7 Secrets to a Richer Retirement

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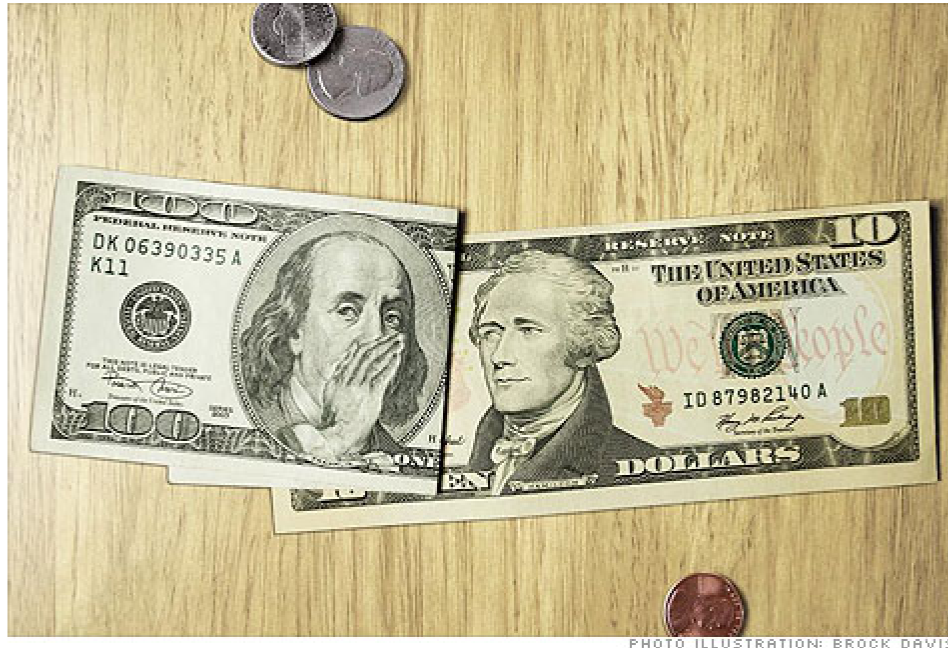

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(MONEY Magazine) -- With stock returns projected to be low and pensions going the way of Lindsay Lohan's career, retirement planning can seem awfully daunting these days. You can't change the market or your employer's largesse.

But there is one factor you can do something about: you. You can be your own worst enemy, buying what's hot only to sell in a panic or wildly overestimating how long your money will last.
"Our brains are hardwired in ways that are the opposite of what we need to invest well," says Carnegie Mellon economics and psychology professor George Loewenstein.

Fortunately, a new wave of research is emerging from the still-young field of behavioral finance -- a blend of psychology, neuroscience, and economics -- that gives better insight into how your unconscious can help or hurt your financial future.

Though much of the work is still in progress (retiree avatars, anyone?), it suggests specific moves you can make before and during retirement to avoid your worst tendencies and get the most from your best intentions.

Secret #1: Get a good picture of the future you

You probably imagine that when you're retired, you'll be pretty much like you are now -- maybe with a new fondness for early-bird specials and PBS wellness shows. But studies show that the present-day you doesn't really identify with this future person very much.

In fact, "your mind creates neural patterns similar to those created when you think about a stranger," says Northwestern University researcher Hal Ersner-Hershfield. That disconnect means you're reluctant to trade rewards today for rewards tomorrow -- the biggest hurdle to saving for retirement.

25 Best Places to Retire

Behavioral scientists wondered: Could creating a better picture of your older self help you improve focus on your long-term goals? Researchers at Stanford University recently tested that question.

They put two groups of college students in virtual reality headgear and had them interact with life-size versions of themselves. (Each student shared a room with his or her avatar, which mirrored that person's movements.)

One group of students saw themselves at their current age; the other saw themselves age-morphed to appear 70 years old. Then the researchers asked how much the students would save for retirement. Those in the latter group said they would save twice as much, on average, as the other.
Experts are now building online tools to help you do such visualizations. Example: Ersner-Hershfield and colleagues are testing software that changes your photo as you move a slider to select different savings levels.

If you choose a low savings rate, your current photo will look happy (I can spend more now!), but your older one will look sad (my nest egg is shrinking!). So far they've found that people who see older, sadder versions of themselves choose to save 6.75% of salary, on average, vs. 5.2%.
Put these findings into action:

Write it down. While you're waiting for such a slider to hit the Net, do a lower-tech exercise. Imagine the retirement future you want -- house by the lake? annual trips to Italy? worry-free sleep? -- in as much detail as possible. Then write down how you feel about that future. "It's not just imagining, but the act of writing, that helps you to focus your thoughts and take action," says Alessandro Previtero of the Ivey School at the University of Western Ontario.

Think of Gramps or Nana. "The grandparent of your sex who you most closely identified with can be a great proxy for your future self," says Ersner-Hershfield. Calling him or her to mind can lead people to budget better and save more, Northwestern researchers found.

Secret #2: Try to beat the other guy

Thanks to your normal natural competitiveness, comparing yourself to others can speed you to your goals -- just look at TV's *The Biggest Loser*.

