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MARKET MATTERS: What's your funding ratio?

Joseph Matthews

Those entrusted with managing municipal pension funds — like the ones paid to our local firefighters, police officers and other municipal workers — should pay careful attention to funding ratios. This ratio tells the trustees what percentage of expected future payments can be satisfied by the portfolio's current assets coupled with an estimated rate of return on those assets.

This ratio also applies to individuals and individual retirement funds. Have you taken the time to calculate yours?

As investors, we all make decisions — through action or inaction — that may greatly impact our future. Many of us have spent countless hours visualizing how we'd like our retirement years to look. Do your dreams involve warm weather and golf? Extensive traveling? Spending as much time with your grandchildren as possible? Writing the book you always wanted to write?

Regardless of when you would like to retire, and regardless of how you would like to spend your retirement years, it is critical to gain an understanding of the success probability of achieving your goals. Taking time to understand the following considerations can help you determine if you are on the right path to achieving your retirement goals. A financial adviser can also help you develop a snapshot of where you are — and offer suggestions to keep you on the path toward achieving your goals.

A recent survey shows that a major retirement concern among individuals is outliving their money. With life expectancies getting longer — coupled with the increasing cost of health care for those in their golden years — many retirees will face significantly greater expenses than in previous generations.

As an example, a 65-year old individual retiring in 2016 can expect $4,660 of health care expenses during the first year of retirement. Using a prudent assumption of 7 percent annual growth in the cost of health care, that same individual at age 85 can expect health care costs of over $18,000 by 2036. With a recent study showing a nearly 50 percent chance that one member of a 65-year-old couple will live to age 90, a 30-plus-year retirement is becoming more of a reality for all of us. That means that most Americans, with an average 401(k) balance of $96,288, have considerable work to do to.

So what do you do if your funding ratio is below a level acceptable to you?

I believe the first step is to consider increasing the amount of your salary you are putting into a retirement plan. For those already maxing out retirement plan contributions, other types of savings can be increased. While both of these changes may cause some short-term financial discomfort by reducing your current spending capability, they can pay off in the long run.

Another strategy involves pushing the date of retirement farther into the future. This can allow your retirement plan to continue to grow through additional contributions and accumulated profits. An additional bonus to working extra years would be an increased Social Security benefit. For an individual born in 1954 who is eligible to receive the maximum benefit, the difference between claiming benefits at age 62 and at age 70 is significant.

For most of us, changing our lifestyle in retirement by reducing spending and lifestyle downsizing is the least desirable step.

Greater savings, retiring at an older age and being mindful of how we invest for retirement can go a long way toward living comfortably in retirement. That being said — it sure is hard to ignore the financial elephant in the room. Historically low interest rates have thrown a wrench into many investors' plans for retirement. And with that, I have seen that many investors have become overly aggressive in their portfolios — or even overly conservative. With too much money in money markets and short-term investments, and by overreacting to short-term volatility in their portfolios, they may be undermining their chances of achieving their long-term goals.

As Tolstoy famously wrote in "War and Peace," the two strongest warriors are time and patience. Concerning your investments, these warriors can become your greatest allies if your portfolio is properly allocated to reflect your investment goals and your ability to tolerate risk.

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