# Three ways to manage spending volatility

## as clients transition into retirement

January 2018

Assumptions about how spending changes in the years just before and after retirement are a crucial part of retirement planning. New research, drawing on proprietary Chase data, gives us insights into real-world spending behaviors during the retirement transition years. Our analysis has found that for a majority of retirees, spending became volatile as they adjusted to this new phase of life—and that volatility may have serious financial implications through their retirement years.

Below we share highlights of our findings—and three ways for advisors to help their clients build stronger retirement portfolios.

### KEY FINDING: VOLATILE SPENDING AS HOUSEHOLDS ADJUST TO A NEW PHASE IN LIFE

We found that median spending gradually increased prior to retirement and tapered off in the early retirement years. This led us to the question: Were the same households that spent more before retirement also spending more after retirement? To find out, we designated the year before retirement as the benchmark year and then compared the benchmark with each of the three years following retirement. We also defined a significant variation in spending to be 20% more or less than the benchmark year.

EXHIBIT 1: SPENDING VOLATILITY

In each of the three years after retirement, spending increases or decreases by more than 20% compared with the year before retirement.

### OUR DATA ANALYSIS AT A GLANCE

- We started with 31 million households. By looking at changes in the mix of labor and retirement income, we determined who had likely retired during the study period, October 2012 to December 2016.
- We then narrowed our focus to only those who had retired and appeared to do most of their spending via Chase. This left us with a robust data set of nearly 60,000 households for our analysis.
- The most common retirement ages were 60 to 69, with a median age of 64.
- We also saw that people who retired before age 60 were more likely to have a pension.

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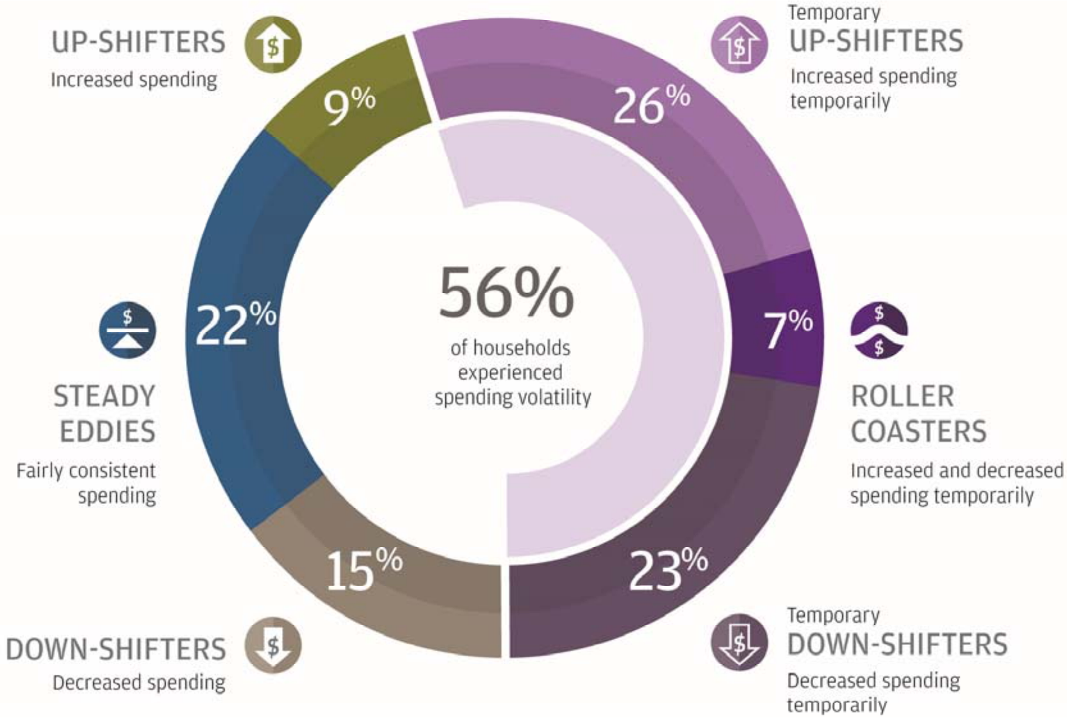
EXHIBIT 1: SPENDING VOLATILITY




Note: For those who retired age 60–69. Percentages may not add to 100 due to rounding.
Source: Aggregated and de-identified Chase credit card, debit card, electronic payment, ATM withdrawal and check transactions from October 1, 2012, to December 31, 2016. Outliers in each asset group were excluded (0.1% of top spenders in each spending category).

The majority of the households (56%) experienced spending volatility, including a small group with variation both up and down: the Roller Coasters. It is important to keep in mind that this spending behavior may not be permanent; we focused on a short period of time when individuals may be making adjustments as they are going through a lifestyle change.

## HOW TO MANAGE THE IMPACT OF SPENDING VOLATILITY

Many retirement plans include simple assumptions that use current spending as a starting point, since that is easy for individuals to understand. Given our results, we believe that plans also need to account for the possibility of a spending surge. This is critical because a large withdrawal from investments—just before or early in retirement—may have a significant impact on the portfolio, particularly if it happens to coincide with a bear market. We suggest that financial advisors:

- **Help identify large expenditures**
  Some clients have big plans and dreams for retirement. About five years before the retirement transition period is a good time to incorporate such changes, if they haven't already been accounted for in the plan. Discuss planned housing changes, such as moving to a new location or renovating a current home; a new vehicle; travel; plans to pay off debt; and lifestyle changes (such as going from skiing one week a year to skiing three months a year) and include them in the plan.

- **Stress-test a spending surge**
  Many clients may know what they are retiring from—but not what they are retiring to. For these individuals, stress-test a spending surge during one or more of the years just before and after retirement. Most commonly, spending may temporarily change about 30% up or down just before or after retirement, although over one-third of retirees have even bigger spending changes, including a few who temporarily more than double their spending in the retirement transition period, most likely as a result of a single event or purchase.

- **Build a cushion**
  Opportunistically move money to liquid assets prior to retirement to build a cushion that will mitigate the effects of unforeseen spending volatility and reduce sequence-of-return risk.

The takeaway for advisors is that addressing spending volatility in the transition years will make a vital difference to their clients' long-term financial well-being. For more information on our research and findings, listen to our webcast **Spending in Transition** ,which also includes trends in spending beyond the retirement transition period.

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Source: Aggregated and de-identified Chase credit card, debit card, electronic payment, ATM withdrawal and check transactions from October 1, 2012 to December 31, 2016. Outliers in each asset group were excluded (0.1% of top spenders in each spending category). Information that would have allowed identification of specific customers was removed prior to the analysis.

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