Exchanges at Goldman Sachs

Caught in a 'Financial Vortex': Why Retirement Expectations Often Fall Short of Reality

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Allison Nathan: Amid rising rates and market volatility, the slowing economy is putting a major strain on individuals' investments. So, what does that mean for those saving for retirement and for those in retirement?

Mike Moran: Obviously, inflation is front and center for both current workers and retirees. But that challenge feeds into other challenges that these individuals face. The current economic climate just makes them more pronounced.

Allison Nathan: I'm Allison Nathan. And this is Exchanges at Goldman Sachs.

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Allison Nathan: To help break down the challenges of saving for and spending in retirement, I'm joined by Mike Moran, a pension strategist in Goldman Sachs Asset Management. Mike is out with a new report that looks at how today's complex backdrop is affecting individual's retirement plans. Mike, welcome back to the program.

Mike Moran: Thanks, Allison. It's great to be here.

Allison Nathan: So, you and your team interviewed working and retired individuals across generations and genders for this survey. Walk us through exactly who your respondents were and why you chose to survey such a broad audience.

Mike Moran: Sure. So, we surveyed over 1,500 individuals in July and August of this year spanning across both those currently working and those in retirement. And by serving both populations, what we were really trying to do is to compare how current workers are planning for retirement. And compare that to what retirees went through, both when they were planning for their retirement, as well as what they were actually experiencing in retirement.

And when we look at that population across both populations, currently working and retired, the gender split was about 50/50 for between male and female. And with respect to currently working individuals, we had a pretty good distribution of age groups, which allows us to break down their responses by generations. So, we have a fair amount of material in our survey where we can break out responses by boomers, Gen X, millennials, Gen Z. We can really see how different generations are planning for and saving for retirement.

Allison Nathan: So what are some of the key takeaways from the report?

Mike Moran: So there were a number of key takeaways, Allison. But obviously, we're not going to be able to cover all of them on this podcast. So, let me just hit you with a couple of them.

The first would be that more than half of the retirees in our survey reported that their income is less than 50 percent of their pre-retirement income. And that's a pretty alarmingly low percentage when you consider that we often consider 70 percent as the starting point for the amount of income in retirement you need to replace in order to sustain your standard of living.

Another key takeaway would just be the high amount of stress that current workers are feeling. Almost 60 percent of respondents are feeling stressed about managing their retirement savings. And out of all the different generations, Generation X is the most stressed out of them.

Allison Nathan: And was there any survey result that was particularly striking to you?

Mike Moran: There were a couple things that jumped out of the survey. One of the things would really come back about what are retirees concerned about right now? And certainly, given the inflationary environment, inflation was the number one concern for retirees. But another thing that jumped out of the results was basically every concern was up for retirees. When we look at results from this year versus last year, there was an increase in concerns across the board.

And a lot of this ties back to the financial vortex. When you have increasing inflation, when you have market volatility, it feeds into other concerns that retirees have, such as, am I going to run out of money? Am I going to become a financial burden to my family?

Allison Nathan: So, people's income and retirement is basically a fair amount lower than what they were used to while they were working. But isn't that normal? What would you expect to see for a normal income replacement rate in retirement?

Mike Moran: I cited that 70 percent figure, Allison. Which quite, honestly, is starting point for the analysis. Right? That's what we would call the baseline. But then anyone's individual needs of having more or less is going to be driven by their own unique circumstances and fact patterns.

So, this is one of the things when we talk about retirement planning going forward, one of the key things for individuals is having a customized and personalized retirement plan to figure out what exactly their income needs are going to be in retirement. And therefore, they can develop a saving strategy and investing strategy to meet those goals.

Allison Nathan: Right. And so, that's what we call income replacement, right? So, ultimately, you're trying to establish what kind of income you do need to keep up your standard of living. It may not be what you earned during your working years.

Mike Moran: Exactly. And that comes back to, for a lot of individuals, figuring out what their budget is going to be in retirement. Some may spend less in retirement than they spent when they were working because maybe they're not commuting anymore. They're not buying work clothes. Others may spend more because they may decide they want to travel more. They want to do more entertainment. So, it really depends on the individual circumstances.

