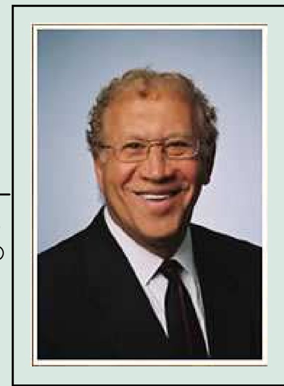
In the Press

Webb Financial Group, LLC

Jerry Webb
CFP®



Financial Myths: What You *Think* You Know Can Hurt You

October 2005

A major financial decision can be an expensive mistake if made on the basis of sketchy facts or outright error. Here are a few of the common mistaken ideas about finances:

Myth: I don't earn enough to save any money.

Fact: Eva Rosenberg, a Northridge, Calif.-based tax advisor, calls this the No. 1 myth about saving and investing. It's true for a few people—those with little or no earnings and high expenses that they simply cannot avoid—but many more people mistakenly believe that it applies to them. As Rosenberg points out, saving is not difficult as long as you learn to do so early, as soon as you start earning money. "It only takes a little, consistent amount set aside each month to start building a decent nest egg," she says.

Myth: You have to have a high income to retire rich.

Fact: This is the mistake of confusing income with wealth. Income is what you take in. Wealth is what you keep. It is easier to get rich with a high income, but it's hardly assured. You can spend everything you earn and end up with nothing, whether your annual income is $10,000 or $1 million. By the same token, it's harder but not impossible to build up a small fortune from a modest income. It can be done if you start saving early, keep saving and always live below your means.

Myth: Bonds are less risky than stocks.

Fact: They are safe and appropriate as a source of near-term income, but they can fall steeply in value over the long run, whereas well-diversified stock holdings almost always come out ahead of other investments (and inflation) if held for 20 or 30 years. So it's obvious that bonds don't make much sense for the retirement funds of

younger workers. What’s less obvious is that they can be problematic for retirees, too.

Jerry Webb, a certified financial planner in Bloomington, Minn., says people tend to put too much of their wealth into bonds too early when they retire. He says people hitting their mid-60s should be looking ahead to a long retirement, since it’s increasingly likely that they will have one. They have to plan for 30 years from now, with the possibility of high inflation and rising interest rates (both bad for bonds) in between.

“Because people are living longer, they’ll need stocks,” says Webb. He says stock mutual funds can also produce income as well as bonds do, through automatic withdrawal plans that draw a preset amount regularly—such as every month—from the fund account.

Myth: Living expenses will fall sharply in retirement.

Fact: An old rule of thumb in financial planning says costs after retirement will be some percentage (usually around 75 percent) of what they were when the retiree was still working. But expenses in any individual case may differ greatly—and to the upside.

Webb says people tend to underestimate their post-retirement costs, and his view is backed up by results of the annual Retirement Confidence Survey by the Employee Benefits Research Institute (EBRI). In a 2005 survey, 59 percent of the workers surveyed said they expected to need 70 percent or less of their pre-retirement income when they retired. Among retirees, 61 percent said they need 70 percent or more. More than half—52 percent—said they needed 95 percent or more, and 14 percent said their expenses rose.

Costs of employment (such as work clothes, commuting costs and the Social Security payroll tax) do go down. But retirees may spend more on travel, hobbies and other recreation they have deferred. Health costs also may rise. The shaky state of some pensions and retiree health coverage may lead to further expenses down the road. The smart move is to ignore rule-of-thumb numbers, assess your own budget and decide what you want to do in retirement. Then figure out what all your plans will cost.

Myth: I’ll work up to my full retirement age.

Fact: The EBRI’s Retirement Confidence Survey consistently finds that workers tend to think they will retire later than they actually do. On average, workers say they plan to retire at 65. Among current retirees, the average retirement age was 62. The EBRI says its survey has found that four in 10 retirees leave the workforce earlier than planned. And the move is not always voluntary. Often job loss or health problems are to blame.

The EBRI also has found that workers have trouble identifying the age at which they will get full Social Security retirement benefits (it is gradually being hiked to 67). Half the workers in the 2005 survey said they would be eligible for full benefits sooner than they actually will.

Myth: Buying a home is always better than renting.

Fact: Residential real estate always goes up in price—except when it doesn't. And what about the mortgage-interest tax break? It's a great write-off if you actually need that much house. But borrowing too much and over-spending just to save on taxes is a great way to lose money, because you will always be wasting more than you get back at tax time.

Compare your rent to the after-tax cost of a suitable home in your area. If the home is more expensive, you may be buying into a bubble. And you're sure to be taking on plenty of debt. Notes Rosenberg, "If you live in a rent-controlled place and your mortgage (would be) three times your rent, that mortgage is going to get you into trouble."

Myth: At least I'll have a pension when I retire.

Fact: Corporate pensions and health coverage for retirees once had the look of a sure thing. But rising costs (especially for health care) are forcing some of America's largest employers to rethink their commitments. In the worst cases, companies can go into bankruptcy and turn their pension obligations over to a federally sponsored agency, the Pension Benefit Guarantee Corporation (PBGC). The PBGC covers pension payments up to a certain amount. For some of those who counted on living large on their pension, the reality may be a sharp disappointment unless they have done plenty of saving on their own. It's always good to save as much as possible and not to depend on anyone else, such as your employer or the government, to ensure you a comfortable old age.

Resources:

A well-known site for information on saving and investing, including calculators to determine retirement income needs, is that of the American Savings Education Council (www.asec.org). Go directly to www.asec.org/tools for calculators and other resources.

The Millionaire Next Door: The Surprising Secrets of America's Wealthy by Thomas J. Stanley and William D. Danko. Available in paperback (Pocket, 1998), unabridged audio (Sound Ideas, 2000) and hardcover (Longstreet Press, 1996).

Sources: Employee Benefits Research Institute, www.ebri.org; National Council on Economic Education, www.ncee.net; Eva Rosenberg, MBA, EA, www.taxmama.com; **Jerry Webb, chairman, Webb Financial Group, Bloomington, Minn., www.webbfinancial.com.**

By Tom Gray
© 2005 Achieve Solutions