U.S. House of Representatives
Committee on Financial Services

Hearing dated Wednesday, April 20, 2005
Testimony of Sheryl Garrett, CFP®

Introduction

Thank you, Chairman Oxley, Congressman Frank and distinguished members of the Committee. I am extremely honored for this opportunity to share with you my thoughts and observations regarding financial and retirement planning.

Why me? My name is Sheryl Garrett. I am a Certified Financial Planner Professional and have worked with individual clients for 18 years. I have received significant media exposure for my "unconventional" way of working with clients. Over the last seven years of my financial planning career I worked exclusively on a fee-only, hourly, as-needed basis – assisting clients, from all walks of life – providing as much or as little financial planning and advice as they needed. Everyone has questions about their money at one time or another. They need access to a competent, objective financial advisor, who will work on their terms – as fiduciaries, with no hidden agendas.

The popularity of this service model with clients and advisors led me to create the Garrett Planning Network, which launched in July of 2000. We train and support other financial advisors in developing their independent hourly, as- needed, financial planning practice, and thereby increase the public's access to competent, objective, one-on-one financial advice. *Our mission is to make competent, objective financial advice accessible to* ***all people***.

Although I am no longer working with individual clients, I am still intimately involved in the personal financial planning industry. Currently I focus my energies on mentoring other advisors, promoting our brand of advice, writing a column for Advising Boomers magazine, promoting my third book, *Money Without Matrimony*, and doing expert witness and consumer advocacy work.

Investment Advisor Magazine recently notified me that I have been selected as one of the 25 most influential people in financial planning for the third consecutive year. What an honor it is to be recognized by your peers for doing something you love, and that really makes a difference in people's lives.

The Role of a Financial Advisor

The job of a financial advisor is one of the most rewarding and important jobs I can imagine. It is the responsibility of the financial advisor to consider all potentialities and help clients consider all pertinent issues, understand the risks they are exposed to, determine what risks they must bare, and determine what strategies should be employed to increase the likelihood of financial success under each plausible future scenario.

The Variables

The majority of smart money management techniques are really quite simple. There are only so many variables involved. When it comes to determining when and if you can afford to retire, the only variables involved are; spending less and saving more now, spending less in retirement, getting a better return on your investments, working longer, or dying earlier. However, the last variable is not recommended as a planning strategy.

Spending Less and Saving More Now

Unfortunately, too many people feel that they have little or no control over the amount of money that they need to spend, now or in the future. For most Americans, this is simply not the case. We have much more control than we are willing or able to enforce upon ourselves or our families. We are a society in search of instant gratification and we have a severe lack of discipline.

Former generations had a much healthier approach to money-management. If they could not pay cash – they did not buy. There was no such thing as credit cards, revolving charge accounts, home equity lines of credit, or interest-only mortgages. Easy access to credit has enabled many Americans to destroy their own financial futures.

Our financial system has “evolved” to the point that some lenders – I argue – are in the foreclosure business, rather than the lending business. Not long ago, one could only qualify for a mortgage if their total housing expenses did not exceed 28 to 31% of their gross income. Now, I am hearing about people taking out mortgages 8 to 10 times their annual salary. They CAN NOT afford this mortgage, yet they have “qualified” for it. Nearly all of their paycheck will go to pay this debt.

Most Americans spend 100%, or more, of their net take-home pay. Therefore, one of the strategies I recommend to help enforce the concept of spending less and saving more is to invest a portion of this money, before we have a chance to spend it. These automatic investment plans give us the opportunity to withdraw money from our paycheck and contribute it directly into our 401(k) plan or equivalent employer sponsored retirement plan. This same strategy can be achieved through automatic deductions from an individual's checking account and invested into an IRA account. I strongly recommend Roth IRAs, if the investor is eligible.

Spending Less in Retirement

Where in the world did the notion that we need 70 to 80% of our current income in retirement come from? I have yet to meet that retiree. If we can't make ends meet now, how in the world can we spend less in our retirement years?

