RETIREMENT INSIGHTS

SPARKING BETTER RETIREMENT CONVERSATIONS AND OUTCOMES

The lifecycle of spending

January 2014

IN BRIEF

- Gaining insight into how people spend as they age can help financial advisors and their clients build better retirement plans, craft more effective investment strategies and reach more successful retirement outcomes.
- Research shows that U.S. household spending peaks at age 45 and then declines in every consumption category except health care. Overall spending, in today's dollars, falls about 30% from age 45 to 75.
- Many financial plans assume that a mortgage is paid off in retirement, but that expectation may be outdated. In 2010, a little over 40% of 65- to 74-year-old Americans had mortgages, nearly double the share in 1989.
- Traditional financial planning assumptions project that annual spending, accounting for inflation, almost doubles from age 65 to 90, but our research finds an average increase of just 15% over this period. This suggests that many Americans can have a greater level of confidence in their retirement plans and take on less risk than they assume to generate required investment returns.

After several years of paying down their debts, many American consumers are feeling more confident and a little bit richer—total U.S. household net worth has increased $7.4 trillion from the summer of 2007—and they are ready and willing to spend. Consumption, which accounts for nearly 70% of GDP, has propelled much of the U.S. economic expansion.

With consumer spending top of mind after what looks to have been a solid holiday shopping season, we are re-examining several assumptions about the patterns of consumer spending. For example, December has typically been the highest-spending month of the year based on total Chase credit card usage. But this year, August spending exceeded December 2012 levels; for the first time post-recession, a month in mid-year surpassed the previous December. As more Americans buy online—during Black Friday weekend, 44% of spending took place over the Internet—a year-end surge of spending may be giving way to more "spread out" spending patterns. Similarly, some key assumptions about spending in retirement should be reassessed. Many financial plans assume that the pattern of spending during this life chapter is constant, but in fact it will change over time. Many plans assume that mortgages will be paid off at retirement, but a growing share of retirees hold mortgages.

AUTHOR

S. Katherine Roy, CFP®
Chief Retirement Strategist
J.P. Morgan Asset Management

J.P.Morgan
Asset Management

Gaining insight into how people spend as they age can help advisors and their clients build better retirement plans, craft more effective investment strategies and reach more successful retirement outcomes.

Preparing for retirement

Facing the persistent tension between a desire to spend today and a need to save for a retirement many tomorrows in the future, Americans are saving less. The U.S. personal savings rate, which rose to 5.4% in 2008, stood at 3.65% in January 2013. That 3.65% rate is well below the 7% average for the 1959–2012 time period, to say nothing of the 10%-15% that many see as the recommended target savings rate.

In our study of spending and retirement, we drew on data from 1.5 million U.S. households who have mortgage, debit and credit card relationships with Chase and who use those payment types to do a majority of their spending. While the group represents a national sample, it skews more heavily toward regions in the Chase "footprint."[1]

From this data we have created a retirement spending profile. Anecdotally, we find retirement spending falls into three phases, first identified by Michael K. Stein, a certified financial planner and author of *The Prosperous Retirement: Guide to the New Reality* (Emstco Press, 1998). They are:

- **The active "Go-Go" phase:** From age 65-75, retirees spend about 100% of pre-retirement spending.
- **The passive "Slow-Go" phase:** From age 75-85, retirees reduce spending 20%-30%.
- **The final "No-Go" phase:** From age 85, retirees spend less across most consumption categories but they face unpredictable, and potentially large, health care and long-term care costs.

Defying the expectations of many financial planners, our research finds that average U.S. household spending peaks at age 45 (**Exhibit 1**). After that age, spending, in today's dollars, declines in every category but one—health care. Overall, spending falls about 43% between today's 45-year-olds and today's 75-year-olds, with some of the most dramatic reductions in the apparel and services category. This decline in spending does not take into account possible long-term care costs, which may vary significantly depending on individual circumstances.

