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4 stages of retirement planning

Planning for retirement is a four-stage process, and requires different strategies

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In ancient Indian texts, it was believed that human life was divided into four ashrams—four stages representing different roles and responsibilities to oneself, family and society. In the same way, planning for retirement is also a four-stage process, and requires different strategies.

Stage 1—I want it all: This stage typically comes 10-30 years before retirement. It is a stage characterised by multiple priorities—the need to accelerate career growth and professional income, planning for children's education, supporting aging parents, a desire to upgrade lifestyle, and the need to plan for retirement. With multiple goals to plan for, the short- and medium-term goals tend to get priority, leaving goals like retirement on the back-burner. Prioritisation of goals is key in this particular stage, and so is the need to understand trade-offs. Impact of inflation on each goal should not be underestimated. Seek professional help if needed.

Managing expenses and working to a defined budget is critical as is a well directed spending strategy. For example, spending on programmes that improve your professional knowledge and skills, is a good spend. Use leverage carefully—leverage is neither good nor bad; it is what you do with it that matters.

Build a specific investment strategy for each goal, with a mix of asset classes that depend on the investment horizon. Since there may be multiple dependencies on you, ensure that you have adequate life, health and critical illness insurance for yourself and your family, along with coverage for assets such as homes and cars.

Stage 2—Time is too short: This stage typically comes 3-10 years before retirement. There are many things to do, but time is less. Knowing how much is enough for retirement takes on increased importance. With corporate careers getting shorter and lifestyle diseases becoming rampant, there is a real risk in this phase that what you thought would be your age of retirement, may not be so. Thus, accelerating your savings and investment rate is critical. As retirement nears, it is important to start moving a portion of the portfolio into defensive assets such as bonds, and fixed income-generating assets that can generate cash flow in a tax-efficient manner once you retire.

Remember to keep a portion of your investments in growth-oriented assets as well, such as equities, to ensure inflation-plus returns for the post-retirement period. It is also critical that large expenses such as higher education for children and marriages are spent on prudently, as these could have a direct impact on the quality of your retirement.

Try to eliminate all debt during this phase. Closely examine the medical insurance covers that you have for yourself and your spouse, so that you are well protected from rapidly escalating medical costs. It's also important to have a Will and a robust succession plan in place. Think about what you will do in the post-retirement phase. Choosing a second career will keep you engaged, financially and mentally.

Stage 3—What do I do with my time? This stage takes place for a period ranging from a few days to about 10 years after retirement. Since this is a phase that typically follows a period where you were short on time, it tends to be enjoyable for a certain period. However, it could also come at a steep cost, as travel and entertainment becomes a time management strategy, thereby creating cash flow mismatches. Spending during this period could also come with enhanced guilt and the fear of running out of money. This stage could also coincide with an empty nest syndrome, wherein children become independent, or require start-up capital to set up a business or buy a home, making you worry about capital draw-downs.

It is important in this stage to accept that your cash flows will come from a combination of fixed sources (for example, interest, systematic withdrawal plans from mutual funds, and annuities) and variable sources (such as dividends, capital gains, rental income). Therefore, cash flows will tend to be variable, unlike a salary which tends to be largely fixed in the earlier stages.

Along with expense management, it's also important to maintain a balance between spending for today and worrying about tomorrow. You can look to cut down unnecessary expenses. Provision for health care may change, as certain health challenges start to emerge. Charitable causes may be supported with money and time.

Stage 4—Now's my time to give back: This stage tends be filled with reflection and typically follows a period after retirement, wherein the willingness to be active reduces.

In this phase, it is important to be prepared to lose a lifelong partner, face a reduction in assets as you continue to draw down on your wealth, and face situations whereby your mind wishes to do something, but your body does not support you. During this phase, it is critical to consolidate your assets to make them simple to manage and then be passed on to heirs. Be prepared for challenges like memory loss and inability to sign. Prepare for these by signing documents such as power of attorneys in favour of trusted persons or institutions, and updating your Will and succession planning documents. You may also need to decide which of your assets you wish to pass on during your lifetime, and which later.

This phase may also require you to rework your asset allocation strategy to become more conservative. You may set up advanced directives, wherein you leave messages for your loved ones, share views on your last rites, and support charities.

Just like the ashrams of life, there is no fixed age band for each of these retirement planning stages, nor is there a fixed time. For some, the stages may come earlier, for others later. But the need for retirement planning is common for all, and you should be prepared for it.

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