feature report

The 13 biggest retirement mistakes

Don't despair. There's still time to correct course.

After Putnam Investments, the Boston mutual-fund company, surveyed recent retirees last fall about what they would do differently, one regret towered above all the rest. A whopping 59 percent of respondents said they should have started saving earlier. Obviously, if you have any time left before you retire, you should ramp up your savings to make up for that common error.

If you're already in retirement or standing on the brink, however, there isn't much you can do about the excess spending of yesteryear, especially given the sorry state of time travel. But there are other common retirement mistakes you can still avoid. Here are 13 of them:

1 Underestimating your needs. That's the No. 1 blunder preretirees make, says David Bach, author of "Start Late, Finish Rich" (Broadway Books, 2005). "Most people underestimate how much they'll spend in retirement, in part because of all the experts telling them it will be 60, 70, or 80 percent of what they were spending before," he says. Considering travel, home remodeling, and all the other big-ticket temptations that new retirees face, "I've seen people whose expenses went to 120 percent or higher," Bach adds.

Neal Frankle, a certified financial planner in Woodland Hills, Calif., has observed the same phenomenon in his practice. "You know how you spend more money on the weekends while you're working?" he asks. "Well, when you're retired, every day is a weekend."

To get a better grip on your likely retirement spending, Bach recommends an exercise favored by many financial planners. "Try living for six months to a year on what you think you'll need," he says. "Some people find they can't do it. Others find they can actually live on less. It's the best reality check I've ever seen."

2 Overestimating your returns. The go-go investment markets of the 1990s may be long gone-gone, but the false sense of optimism seems to live on. In fact, a survey released this April by Northern Trust, the Chicago-based provider of private banking services, found that 40 percent of people with more than $1 million in investable assets overestimated the likely return on their portfolios by 2 percentage points or more. Sixteen percent were off by 5 percentage points.

In case you want to try this at home, here are the percentages Northern Trust used to represent a reasonable rate of return: cash, 3 percent; bonds, 4 percent; and real estate, 9.5 percent. While the survey let respondents make their own guesses as to what stocks would earn, the average annual return on the Standard & Poor's 500 Index during any 20-year period between 1926 and 2004 has been 11.4 percent. Note, however, that your personal return will depend on the composition of your portfolio. If you keep 40 percent of your money primarily in low-risk cash instruments and bonds, for example, your personal rate of return won't equal those heady stock returns.

3 Withdrawing too much too fast. The conventional wisdom among financial planners is that most people can safely withdraw 3 to 4 percent of their principal each year during retirement. While some experts quibble with that formula, everybody seems to agree that it's important to set limits, no matter how rosy the economy appears at a given moment.

"When the market is up, some people take out 10 percent," Bach says. "You tell them, don't get used to this, but they do get used to it." Come the next downturn, they could be filling out job applications or hammering "For Sale" signs into their front yards.

4 Denying yourself needlessly. This is the flip side to mistake No. 3. Perhaps not surprisingly, "great retirement savers tend to be frugal people," says Paul Merriman, president of Merriman Capital Management in Seattle and author of "Live It Up Without Outliving Your Money" (Wiley, 2005). "As a result, they end up with the most money—and also the least ability to spend it."

If this sounds like you, congratulations. You'll probably have more than enough cash socked away for a comfortable retirement. Just don't forget to enjoy it while you have the chance. Or the energy. If you don't, and your estate is more than $1.5 million this year and $2 million in years 2006 to 2008, the government will take a 45 to 47 percent bite and spend the money for you.

ILLUSTRATION BY BOB ECKSTEIN

And now, the 14th

Not using "catch-up." The 2001 tax law entitled workers age 50 and older to sock more pretax money in their 401(k)s to catch up on retirement savings. This year workers age 50 and up can contribute an extra $4,000 to a 401(k) on top of the $14,000 annual limit. But the Vanguard Group, the Valley Forge, Pa., mutual-fund behemoth, discovered in an April study of the plans it administers that only 13 percent of eligible participants made catch-up contributions in 2004 when they could contribute $3,000.

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5 Focusing too much on yield. While you want your portfolio to generate cash flow for you during your retirement years, it's a mistake to choose mutual funds or other investments based solely on their current yield, notes Mari B. Adam, a certified financial planner in Boca Raton, Fla. Instead, concentrate on total return, which takes into account not only the income an investment produces but also any rise or fall in its underlying share price. "We see income funds where principal is eroding because their market value is going down," Adam says. In other words, today's cash cow can be tomorrow's lean cuisine.

