Spending in retirement

Effective investment strategies and successful outcomes depend on realistic spending projections

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IN BRIEF

- Understanding how people spend as they age can help financial advisors and their clients build better retirement plans, craft more effective investment strategies and attain more successful retirement outcomes.
- On average, spending is highest for households led by 45-year-olds; households led by older individuals spend less. While this pattern holds for the majority of households, spending patterns do vary.
- Research shows that most retirees fall into one of four spending profiles: ***foodie, homebody, globetrotter*** or ***health care spender***.
- Financial advisors need to ask the right questions to create accurate profiles of their clients and adjust their retirement plans accordingly. Inquiring about housing, desire to travel and concerns about health care expenses are good places to start.

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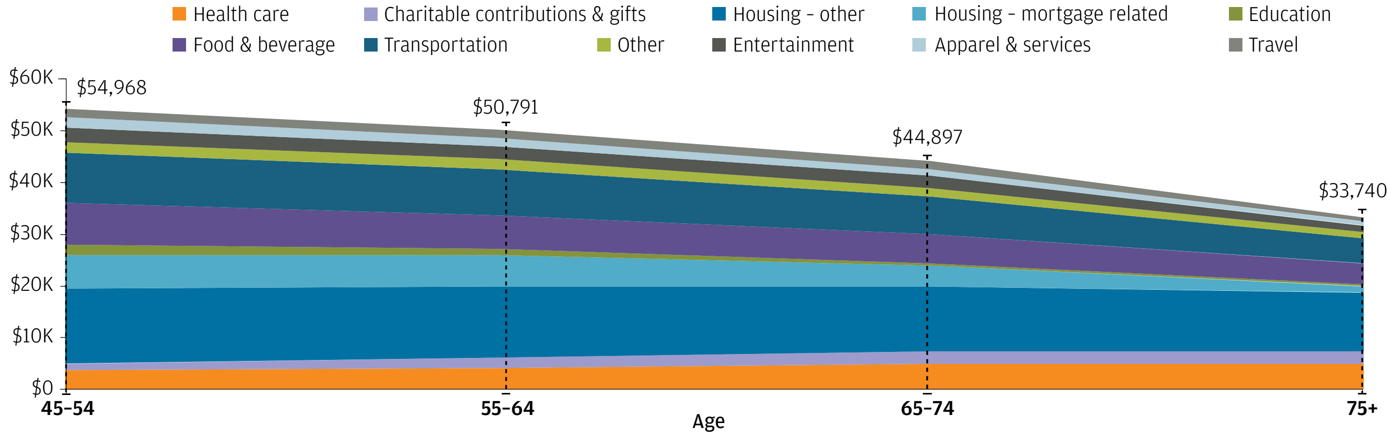
Where does the money go? Spending is an important component of any sound retirement plan. But individuals and financial advisors often do not know how to estimate spending over the long road of retirement. Older people tend to spend less than younger people, although both groups will face price inflation. Factoring in inflation without taking spending patterns into account may result in overestimation of spending in later years. Not surprisingly, individual experiences will vary along with lifestyles. To create realistic estimates of income needs over the 30-odd years of many American retirements, those differences must be taken into account. Individuals can then build better retirement plans, execute more effective investment strategies and reach more successful retirement outcomes.

In the following pages we present an analysis of spending in retirement, drawing on data from 613,000 U.S. households. They are led by men and women age 55 and up, who have debit and credit card relationships with Chase, pay their mortgages through Chase checking and, we believe, use Chase facilities to do a majority of their spending. Although the group represents a national sample, it skews more heavily toward regions in the Chase "footprint."[1]

[1] The New York Tristate area, Midwest, Florida and most of the West.

Changes in spending

EXHIBIT 1: AVERAGE HOUSEHOLD SPENDING PATTERNS BY VARIOUS AGE GROUPS, BASED ON CONSUMER EXPENDITURE SURVEY DATA



Source: J.P. Morgan Asset Management. Estimates based on average consumer expenditure from the 2013 Consumer Expenditure Survey (BLS) for each age group excluding pension contributions. Average household size for age 45-54 is 2.7; age 55-64 is 2.1; age 65-74 is 1.9; and age 75+ is 1.6.

