

# Planning for a Successful Retirement Journey

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s a local government manager, you know the importance of saving for your retirement future. In fact, many managers already have started their retirement journey by contributing to an IRS Section 457 supplemental retirement plan. But how do you know if you are saving enough?

There is no right answer. Many experts estimate, however, that your annual income should equal about 70 percent of your preretirement annual income to maintain the same standard of living. Like any trip, your retirement journey requires careful planning. Developing a long-term strategy and sticking to it lets you smooth the ups and downs you will encounter along the way.

Part of planning for your trip is deciding how and where to invest your retirement money. This is known as asset allocation. Whether your retirement is 30 years or 30 months away, an asset allocation strategy is needed that can help ensure that you meet your retirement objectives.

## **The High Road and the Low Road: Risk Versus Reward**

There always is some risk associated with investing. But investing wisely means managing risk so that you will be comfortable while meeting your investment objectives.

Understanding risk is vital to investing retirement funds successfully. What exactly is risk? Often, it is defined as the possibility that the value of your savings will fail to increase or will actually go down, or that an investment will not meet your expectations of performance. This can

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**Cynthia A. Hargadon**

happen for a number of reasons—a lack of knowledge about an investment, a failure to outpace inflation, unfavorable business conditions, and fluctuations in the stock and bond markets.

The risks an investor should consider are:

**Inflation Risk.** Inflation risk sometimes is called purchasing-power risk because inflation reduces what your money can buy. If your investments consistently earn less than inflation, you actually are losing money. The only way to get ahead is for your investments to outpace inflation over time.

**Interest-Rate Risk.** Changes in interest rates can change the value of such marketable fixed-income investments as bonds. Bond prices are related closely to interest rates. When interest rates rise, bond prices drop, and vice versa. For example, you purchase a bond for \$1,000 that pays 6 percent interest and matures in 30 years. Suppose you decide to sell the bond after only 10 years, and at that time, interest rates on new loans are 9 percent. A smart investor will not pay \$1,000 for your bond at 6 percent when he or she can get money paying 9 percent elsewhere. You will need to drop the price of your bond to induce someone to buy one with a rate of return lower than the going rate.

**Market Risk.** Stock and bond markets can be affected by factors unrelated to the economy or to the value of a particular company. Political development, investment fads, or investor reactions to recent news can cause temporary or even long-term effects on the market.

**Issue-Specific Risk.** Issue-specific risk, as its name implies, involves occurrences that affect only a particular investment. If you own shares in a company whose only factory burns

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down, for example, the ensuing decline in share price is an event that is specific only to this company and one that puts your money at risk.

Risk and reward go hand in hand. A higher-risk investment usually has a higher potential for greater reward. Your challenge is to set realistic financial goals that can be met with the level of overall risk you are willing to accept. One of the best ways to moderate risk is to diversify your investments. By allocating your savings among investments with different levels and types of risk, you can spread the risk yet obtain returns that are consistent with your retirement goals.

### Choosing a Path

When you invest in a retirement plan, you often have the opportunity

to choose among investment options and judge the risk inherent in each. The amount of risk you accept has a lot to do with your emotional makeup, but your age, financial situation, and future plans also should be taken into consideration. Although the fear of losing money may prevent you from making catastrophic investment blunders, it also may prevent you from making advantageous decisions about your retirement investments. Knowing your investor type can help you make informed decisions about where to invest.

Most people, based on their comfort level with risk, fall into three basic investor categories—aggressive, moderate, or conservative. You may have a pretty good idea of your investor category.

**Aggressive Investors.** “It’s only money. Nothing ventured, nothing gained. People spend too much time worrying about what they might lose instead of concentrating on how to get the biggest gains. You have to take chances to get ahead.”

Aggressive investors like to manage their money and seek investments that have the potential for high returns. They are willing to accept occasional losses in exchange for potentially greater rewards. Usually, these investors have prior investment experience and are in their peak earning years, or are young people with higher earnings potential and time to ride out the cyclical ups and downs of the financial market. Typically, such investors will own a portfolio invested primarily in equities, which likely will include such growth stocks and other more adventurous investments as limited partnerships, precious metals, and the like.

**Moderate Investors.** “I want my money to be relatively secure, but I also want to beat inflation and get ahead for the future. I know this

means I have to take some risk. I might lose a little now and then, but in the long run, I want to be ahead of the game because I took a few calculated chances.”

Moderate investors seek investments that allow them to generate a high level of income (earnings on their initial investment), with some fluctuation in the value of their portfolio. Over the long term, they expect growth from a combination of capital appreciation and reinvestment of income. Moderate investors may invest in intermediate- or longer-term bond funds and balanced funds that hold a mix of stocks, bonds, and cash.

**Conservative Investors.** “I don’t want to take chances with my money. I worked hard for it, and I don’t want to lose a penny. I want the safest investments I can find, even if the return is less than I would get from other investments. Safety means that much to me.”

Conservative investors seek steady current income and a high level of safety for their principal, with minimal or no fluctuation in value. Conservative investors usually have limited capital, lack investing experience, or are retired. They may choose funds that invest in U.S. Treasury securities, investment contracts, or cash.

Although it is important to be

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comfortable with your investments, it also is important to understand the consequences of your investment choices. Conservative investors may be happy with the “safest” investments, but if they are not aware of inflation risk or interest-rate risk, they may be unhappy with the results years from now. Moderate and aggressive investors also may be satisfied, but they too may be surprised by the risks they have taken when the results are finally in.

**Not Everyone Takes the Same Road**

An investment program should be designed to meet your individual needs. The investment choices a person makes should take into account the amount of time until retirement and how retirement-plan assets fit into the total plan for retirement savings. You need to assess your total financial condition, including the value of your home, money market funds, savings accounts, insurance policies, and other securities.

There are as many investment strategies as there are investors. The basic investor profiles depicted in the accompanying pie charts show how to develop an investment mix. A Section 457 deferred-compensation retirement plan makes a wide variety of investment options available. Most investment professionals agree that allocating investments among several fund types (stocks, bonds, investment contracts, and so on) provides the investor with greater diversification, stabler returns, and better long-term performance. This strategy also reduces an investor’s susceptibility to the risk factors described earlier. (The profiles shown on this page are for illustrative purposes only and are not intended as investment advice.)

Your financial needs are unique; you should consider your situation carefully. Before making any investment decision, carefully read the prospectus and any other disclosure materials. If more personal planning assistance is needed, seek out a certified financial planner, accountant, attorney, or other qualified individual. **ICMA**

*Cynthia A. Hargadon is chief investment officer of the ICMA Retirement Corporation, Washington, D.C. The ICMA Retirement Corporation will conduct a preretirement planning session at the 1993 Annual Conference in Nashville/Davidson County, Tennessee.*