U.S. household spending peaks at age 45

EXHIBIT 1A: AVERAGE SPENDING PATTERNS OF VARIOUS AGE GROUPS

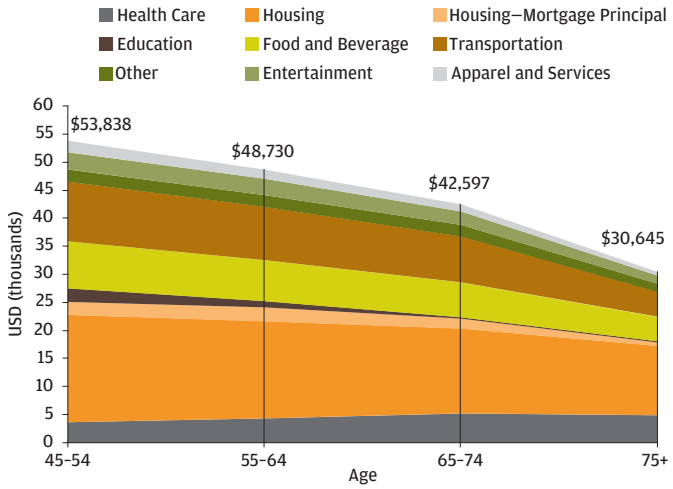


EXHIBIT 1B: AVERAGE ANNUAL SPENDING REDUCTIONS

Category	Age 45–75+ (%)	Age 65–90 (%)
Apparel and Services	-3.28	-5.54
Entertainment	-2.10	-3.70
Other	-1.21	-2.27
Transportation	-2.64	-4.89
Food and Beverage	-2.00	-2.86
Education	-7.08	-4.73
Housing—Mortgage Principal	-3.76	-18.67
Housing	-1.34	-1.62
Health Care	0.91	-0.79

Source: J.P. Morgan Asset Management. Estimates based on average consumer expenditure from the Consumer Expenditure Survey for each age group, excluding pension and cash contributions, and including mortgage principal pay down in the housing category; BLS data as of September 2013.

[1] The New York Tri-state area, Midwest, Florida, Texas and most of the West.

Spending profiles by generation and affluence

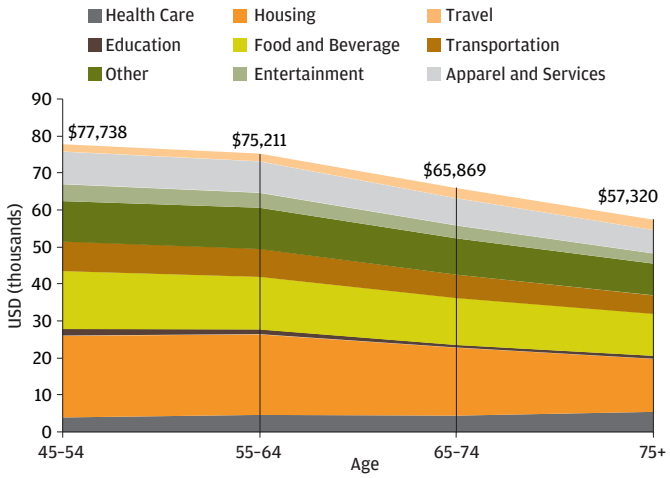
A pattern of reduced spending prevails for the Silent Generation (Americans born 1925–1942) and the trend does not appear to be a generational anomaly. We segmented the 1.5 million Chase households in our survey into three groups (Exhibit 2):

- Mass affluent households, with $1 million–$2 million in investable wealth
- Affluent households, with $2 million–$5 million in investable wealth
- High net worth households, with more than $5 million in investable wealth

While spending on apparel declines almost in half by age 80, travel spending continues at a brisk pace and is consistently high between ages 70 and 85. In our survey, the average 75-year-old spends about 43% more on travel than the average 45-year-old.

An alternate view: Chase households

EXHIBIT 2: AVERAGE SPENDING PATTERNS OF VARIOUS AGE GROUPS



Source: J.P. Morgan Chase. Based on Chase credit card, debit and DDA mortgage payments from September 2012–August 2013.

Mortgages are paid off at retirement—an outdated assumption?

Whether they are world travelers or happy stay-at-homes, many retirees have paid off their mortgages. But it may be outdated to assume that a mortgage is likely to be paid off at retirement.

Between 1989 and 2010, as mortgage interest rates have declined dramatically more retirees have outstanding loans on their primary residence. Among 65- to 74-year-olds, 40% had mortgages in 2010, up from less than 22% in 1989. Among Americans over 75, approximately 24% had mortgages in 2010, vs. a little over 6% in 1989. Median mortgage debt has climbed as well, across all age cohorts. In the 75-plus group, median debt on primary residences rose from $11,800 in 1989 (in inflation-adjusted 2010 dollars) to $52,000 in 2010.