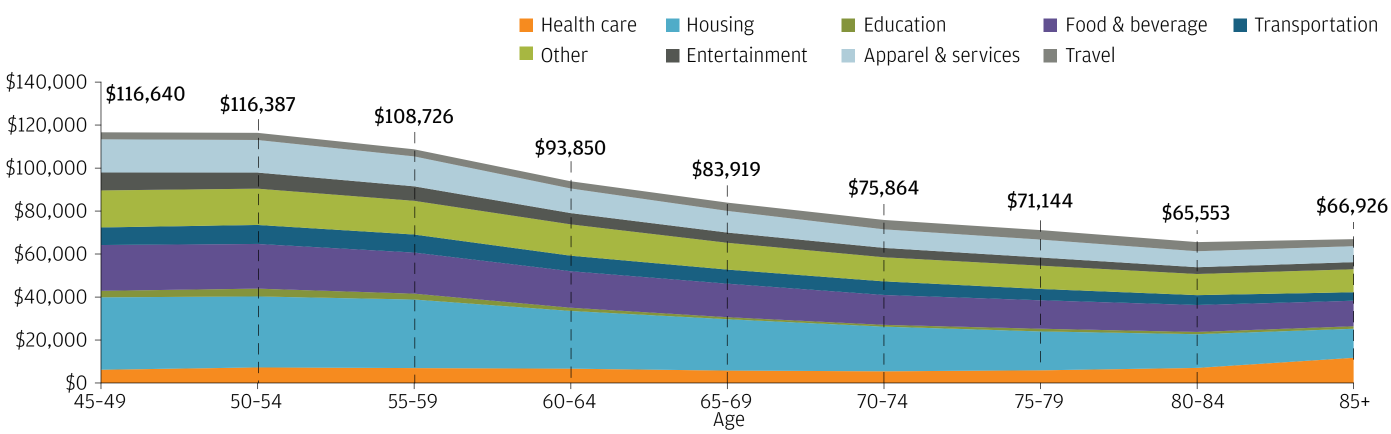
SPENDING PROFILES

Some general patterns in retirement spending can be observed. According to the 2013 Consumer Expenditure Survey of the Bureau of Labor Statistics, average U.S. household spending peaks at age 45. After that age, spending declines in all categories but two—health care and charitable contributions and gifts. Among the categories with the most dramatic reductions in spending: apparel and services (spending in this category declines almost in half by age 80), transportation and mortgage payments (**EXHIBIT 1**). The trend does not appear to be a generational anomaly. We looked at historical data for the silent generation (Americans born 1925-1945) and the oldest of the baby boomers (the generation covers Americans born 1946-1964), and the decline in spending looks very similar.

The drop in spending at older ages holds across wealth levels. **EXHIBIT 2** illustrates the average spending patterns of various age groups for Chase households with $1 million-$2 million in investible assets. We looked at retiree spending at $2 million-$5 million and $5 million-plus wealth levels, and the same patterns can be seen, with only minor variations.

A mass affluent view: $1MM–2MM in investible wealth

EXHIBIT 2: AVERAGE SPENDING PATTERNS OF VARIOUS AGE GROUPS, CHASE HOUSEHOLDS $1MM–$2MM IN ASSETS



Source: J.P. Morgan Chase. Based on Chase credit card, debit and DDA mortgage payments from 9/2012-8/2013.

Although the average spending patterns were similar for households of different wealth levels, there is some variation by lifestyle. Examining the data for our 613,000 Chase households age 55-plus, we looked at spending behaviors and observed five different retirement spending profiles. Using statistical analysis that grouped households whose spending was most similar, we identified four profiles—**foodie, homebody, globetrotter** and **health care spender**. A fifth profile, **snowflake**, includes people whose spending did not look very similar to any particular profile. (No two snowflakes are alike.) Of the households in the Chase database, about 75% fit comfortably into one of the four spending profiles, while the remainder, the snowflakes, have distinct spending patterns that are not similar to others. It's important to note that our data analysis does not reflect the same individuals over time; rather, the profiles are based on a snapshot of spending behavior by age at a particular period of time (September 2012–August 2013).

