: Next!

Backman: Next! And it's not because Social Security is going away. Let's debunk that, too, while we're here for a second. Yes, there are talks of future benefits cuts if things continue to go the way they're going. Generally speaking, we will have Social Security down the line, but the thing that a lot of people need to realize is that those benefits are only designed to replace roughly 40% of the average earner's pre-retirement income.

And that means, first of all, that if you are a higher earner, that it will replace even less. So we just talked about the fact that as a rule of thumb, you want the 70-80% replacement target. Social Security, then, if you were an average earner, will maybe cover half of that, so the other half is going to have to come from somewhere, whether it's your retirement savings in an IRA or a 401(k). Maybe you're lucky enough to have a pension. Maybe you're going to work. Maybe you're going to be a killer landlord and rent out different rooms in your house and take in income that way.

And that's all fine. It doesn't have to come from a single source, but I think the key is to be realistic about what Social Security will and won't pay for.

Brokamp: I mean, the average benefit this year is $17,000.

Backman: Right.

Brokamp: So Social Security is basically poverty protection.

Backman: Right.

Brokamp: It's just enough to keep you out of being homeless and without any food, but it's not enough to pay for the retirement that most people want.

Backman: Exactly.

Southwick: Number four. *Owning a home makes more sense than renting -- in retirement or otherwise*.

Backman: I think that's something that's not necessarily true in life and in retirement -- for working people and your retirement. I'm not a fan of owning a home in retirement and here's why. For a lot of people, once they retire they move over to a fixed income where basically you're living on your Social Security payments and whatever withdrawal you're taking from your IRA or whatever it is.

And when you own a home, you introduce a world of variable expenses into your budget. You never know when your roof might spring a leak, or your air conditioning unit might bust. And so suddenly you've got this mismatch where you've got a fixed income and you've got all of these variable costs.

So to me, renting is a safer prospect in retirement. Unless you have a compelling reason to own your home, renting is a safer prospect because you're basically, at least for the term of your lease, locking in a fixed payment. You're saying, "OK, this is what I'm committing to month after month and I don't have to worry about surprises."

Southwick: But you could, as you're entering retirement, sell your home and then you would have all that equity that you would then burn through and rent going into retirement. Or through your retirement?

Backman: Yes, there's lots of options to play around with. Selling a home prior to retirement is a good way to generate a lump sum of cash that you could then, if you invest wisely, use as an ongoing income stream itself.

I want to be clear on this one. It isn't to say that owning a home in retirement is always a bad idea. It's just not always a good idea especially in light of recent tax changes. When you think about the tax benefits of owning a home; a lot of those are at least, right now, are not as strong. They're not as compelling. A lot of people aren't going to be itemizing now that the standard deduction is what it is. It's so much higher.

That mortgage interest deduction is a big tax break that a lot of people aren't going to take anymore, so you lose one very compelling reason, right there, to own a home in general; and then especially in retirement when it's just a financially precarious period in your life.

Southwick: Number five -- our fifth and final myth we're going to debunk today. *You can plan on withdrawing 4% of your nest egg annually in retirement.*

Backman: That's classically been the convention. The "4% Rule" was invented -- or initiated, instituted, or whatever you want to call it -- back in the mid '90s and it basically states that if you begin by withdrawing 4% of your nest egg value during year one of retirement and adjust subsequent withdrawals for inflation, your nest egg should conceivably last you for 30 years. And while I think it's a good baseline to follow, I don't necessarily think that we should be following it to the letter, and here's why.

Back when that rule was established, first of all, we were in a very different interest rate environment when it came to bonds, and now we are not in that sort of environment. So if you have a portfolio that's reasonably loaded with bonds (let's say anywhere from 40-60% bonds, which is the general recommendation), you're not going to be generating the same sort of income from those bonds as you were back then. And that's obviously going to limit the extent to which you can withdraw that aggressively.

The other thing is that the rule makes a lot of assumptions. It does assume a fairly even split on stocks and bonds which not everybody has. It assumes that you didn't retire on the really early side. People are living longer these days. The Social Security Administration says that, I think, about 25% of 65-year-olds will live past 90. So if you retired at 55, which some people are doing, all of a sudden you've got a little bit of a shortfall, there, if you start withdrawing at 4%. So I would say use it as a guideline but be careful with it.

Brokamp: It originally came out, as you pointed out, in a study in the mid-'90s from

Bill Bengen. In subsequent studies that he came out with, he actually moved it up to 4.5%. And he recently moderated a Reddit discussion and said, "I still stand by 4.5%." But he recognizes and values the research from other folks (from people like Wade Pfau) who say, "No, it really should be closer to like 3% because, like you said, very low interest rates, high stock valuations."

Really the bottom line is to choose something that is within that range and be prepared to be flexible, because regardless of where you start, the research shows that one of the best things you can do is if the market does go down, or you don't get from bonds what you were hoping, that you can cut back on your spending during those tough times and then wait until your portfolio recovers. If you can do that, whether you choose 3%, 3.5%, 4%, or 4.5% is less important than your ability to cut back when the market is down.