6 Overpaying investment expenses. Morningstar, the Chicago-based fund tracker, compared two mutual funds, both producing a 10 percent annualized return but one charging 0.98 percent in annual expenses, the other 1.55 percent. If you invested $10,000 in each, by the end of a decade you'd be $1,300 ahead with the cheaper fund. And even 0.98 percent isn't exactly bargain-basement as fund expenses go. Vanguard's famously tightfisted S&P 500 Index fund, for example, charges a mere 0.18 percent.

In its recent book "Find the Right Mutual Funds," Morningstar offers these guidelines: Avoid bond funds with expense ratios greater than 0.75 percent, large-company stock funds charging more than 1 percent, and small-company or foreign-stock funds that go much over 1.5 percent.

7 Being too generous. Merriman believes retirees' ill-considered charity often begins at home. As you near retirement, you may find yourself feeling unusually generous, especially if you've invested well or you were just plain lucky. And the federal government allows you to give anybody (and everybody) you know $11,000 a year without incurring a gift tax. But Merriman advises caution when playing Lord or Lady Bountiful. Your situation may change over the next couple of decades, and you may need the money. All in all, it's probably better to make the kids wait for an inheritance than to risk running out of money and find yourself knocking at their door, suitcase in hand.

8 Not coordinating with a spouse. Retirement not only brings couples closer, but it also has a way of turning what had been *his* and *her* money into *their* money. But even before retirement, you should be thinking about those savings as one portfolio rather than two separate ones, Merriman suggests. "If you both have 401(k) plans at work, look at which one has the best funds and invest accordingly," he says. "Maybe one has a better large-cap fund, the other a better small-cap. Also, be smart about the investments outside of your 401(k)s. If there are no international funds available through your plans, or the choices are terrible, make that part of an Individual Retirement Account."

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9 Investing too conservatively or too aggressively. "People who fail are taking either too little risk or too much. It's the people in the middle who survive," Merriman says. He believes a 50/50 mix of stock and bond funds works well for many people who are nearing retirement or already retired.

Financial planner Adam also makes the case for stocks in retirees' portfolios. "Your worst enemy in retirement is inflation," she says. "If you just stay in place, you're losing ground every year. You have to have some growth." One investment that straddles the line is dividend-paying stock, which not only produces income but, unlike bonds, also offers the potential for growth.

10 Forgetting to rebalance. This assumes, of course, that your portfolio was in balance to begin with. If you'd like some help in crafting a properly diversified portfolio, you can consult a fee-only financial planner, the kind who shouldn't have any ulterior motive, like a commission, for steering you toward one investment over another. You can get some names from the National Association of Personal Financial Advisors at *www.napfa.org*. Having done that, however, your job isn't over. Periodically you'll need to get your portfolio back into balance. That means selling some of the investments that have grown too big for their piece of the pie chart and buying more of the shrunken slices. Merriman recommends rebalancing once a year.

11 Failing to protect yourself from losses. "A buy-and-hold strategy is great when the market is going up," Frankle says. "But since the 1890s, there's been a bear market every 3.3 years, with an average loss of 27 percent. When you're retired, how long can you afford a catastrophic loss?" Frankle suggests using stop losses, which automatically instruct your broker to sell an investment when its price falls below a certain level. One way to do that is by investing in exchange-traded funds (ETFs), which are much like the index funds sold by mutual-fund companies but trade on exchanges like stocks.

12 Retiring with too much debt. "People with the greatest retirements usually have the least debt," Bach says. His advice: Add an extra 10 percent a month to your mortgage check and pay it down. If you can retire mortgage-free, so much the better. And it goes without saying, but we'll say it anyway: Pay off the credit cards.

13 Just giving up in frustration. Planning for retirement can be hard work—and sometimes downright discouraging. "I've seen people give up hope," Bach says. "They do retirement plans and find they now have to save 100 percent of every paycheck. So it's easy to beat yourself up and do nothing."

If you find yourself overwhelmed by the prospect of saving, Bach suggests breaking down the task into more manageable pieces. Could you put aside just one hour a day of income, for example? Figuring on an eight-hour day, that's a sneaky way of getting yourself to save a very respectable 12.5 percent of your salary. Another possibility: stashing all "extra" money—bonuses, gifts, and tax refunds—into savings. $