Allison Nathan: But one of your findings in your survey, I think, is ultimately that people were just not as prepared for retirement as they'd hoped they'd be. Why do you think we're seeing that trend?

Mike Moran: That really comes back to the title of our report, "Navigating the Financial Vortex." The financial vortex refers to competing financial priorities and life events that can throw us off course as we're preparing for retirement. As we progress through our lives and through our working careers, other financial priorities come into play that may hinder our ability to save for retirement.

For example, in our survey, current workers indicated that having too many monthly expenses, dealing with a financial hardship like an unexpected home repair, and financially supporting other family members all affected their ability to save for retirement. The need to save for retirement competes with these other financial priorities.

In addition, life events can throw retirement savings off course. In our survey, 43 percent of current workers indicated that at some point they needed to take time away from the workforce to care for a family member. Now, that can interrupt retirement savings, as well as the compounding returns on those savings.

As discussed, a lot of retirees have to think about when am I going to retire? How much do I need to save? How much money am I going to spend in retirement? All of these factors can change over the course of your working career. And that can really throw off course retirement readiness.

Allison Nathan: So, life happens. And people are often just not prepared for the turns that life takes. You mentioned inflation is a major concern today for people working and people in retirement. But, in general, it's a pretty complicated macro backdrop right now. So, what are some challenges, both the retired population and working population are facing more broadly?

Mike Moran: Obviously, inflation is front and center for both current workers and retirees. But that challenge feeds into other challenges that these individuals face. So, for retirees in our survey, the top three challenges they face that they said that they would like advice and guidance on were, number one, generating retirement income. Number two, understanding how long their savings will last. And number three, managing through market volatility.

Now, those are three challenges that would likely score highly in our survey no matter what the market environment. But it's not hard to assume that the current macro backdrop had just made those challenges even more acute.

Now, for current workers, our survey found that in addition to inflation, they are concerned about having sufficient savings for retirement. And leaving a steady paycheck behind. So, as a result, they're looking for advice on how to generate retirement income when they get to retirement. Understanding how long their savings will last. And understanding if their savings are on track. And if not, how to adjust that plan.

And again, these are common concerns for workers in any environment. But the current economic climate just makes them more pronounced.

Allison Nathan: But for people who are not in retirement yet but thinking about retirement, how do they think about saving for retirement in an environment like today's where there are just down markets, and a lot of assets are not yielding enough?

Mike Moran: I would answer that really two ways. Number one, during periods of market volatility, we often see retirement savers, in particularly those closer to retirement or those in retirement, shift to a more conservative asset allocation as a way to preserve what they have. And to avoid potentially larger drawdowns than what they've already experienced. And in particular, we tend to see allocations to stable value funds or other capital preservation options increase. Stable value is a conservative fixed income option.

These are things that I'd say, again, when we think about for individuals, oftentimes they're looking about preserving what they have. But the other way I would answer that question is to really acknowledge the shift we've seen in the defined contribution market over the past several decades. From a model where we went from what I would call do it yourself to more of a do it for me.

And really, what I'm acknowledging here is the growth in the market of target date funds in managed accounts. While certainly a number of individual retirees or individuals saving for retirement are still picking their own investments off the sponsors' line up, that's the do-it-yourself model, where they construct their own portfolio, there is increasing demand for more personalization and customized retirement planning. The do it for me model.

And this is what the financial vortex sort of demands. Right? It is becoming increasingly complex for individuals to juggle all their priorities and come up with an appropriate investing strategy. And then adjust that strategy when life gets in the way.

So, coming back to what retirement investors are doing in a down market, for those that are taking advantage of professional management through a managed account, for example, those managers are helping that individual ensure they have an appropriate strategic asset allocation based on their own individual unique circumstances. And then rebalancing their portfolio, which of course is a prudent risk management action.

Allison Nathan: And the silver lining here is even though the macro environment is volatile and uncertain and complicated, we are seeing high interest rates. So, a lot of fixed income products are actually doing a lot better than they did in the past, with lower risk.

Mike Moran: That's been one of the biggest downsides to low interest rates over the past several decades is for retirees that are reliant upon a fixed income in retirement.