This strategy has definite potential in retirement planning. Preliminary research suggests that people who see data showing how their peers are saving are more likely to participate in their company retirement plans and to put more money in.

Thanks in part to these findings, financial services company ING recently set up a website that allows people eligible for some 401(k) plans it administers to compare their progress against that of their colleagues.

So far more than 20% of people who have spent time with the tool have made a positive change, such as joining the plan or upping the percentage of salary they contribute, says Ashley Agard, head of retirement research at the company.

Your peers can be powerful in another way too: They can put pressure on you to meet your goals. So-called commitment strategies, in which people publicly proclaim their intention of hitting a target, are often effective for those seeking to lose weight or stop smoking.

Now researchers are looking at how well they work to help increase saving. In 2008 Yale professors Ian Ayres and Dean Karlan launched StickK.com, a free website that lets users make a public or private commitment for just about any kind of goal.

To up the pressure still more, users can bet money on the outcome. The researchers need more data to show how well the approach works for retirement-related commitments, but early results are encouraging.

Put these findings into action:

Benchmark yourself. You can start at INGcompareme.com, a public website run by ING. There you compare your financial status -- free and anonymously -- with those of nearly 140,000 other users who have similar ages, incomes, and other details.

Does your savings level fall short? Get moving! Are you way ahead? Great, but just because you're beating your peers doesn't necessarily mean you'll meet your goals, warns Jack VanDerhei, research director at the Employee Benefits Research Institute.

To see if you've succeeded in hitting recommended savings benchmarks, check out our retirement checklist.

Make a commitment contract. You could do anything from telling a few friends about your savings goal and asking for their support -- perhaps meeting once a month -- to placing a bet in public that you'll succeed in reaching a certain saving level by a certain time. You can broadcast your pledge via social media such as Facebook or Twitter. Or use **StickK.com**.

Secret #3: Use reminders and checklists

Human beings are prone to distraction by immediate events -- helpful in the days when an angry wildebeest might interrupt your dinner, but not so much when you're planning for retirement. "Reminders are one of the simplest, lowest-cost ways to cut through distractions and stay focused on your goal," says Yale's Karlan.

He and other researchers working with banks in Peru, Bolivia, and the Philippines looked at the impact of sending account holders reminders to save by text message or postcard. The savers who got those messages put away as much as 16% more.

Checklists are another effective tool to help you stay on task. As Harvard surgeon Atul Gawande pointed out in his 2009 book, *The Checklist Manifesto*, the simple act of going through one of these lists can help you avoid missing a vital step.

When surgeons and airline pilots began using them, hospital infection rates and pilot error declined. No wonder so many financial advisers rely on checklists for clients nearing retirement.

Put these findings into action:

Arrange automatic prompts. It's easy: Just set e-mail alerts in your digital calendar or via a personal finance website such as Mint.com. The most effective, says Karlan, are as specific as possible ("put $1,000 in my Roth IRA on Dec. 1," not "save more for retirement"). Arrange for them to hit your in-box at tax time, at bonus time, and after your year-end statements arrive (to prompt you to rebalance).

Put a reminder where you'll see it every day. Remember that Northwestern study showing that thinking about a grandparent can help you save? Study subjects wore wristbands with the acronym WWGD (What Would Grandma/Grandpa Do?) written on them. Hokey, sure -- but effective. Placing

a reminder of your goal where you'll see it day in and day out (a photo of your dream retirement house by your bed, for example) could have a similar effect.

Secret #4: Think in bite-size pieces

Use a retirement checklist each year. For one tailored to your age group, try ours.
Your 401(k) plan has likely trained you to think about building a single lump sum. But even savvy investors tend to overestimate how long such a sum will last.

When you look at a dollar figure, explains Princeton psychology professor Eldar Shafir, you're inclined to focus on its nominal value rather than on its total purchasing power, which will be eroded by inflation.

Experts call this phenomenon "the money illusion." And they've come up with a technique to correct it, known as reframing. Instead of focusing on the total sum, focus on the monthly income that the sum will create during your retirement years.

"People understand how much money they need each month, so it makes the saving process more relevant," says UCLA behavioral finance professor Shlomo Benartzi.

The idea is catching on. Financial services firm Putnam, for example, recently redesigned the website and statements for the 401(k) plans it administers to prominently display monthly income projections rather than total balances.

Put these findings into action:

Run the numbers. Estimate your monthly retirement income by using the calculator at troweprice.com. Compare that amount with what you'd like to spend. Falling short? Ramp up saving, cut spending, or postpone retirement (or all three).

Tweak your investment mix. Inflation, tame now, could increase dramatically over the years, warns Marilyn Dimitroff, a financial adviser in Bloomfield Hills, Mich. One way to limit the damage is to increase the amount of money you keep in dividend-paying stocks.

Secret #5: Make friends with an annuity

Many retirees should consider an immediate annuity, which kicks off a fixed, regular stream of income for life. The advantage isn't just financial: Studies show that retirees who have guaranteed income to cover some of their costs are happier than those who don't.