These statistics, surprising to some, serve as a useful reminder to all financial advisors: in creating and monitoring a client's retirement plan, it is critically important to make sure cash flow projections will adequately cover mortgage payments.

Investment implications: Building better retirement strategies

Taken as a whole, our research offers a new perspective on the relationship between spending and retirement. Indeed, in many ways it challenges conventional thinking on the subject.

Traditional planning assumptions project that average annual spending for a 65-year-old in 2012 will rise from $43,000 that year to about $79,900 when he/she is 90. That calculation is typically based on a static spending mix and a single, constant inflation rate of 2.5%. According to this scenario, annual spending will almost double over the course of this 25-year period.

But our research examines each component of spending—apparel, housing, education (for grandchildren), etc.—and applies a rate of expected inflation to each component. Our projections anticipate that spending on all categories except health care will decline, and in some cases fall significantly. We conclude that even as the mix of retirement spending

Traditional versus historical spending assumptions

EXHIBIT 3A: "TRADITIONAL" SPENDING ASSUMPTION VERSUS HISTORICAL REALITY

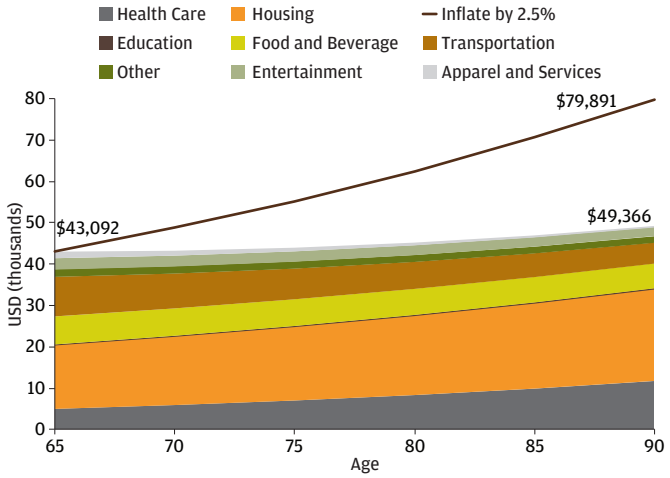


EXHIBIT 3B: NET CHANGE IN SPENDING

Category	Net change (%)
Apparel and Services	-5.48
Entertainment	-0.90
Other	-0.67
Transportation	-2.49
Food and Beverage	-0.46
Education	0.67
Housing	1.48
Health Care	3.51
Total	**0.55**

Source: J.P. Morgan Asset Management. Estimates based on average consumer expenditure from the Consumer Expenditure Survey for each age group, excluding pension and cash contributions, and including mortgage principal pay down in the housing category; BLS data as of September 2013.

shifts during retirement, the total net increase in spending during a 25-year period will be 0.55%. As a result, we project that a 65-year-old in 2012 will see his/her spending rise from $43,092 to $49,366 when he/she is 90. Instead of doubling, average spending will increase just 15% (**Exhibit 3**).

A near-retiree who hoped to spend at pre-retirement levels in the early years of retirement but worried about a projected doubling of annual spending over 25 years would be far less alarmed to contemplate just a 15% increase in that time frame. A retirement plan that projected the lower—and more realistic—spending assumptions would inspire more confidence that early retirement, especially, could be enjoyed without threatening the financial security of one's later years.

Such confidence would also dissuade the pre-retiree from adopting a financial plan that took on undue levels of risk to keep pace with an unrealistically high expected level of spending.

Conclusion: Realistic spending assumptions, better retirement outcomes

Spending projections are a key component of a retirement plan. Our research suggests that some commonly held assumptions about spending should be re-examined. Most significantly, spending in retirement isn't constant—the mix of categories will shift over time and overall spending will likely decline in every category except health care. Carefully constructed, realistic projections about spending and inflation will inform the most useful retirement plans and lead to the most successful outcomes.

To learn more about the Retirement Insights program, please visit us at **www.jpmorganfunds.com/RI.**

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