Unfortunately, most of us will have to get along on a fraction of what we did before we retired. We will only have what we've saved, hopefully some Social Security, and possibly a company pension.

We must adjust – just like everyone before us. There are no other options.

Getting Better Returns on Our Investments

Getting better returns on our investments does not merely mean getting more return. Rather, it means getting the appropriate amount of return, given our level of risk with which we are comfortable and our investment objectives.

Unfortunately, most citizens have little or no education or interest in historic investment returns, the behavior of various asset classes, or appropriate asset allocation techniques.

This fact becomes evident when looking at the statistics of how people invest their 401(k) plan assets. A recent study revealed that 29% of the assets were held in stock of the individual's employer. The percentage jumps to 43% if we are talking about employees of very large companies. Enron illustrated just how dangerous that type of portfolio concentration could be. But not enough of us have made the appropriate adjustments to our portfolio allocation – or, we have overcompensated.

Some retirement plan participants are so scared by the stock market that they keep most or all of their money in short-term, very low-yielding fixed income or money market accounts. These individuals select this allocation in an attempt to be conservative. However, after even modest inflation and taxes the real return on these "investments" is negative. This is not a conservative allocation.

To determine the right portfolio mix we need to ask the following questions:

How long is my investment horizon?
What is my tolerance for risk?
What are my financial objectives?

There are excellent Internet based tools available, which anyone can use to determine the appropriate asset allocation for themselves. One of my favorites can be found at www.tiaa-cref.org. There are also excellent and plentiful resources available for little or no cost from 401(k) plan sponsors, public libraries, on the Internet, and through professional financial advisors.

Following are sound general guidelines:

Time Horizon	Maximum Equity Allocation
0-3 years	0%
4-5 years	20%
6 years	30%
7 years	40%
8 years	50%
9 years	60%
10 years	70%
11+ years	80%

Important note – time horizon is not how many years before you retire, rather it should be viewed as how many years before you will need to spend these dollars. Therefore, for a 40 year old, the time horizon on their retirement assets is 25-60 years. In 25 years they plan to retire, and given current and projected increases in life expectancy, they anticipate living to age 100.

What does this type of equity exposure mean from a risk tolerance perspective?

Maximum Tolerable Loss	Maximum Equity Exposure
5%	20%
10%	30%
15%	40%
20%	50%
25%	60%
30%	70%
35%	80%
40%	90%
50%	100%

NOTE: If one factors in the tolerable loss with the investment time horizon, the lower of the two percentages should be the portfolio's maximum equity exposure.

The following illustrates annualized returns (1926-2000) for various portfolio mixes.

Portfolio Allocations % Equity / % Treasuries	Annualized Returns
80 / 20	8.87%
70 / 30	8.28%
60 / 40	7.92%
50 / 50	7.24%
40 / 60	6.70%
30 / 70	6.00%
20 / 80	5.31%

SOURCE: Ibbotson Associates

These illustrations highlight the fact that virtually everyone must have at least a fraction of their portfolio invested in equities for growth opportunity, or they don't stand a chance of offsetting the effects of inflation. And the younger you are – the more you must have invested for growth.

Inflation is one of the biggest risks to our long-term financial security. Over the period 1926-2000 inflation averaged approximately 3% per year. On a year by year basis most of us would not feel the impact of this type of risk. However, at 3% annual inflation our expenses will double in less than 25 years. So the 40 year old, planning to retire at 65 will need twice the annual income they need today, just to maintain their standard of living. But it doesn't stop there. By the time our retiree reaches 90, they'll need twice again the income to maintain their standard of living. Chances are they will still be living, but their lifestyle will be severely eroded, unless their portfolio is invested to minimize the effects of inflation.