We determined that 39% of the households could be classified as foodies; 29% were homebodies; 5% were globetrotters; and 4% were health care spenders. Snowflakes, the unclassifiable, accounted for 24% of the total (**EXHIBIT 3**).

Foodie

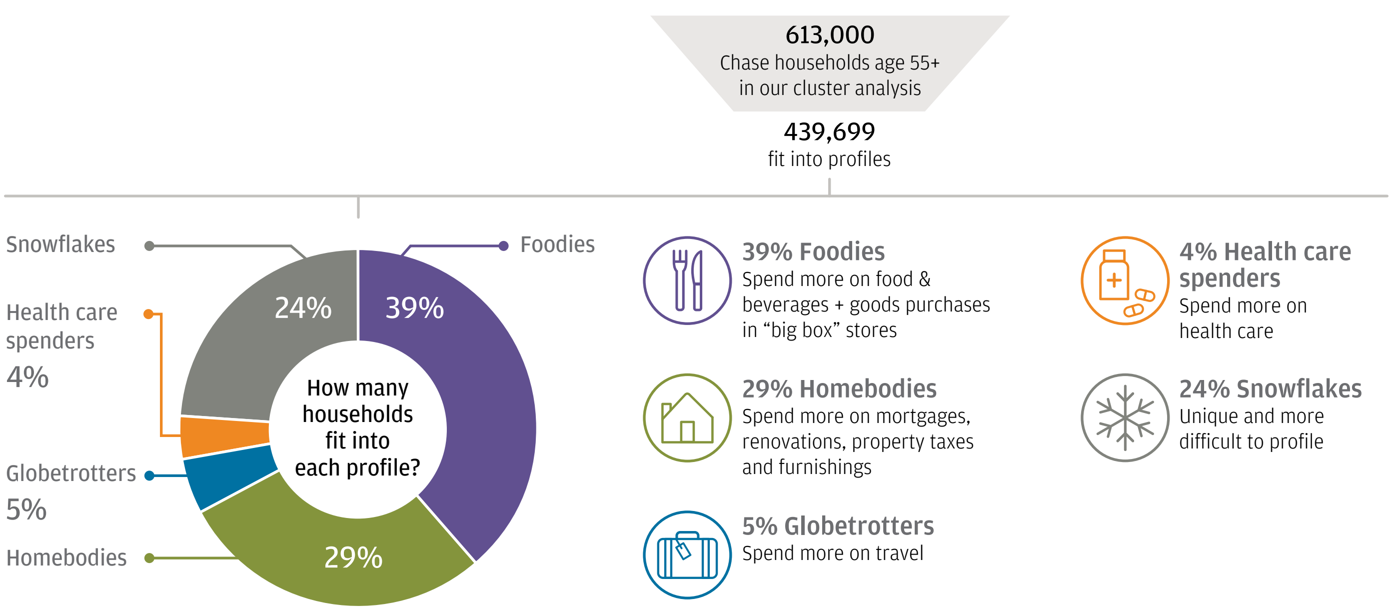
This group, which represents the largest percentage of the population, spends on average 28% of their income at retailers in the food and beverage category. It is important to note that these retailers include big box stores, such as Target, or their online peer, Amazon, so this spending could be on other goods as well. Outside of this shopping behavior, foodies are fairly frugal: of all the groups we examined they had the lowest overall total spending. They tend to have low housing expenses, often because they have paid off their mortgages and do not have significant property tax bills. They also tend to spend less as they get older. Retirement plans for foodies should separately account for health care costs and may use a lower rate of inflation (1% or 2%) for the rest of their expenses.