Low rates have been their enemy. Now with rates increasing, you're seeing more interest in them. Again, we've talked about stable value, a conservative income option. But even at other parts on the curve, as interest rates have gone up, that's become more attractive to retirees.

Now, they're still feeling the impact of inflation. And certainly, that can erode the purchasing power of their assets and retiree income. But at least we actually have fixed income assets that are yielding more than what they have in the several decades.

Allison Nathan: COVID hasn't come up at all in this conversation. But is that impacting retirement at all? Did that come through in the survey?

Mike Moran: One of the things we addressed in the survey was how COVID, in particular, was affecting retirement savings and the retirement timeline. So, many individuals needed to withdraw money from their 401(k) plans in COVID as a way to meet expenses. And that is certainly understandable. Our survey showed that one in four working individuals withdrew money from a 401(k) during

COVID.

And COVID certainly impacted how many individuals are thinking about their retirement timeline, in particular, 37 percent of respondents in our survey indicated they expect to delay their retirement due to the COVID pandemic. So, from a retirement savings perspective, the key becomes what do you do from here? And this is where life, at times, throws retirement planning off course. And individuals need to recalibrate their savings and investment strategy. Maybe they need to increase savings. Maybe they need to take more investment risk in their portfolio.

This is where a personalized plan takes all that into account and recalibrates a retirement plan strategy.

Allison Nathan: So, COVID is a reason why a lot of people are having to delay their retirement. But one observation in your survey that I found particularly striking was that a lot of people are actually finding themselves having to retire earlier than expected.

Mike Moran: And for a variety of reasons. So, that was one of the interesting things we noticed in last year's survey.

We often think about, or individuals often think about this belief, I'm going to have to work into my sixties or seventies to saving enough to retire. In last year's survey, we noted that 51 percent of retirees actually retired earlier than expected. Now, that sounds like good news. But it actually isn't because in many cases, those individuals were retiring earlier, not because of their choice but because of some other reason, in particular oftentimes that was because of health issues. That was because they had to leave the workforce to take care of a family member. Or maybe their job was no longer available.

In this year's survey, that percentage actually increased to 56 percent. 56 percent of retirees are retiring earlier than they expected. And again, this comes back to the financial vortex. Many individuals have an expectation or an assumption for how long they're going to work, at what age they're going to retire. And when life happens, your job is no longer available or you have to leave the workforce, perhaps to take care of somebody else in the family, that can throw a retirement savings off course.

Allison Nathan: And so, as we've discussed, just many people are finding themselves in retirement without enough savings to keep up the quality of life that they've had. What steps are retirees taking to maintain their spending power in retirement?

Mike Moran: So, in the survey we saw a couple of actions that retirees are taking. And the most common one was controlling what they can control, which is decreasing their spending. Right? So, about 65 percent of retirees indicated they are reducing their spending in retirement.

Other actions that they're taking include tapping into emergency savings, right, as a way to continually fund their outflows. So, it comes back a little bit to what can they control? What can they do? And oftentimes, as we saw in the survey, the biggest answer is just reducing your spending.

Allison Nathan: So, you mentioned some differences between different generations in terms of how they're preparing for retirement and how they are actually acting in retirement. So, talk to us a little bit about some of those differences.

Mike Moran: One of the key things we found, Allison, was that retirement readiness tends to decrease over time. So, millennials and Gen Zs tend to think that they're actually on a pretty good path to retirement. But then when we look at Gen X and boomers, they tend to feel that they're behind.

And some of this comes back to life happens, things change in your life, you have more financial priorities. Things happen where maybe you had to stop savings for a while because maybe you had to leave the workforce. So, it's interesting to see that younger generations maybe feel like they're better prepared for retirement. But then as your career goes on, as your life goes on, you start to feel that you're falling behind. And oftentimes that's because of the financial vortex of other financial priorities.

Allison Nathan: Yes, younger people tend to be more optimistic. But that could change over time. And seems likely to, according to your survey.

Mike Moran: And as well, some of their expectations and assumptions may have to change. So, another thing we saw in the survey was that millennials and Gen Zers expect to retire earlier than boomers or Gen Xs. And so, again, over time that expectation may change. So, they tend to have some expectations that may not match up with reality.