We can not afford to allocate too much of our retirement nest egg into low yielding fixed income investments. And we absolutely can not afford to accept a negative real rate of return on our retirement capital. Yet, that is exactly what the majority of Americans are doing. According to the Social Security Administration, Social Security provides at least 50% of the income for nearly two-thirds of all older Americans. For these retirees, over 50% of their "nest egg" actually earns a negative real rate of return.

We can not afford to remain ignorant or complacent regarding our financial futures. I blame optimism and naïveté. The majority of baby boomers and younger American citizens have never truly experienced financial hardship. Contrast that with Asian-American immigrants of the same age. These individuals have personally experienced or their parents have experienced extreme hardship during their lifetimes. The savings rate of Asian-Americans is over five times greater than that of the average American. Asian-Americans recognize that there will be hard times, and they can only depend on themselves to get through those tough times. Unfortunately those of us who grew up in this land of plenty tend to have an unrealistically optimistic outlook on the future. We think we can always put off until tomorrow what we should be doing today.

If citizens are truly aware of the lack of security regarding our Social Security retirement system, they will make adjustments to take care of themselves in retirement. We need to be informed and educated regarding our financial responsibilities. Time is of the essence. The sooner we begin to make adjustments in our own personal financial planning, as well as, the Social Security retirement system, the healthier we and our future generations will be financially.

Another important role of the financial advisor is to assist our clients in making prudent assumptions in our long-term projections. Many financial advisors, including me, will not assume Social Security retirement benefits for our younger clients. The majority of

individuals that I've spoken with, who were under the age of 40 do not expect to receive anything close to full Social Security retirement benefits. It is very easy to persuade these individuals not to include Social Security retirement benefits in their long-term retirement projections. I encourage them to presume they won't receive any Social Security and they need to accumulate all of their retirement capital on their own. If they do happen to receive some level of Social Security retirement benefits, it will be a positive surprise. However, any additional unplanned income may likely be needed to offset unplanned, extraordinary health care expenses. It is also the only conservative assumption a prudent advisor can make regarding Social Security benefits.

Individuals between ages 40 and 65 will also see a reduction in their Social Security retirement benefits, at some point during their retirement years, unless drastic measures are taken now. For planning purposes, we discount the assumption regarding the amount of Social Security retirement benefits that will be received by 50%.

Working Longer

One of the most significant and controllable variables for the majority of Americans is how long we remain in the workforce. Unfortunately too many people have the unhealthy notion that they are entitled to retire in their 60s. I believe that this notion came about with the advent of Social Security. At the time Social Security Retirement benefits came into being, Americans' life expectancy was approximately the same as when they were to begin receiving retirement benefits. As we all know, life expectancies have drastically increased over the last three generations. And, they will likely increase at an even more dramatic pace in the future.

Some define ultimate financial success as retiring earlier than their parents did. If our parents retired at age 65 and passed away at age 75, they only lived 10 years in retirement. Financial planners now typically project that an individual will live 20, 30 or possibly 40 years in retirement. That requires an enormous nest egg – with or without Social Security. And it's an unreasonable expectation for the majority of us. In my planning projections, I assume life expectancy to be no less than age 100. However, I am concerned that this may not be a prudent enough assumption. The last thing I want is someone waking up broke.

In 1950, 46% of men over age 65 were still in the workforce. Today, that number is less than 20%. We are saving less, living longer, and retiring earlier. Why are we surprised that we cannot afford to maintain our standard of living when we spend as much time in retirement as we did in the workforce?

I believe that it is against human nature to not be a productive and involved member of our society. One of the healthiest developments I am seeing with individual's personal financial planning is that they are planning to work longer or to enter into a staged retirement.

We must be realistic about Social Security. Drastic measures must be taken to ensure long-term solvency. Our citizens must recognize that living in the land of the free, comes with responsibilities - responsibilities to care for ourselves now and in our old age, responsibilities to provide for our families, and responsibilities to our communities and country. We are free to screw up and we are free to succeed. But we must be held accountable for own financial futures.

Thank you for your time and thoughtful consideration,

Sheryl Garrett, CFP®