Homebody

Housing costs continue to be a major expense in retirement, even for those with no mortgages on their homes: real estate taxes, ongoing maintenance and other miscellaneous expenses often add up to higher-than-expected annual obligations. These expenses tend to increase with inflation, particularly because maintenance costs can increase both as owners age—they need to pay others to do chores they could once handle on their

Which of these households is most like the others?

EXHIBIT 3: RETIREMENT HOUSEHOLD CLASSIFICATIONS



Source: J.P. Morgan Chase. For illustrative purposes only.

own—and as houses age. Although in the homebody group there is considerable variation in spending on housing, on average households in this category spend 54% of their income on housing expenses, which we define to include utilities, wireless, broadband, cable or satellite television, home maintenance, repairs and furnishings, as well as mortgage payments, taxes and homeowners insurance. Spending such a significant share of total income on housing can be realistic when someone is working, but once earned income slows or stops it can be a significant burden. Homebodies constitute 30% of Chase households age 55 to 64 and 25% of the group age 65 and up.

Financial advisors helping their clients craft retirement plans should ask a range of questions about current housing expenses and plans for the future. This may be a quick way to get a good sense of spending over the retirement years. For example:

- Is there a plan to pay off the mortgage, and when?
- Is there a vacation home or a desire to buy one? A plan to sell a second home?
- Do property taxes and utility bills represent a substantial share of household spending? If so, overall spending may track close to overall inflation.
- Are there plans for downsizing, renovating or generating rental income?

Gathering this information is important: including any major changes in planned spending is a necessary component of any sound retirement plan.

Globetrotter

Our inveterate travelers, the globetrotters, represent about 7% to 8% of all households age 65 and up, devoting on average 25% of their income to travel. (Of the 55–64 age group, 3% are globetrotters.) Of all our household types, globetrotters have the highest overall spending. Among households with investible assets of $1 million-plus, 11% to 13% are globetrotters. This suggests that more households might fall into this profile category if they felt they could afford to travel more. Travel in retirement may reflect good savings behavior at younger ages—a good reason for some younger clients to boost savings.

Surprisingly, perhaps, there are just as many globetrotters over age 75 as there are in younger age groups. Spending on travel was also the highest for those age 75+ who fit this profile. We would assume that these are individuals who have traveled throughout their lives, like to travel and hope to keep going. Given how important travel is for these individuals, their financial plans should account for these ongoing expenses as a specific spending item. Although there is no inflation rate we can identify for travel expenses, it is important to tailor the spending assumption to the type and frequency of travel each individual prefers or has chosen in the past. For this group, it is probably best to assume their spending will keep going up with inflation. Unsurprisingly, globetrotters are thought to be a relatively happy group, illustrating a key finding of happiness research: experiences often deliver more lasting contentment than material things.[2]

Health care spender

For some retirees (2% of households age 55-64 and about 6% of households age 65+), health care expenses absorb a significant share of disposable income. On average, this group spends 28% of their income on health care; interestingly, about the same percentage of households are health care spenders across all household asset levels.

Medicare-related expenses were the main component of this spending. Given the historically high rate of health care spending growth and the considerable fluctuation in the inflation rate of health care costs, we believe it is prudent to assume that a 65-year-old with median prescription drug expenses will spend $4,400 a year on health care expenses, with those costs rising 7% a year. For those with very high prescription expenses, plans may include a cost of $6,900 at age 65, with a 5.4% inflation rate. In terms of the prospects for long-term care, higher net worth individuals may be especially concerned about spending down assets to pay for these expenses. These costs may be estimated and included in a financial plan at older ages as a stress test or an insurance solution may be considered. (For further reading, see our papers, “Health care costs in retirement” and “Long-term care.”)

[2] *Happy Money: The Science of Happier Spending* by Elizabeth Dunn and Michael Norton (2014).