So why do few people buy annuities? Partly owing to legitimate concerns about insurers that sell them -- the AIG bailout certainly didn't inspire confidence. But also at work is a fear of losing control, plus a bias called the endowment effect: You value what's in your possession more highly than something you don't have, even if that something else is worth just as much. Annuities trigger that bias because they require you to "give up" a big chunk of money upfront.

To learn how to combat this tendency, Jeffrey Brown, a finance professor at the University of Illinois, and some colleagues recently tested different ways of describing annuities to a group of people 50 and older.

One description was of a monthly income of $650 for life; another, a return of $650 for life. Same thing -- but three times more people went for the first option. "Just shifting the perspective away from accumulating wealth to producing income can make a big difference," Brown says.

Put these findings into action:

Remember: It's not all or nothing. One way to overcome your reluctance to lose control, says Harold Evensky, a financial adviser in Coral Gables, Fla., is to remember that the standard advice is to put just a portion of your retirement savings into an annuity -- and to focus on the reliable monthly income it can provide.

See if you can snag an institutional rate. Knowing you got a good deal can help lower your anxiety. And about 1,200 employers now allow their 401(k) participants to buy immediate annuities through a service called Income Solutions at low prices that only large institutions typically get. What's more, Vanguard just announced it will do the same for its 401(k) and retail investors. Check with your plan to see if you qualify.

Secret #6: Take losses in stride

Behavioral scientists have long known that people feel the pain of losses more strongly than the joy of gains. They call this phenomenon loss aversion. What they're just beginning to learn, however, is that retirees are generally much more loss averse than younger people.

How much more? Columbia University business professor Eric Johnson recently conducted a study to find out. He assembled a group of people over age 60 and asked them if they would take the following wager: You have a 50% chance of winning $100 and a 50% chance of losing $10.

Nearly half of those people said they would refuse the gamble -- meaning that they weighed losses 10 times more heavily than gains. By contrast, earlier studies have shown that the population as a whole tends to weigh losses two to three times more heavily than gains.

Reseachers aren't yet sure why loss aversion spikes with age. As you get older, you may feel that you can't afford to take hits to your portfolio because you have fewer years ahead to make up for them.

Another factor may be the endowment effect (see point No. 5), which increases your desire to hold on to something you already have. Whatever the cause, loss aversion is a problem if it leads you to invest too conservatively in your retirement years, loading up on bonds while avoiding stocks. Your stash becomes more vulnerable to inflation that way.

Put these findings into action:

Keep up your financial knowledge. Research suggests that well-educated investors are much less loss averse than average. So continue to follow money news and advice in retirement, or even sign up for a personal-finance class.

Fix your mix. Anthony Ogorek, a financial adviser in Williamsville, N.Y., recommends that by the time you pass age 60 you keep no more than 60% of your assets in stocks: You will be less likely to freak out and flee to 100% cash the next time the market tanks.

Get some outside perspective in your later years. That might mean investing some money in a life-cycle fund targeted to your age or using a money manager (available affordably these days via many 401(k) plans).

Secret #7: Protect the future you

As you age your brain undergoes subtle changes that can affect how you manage money. For example, you'll probably become more optimistic -- a phenomenon known as the positivity effect. In hunter-gatherer days, when you got older, you were no longer called upon to grab a spear and defend the tribe. "You no longer needed to be so focused on all the things that could go wrong," says Laura Carstensen, director of the Stanford Center on Longevity.

Hey, what's wrong with a little optimism? It's one reason old folks tend to be happier than younger ones, according to recent studies. But the positivity effect can also make the 2030 you -- or maybe your parents right now -- less attuned to threats and therefore more vulnerable to scammers.
It's not that older people find the idea of losing money any easier, but that they're more likely to think, "That nice young man would never cheat me."

The more serious risk, of course, is an outright decline in mental abilities. New studies show that this decline is more common than you may realize. After 60, the rate of dementia doubles every five years. By the time they reach their mid-eighties, half of people have some cognitive impairment.

Yet older people are increasingly expected to manage their portfolios on their own -- a fact that has helped make cognitive decline a hot topic among behavioral scientists. Facing the risks now, while you're at the peak of your powers, is a good thing, says Harvard economics professor David Laibson: It means you can act today to protect yourself tomorrow.

Put these findings into action:

Stay active. Researchers have not yet discovered a prescription for staving off cognitive decline. But so far, studies indicate that working out both your body and your brain -- through regular walks, reading books, and solving puzzles, for example -- may help.

Simplify your finances when you retire, suggests Rosanne Rogé, a financial adviser in Bohemia, N.Y.: "It will be harder to mess things up."

Be hard to find. Discourage scam artists from getting to you (or your parents) by keeping the latest spam filters installed on your computers, putting yourself on the national Do Not Call registry, and using caller ID in case any telemarketers slip past.

Arrange now for help later. You need a durable power of attorney, which gives a person you name the authority to make financial decisions for you if it becomes necessary. Assuming you have a will, you probably already have a DPA: They're typically drawn up at the same time. But many financial firms require you to fill out their own forms too. Do so by the time you retire, suggests New York elder-law attorney Daniel Fish. Your future self may thank you.