Webinar Summary

SPENDING IN RETIREMENT

JOSH COHEN
Managing Director &
Head of Institutional Defined
Contribution,
PGIM

MICHAEL FINKE
Professor & Frank M.
Engle Distinguished
Chair in Economic Security,
The American College of Financial Services

MATT PERNA
Director, Institutional Defined
Contribution,
PGIM

JEREMY STEMPIEN
Principal, Portfolio
Manager & Strategist,
Global Multi-Asset Solutions,
QMA, a PGIM company

PGIM's defined contribution and QMA teams recently published a paper exploring the concept of "Needs and Wants" spending in retirement. Along with special guest Professor Michael Finke, the authors also held a webinar to discuss their findings and to examine how providing more participant customization can help improve outcomes. Following are some of the highlights from the discussion:

- **Adopting a liability mindset:** The goal of a retirement investing strategy should be to provide future income to participants, not simply to focus on accumulating assets. The best way to make certain plan participants are positioned to meet their future spending liabilities is to offer investment solutions that are designed to provide the income necessary to do so.

- **The importance of customization:** Retirees have different spending patterns and different types of spending in retirement that require unique solutions, so a more customized approach will ultimately be needed to solve for lifetime income. Participants are going to need more tailored strategies based on their individual circumstances as they approach and enter retirement. For example, using a dynamic or hybrid Qualified Default Investment Alternative (QDIA) where younger participants in a TDF transition into a technology-driven solution like a managed account may be a smart option.

- **Retirement spending varies greatly:** A retirees' liabilities are often thought of within the context of a "replacement rate," or the proportion of after-tax income needed in retirement relative to gross income pre-retirement. But that can oversimplify how spending in retirement is viewed because it treats all types of spending equally. Assuming a single replacement rate may be appropriate for some workers but is inevitably going to create suboptimal outcomes for those with lower and higher target replacement rates.

- **Spending over time:** Research shows that most retirees tend to spend the same the year before retirement as in their first year of retirement. However, their real after-inflation spending declines in each year throughput retirement, and the rate of that decline tends to go up. So, when designing a customized portfolio, it doesn't necessarily need to be done in such a way that it will provide a constant inflation-adjusted income, but instead will roughly match that gradual decline in spending.

- **Needs and Wants spending:** Expenses can be best categorized into two main groups: "Needs" and "Wants," or non-discretionary and discretionary. For most of retirement, the ratio of Needs to Wants remains relatively stable, but over time Wants spending tends to decrease more than that of Needs. Looking at the ratio from an income perspective, we found that Needs expenses were always greater than Wants, but there was notable variation in the results. Retirees with higher incomes have ratios of Needs to Wants that are lower than their lower-income counterparts.

- **Investing for Needs and Wants Liabilities:** Needs income can be addressed with more predictable sources of income such as social security, DB plans, Liability Driven Investments and Guaranteed Income. Wants liabilities can be managed with a more traditional balanced allocation to growth and diversifying investment strategies that can provide a relatively predictable source of income over the long term, with the potential for upside return.

Watch a replay of the Spending in Retirement webinar, and read all of PGIM's DC thought leadership at pgim.com/DC