And again, that's part of the reason why we surveyed both current workers and retirees to say here's how you're planning for retirement today, but let's actually look at those who are either closer to retirement or actually in retirement and what have they actually experienced?

The generation that we focused on the most is Gen X. And this is often viewed as the forgotten generation since it bridges boomers and millennials. This is the first generation that will largely retire not being covered by a defined benefit pension plan. And that really needs to generally navigate their own retirement savings. So, they have a different sort of retirement journey than those that came before them. But also, let's acknowledge that many of them are at later stages in their careers, right? So, they have less time to continue to save for retirement. They may, actually, leave the workforce earlier than they expected. So, their runway for savings is becoming shorter. And they were also the generation that was most stressed about managing their retirement savings. That came in at 65 percent of them indicated that they were stressed. We would say that is the generation that likely faces the most hurdles.

Allison Nathan: So, how can plan sponsors and advisors better support those saving for retirement or those already in retirement?

Mike Moran: So, I think both sponsors and advisors need to recognize that retirement investors look to them for advice and guidance. Again, if I come back to our survey, for current workers in our survey, employer retirement programs were cited as their top source of education and advice to learn about developing a plan for retirement. For retirees, financial advisors were the top source. So, the demand is there.

What has been evolving a bit is how that advice and education is being delivered. So, in our survey when we asked current workers how they prefer to receive financial advice and guidance, the responses were roughly even split between in-person financial counseling, something that's more delivered digitally or a technologically enabled solution. And then the third one was a combination of both, right? So, roughly a third. And that breakdown was pretty consistent across the different generations as well.

So, I think one thing that employers and advisors need to acknowledge is that the way individuals receive information is different. And they need to make sure that they're delivering that advice and guidance in a number of different ways to meet the individual demands of retirees and workers currently saving for retirement.

Allison Nathan: Legislation is also a key part of making it easier for companies to help people save for retirement and Secure Act 2.0 and other legislation may be coming soon. So what are you expecting? What are you looking for?

Mike Moran: There's been a lot of legislation through the years, Allison, that has really helped support retirement savings in this country. You referenced Secure Act 2.0. So, for our listeners, let me just back up for a second and remind everyone, Secure Act 1.0 was passed in 2019. That did a number of things for the retirement industry, again, to help more individuals save for retirement. For example, it gave planned sponsors more leeway to put annuities in defined contribution programs. It created pooled employer plans or PEPs, which should increase access to retirement plans, which will be particularly important for those that work for a small business.

So, now Congress is trying to look to build off of that. And as you indicated, talk about Secure Act 2.0. Now certainly, nothing has been finalized here. And there's a lot still to be hashed out. But some of the key issues that are being debated in Secure Act 2.0 would be expanding auto enrollment, increasing catch up contributions for certain age groups, allowing for employer matching contributions into a retirement plan for employees that are making payments on their student loans and not saving for retirement, and delaying the age for minimum required distribution. So, all of these would help individuals save more for retirement.

Allison Nathan: So, given this backdrop, Mike, what does the future of retirement look like from where you sit?

Mike Moran: I think the future of retirement is consistent with what we've seen over the last couple of decades as we shift from a defined benefit system to a defined contribution system, which basically requires more onus on the individual to save for retirement and decide how they want to invest those assets. And that's why I keep coming back to the future of retirement is one that's more personalized, it's more customized, and it's also more holistic that takes into account these other financial priorities that create the financial vortex.

As I'm saving for retirement, or trying to save for retirement, I'm also balancing other financial priorities. Paying down debt. Saving for my child's college education. Dealing with an unexpected expense. You can't save for retirement in isolation. It has to take into account all of these factors. And then we need to come up with an asset allocation and investment strategy that meets my goals and objectives, but that also is flexible enough that it can pivot along the way and change as life happens, as other new financial priorities come up, it has to be really more customized to myself.

Allison Nathan: Sounds daunting. But we have tools and resources to get us there. It's always great to have you on the show.

Mike Moran: Thanks for having me, Allison.

Allison Nathan: Thanks for listening to another episode of Exchanges at Goldman Sachs. This episode was record on Wednesday, October 12th.

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