USING SPENDING PROFILES IN A FINANCIAL PLAN

As part of the planning process, financial advisors should focus their clients' attention on current spending patterns and future goals. In **EXHIBIT 4** we present a roster of important questions that should be considered in creating a financial plan for retirement. Included in our advice to financial advisors:

- Plan for health care costs as a separate expense.
- Ask about housing costs and include significant changes: it is especially important to get housing expenses right, whether or not a retiree falls in the homebody category. Even when a mortgage is paid off, ongoing maintenance costs can be higher than expected.
- Inflation may be a particular concern for globetrotters and those with high non-mortgage-related housing expenses. This group may want to use a standard inflation rate for projected expenses in retirement.
- Inflation may be a less pressing concern for foodies as they may not increase spending in line with inflation each year. Their financial plans may sensibly use a relatively low rate of inflation (1% to 2%) for expenses other than health care.

INVESTMENT IMPLICATIONS

When assumptions are personalized for particular spending types, financial plans can be more targeted and effective. After a financial advisor has identified a client's spending profile, the advisor should have detailed discussions of where income has been—and will be—spent. The assumptions of the financial plan can then be tailored to fit the client's particular experience. Health care costs should always be carved out as a separate item in a plan. All other expenses should be carefully projected to most closely match a client's profile. In this way, spending assumptions will be more accurate and clients will have greater peace of mind based on what is important to them.

If inflation is a concern, as it is particularly for health care spenders, globetrotters and some homebodies, then there is a basic need for growth in the portfolio, even if income is important as well. If a retiree is likely to decrease spending over time, as foodies tend to do, income generation may be the chief concern. (Still, foodies shouldn't dismiss inflation concerns completely given that health care expenses tend to increase as we age.)

Across all profiles, realistic, personalized projections about spending and inflation will inform the most useful retirement plans and lead to the most successful outcomes.

Using the profiles to help clients

EXHIBIT 4: QUESTIONS TO CONSIDER IN CREATING A FINANCIAL PLAN FOR RETIREMENT

Get housing expenses right

- Do you have a mortgage, and if so, when will it be paid off? Do you have a vacation home or are you going to buy one?
- Do you have high property taxes? Are you planning a renovation?
- Will you have rental income or do you plan to downsize?

What categories will decline?

- Will you have fewer work-related expenses such as commuting and clothing?
- Will you eventually spend less supporting family including shopping at big box stores or for food?

Plan for increasing travel costs

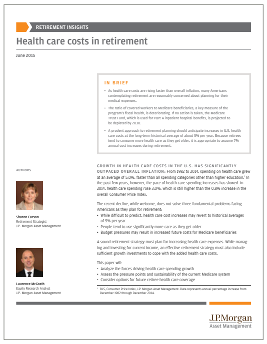
- Do you travel when you get the chance now?
- Do you plan to travel as long as you are healthy?
- What trips are on your bucket list?

Proactively address health care costs

- Do you already use expensive prescription drugs?
- Do you have enough assets or income set aside to pay for a possible long-term care event?

Source: J.P. Morgan Chase. Based on Chase credit card, debit and DDA mortgage payments from 9/2012-8/2013.

ADDITIONAL RESOURCES

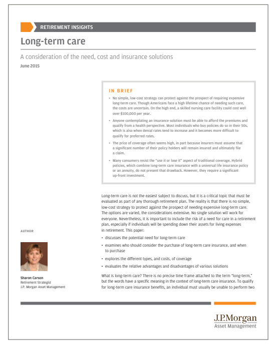

RETIREMENT INSIGHTS

Health care costs in retirement

J.P.Morgan Asset Management

HEALTH CARE COSTS IN RETIREMENT

Health care costs are rising faster than inflation. This paper discusses why retiree portfolios need growth as well as income.


RETIREMENT INSIGHTS

Long-term care

A consideration of the need, cost and insurance solutions

J.P.Morgan Asset Management

LONG-TERM CARE

A consideration of the need, cost and insurance solutions.

NEXT STEPS

To access these additional resources, or to learn more about the Retirement Insights program, please visit us at **www.jpmorganfunds.com/RI.**

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