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GETTING GOING

By JONATHAN CLEMENTS



Forget the Rule of Thumb: Saving 10% of Your Salary Is No Longer Enough

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Just when folks ought to be saving more, they are saving less. Trouble ahead? You'd better believe it.

Yes, I have heard all the arguments about how the true savings rate is higher than the 1.3% calculated for 2004 by the Commerce Department's Bureau of Economic Analysis, or BEA. But don't let that distract you from the bigger issue.

In a world of disappearing company pensions, skimpy bond yields, rich stock valuations and rising life expectancies, anybody interested in a comfortable retirement should be saving a truckload of money every year -- and yet most folks aren't.

• **Rate debate.** Among pundits, belittling the official savings rate has become something of a national pastime. Some of the arguments seem a little suspect, like the suggestion that buying televisions, cars and other consumer durables ought to be considered saving rather than spending.

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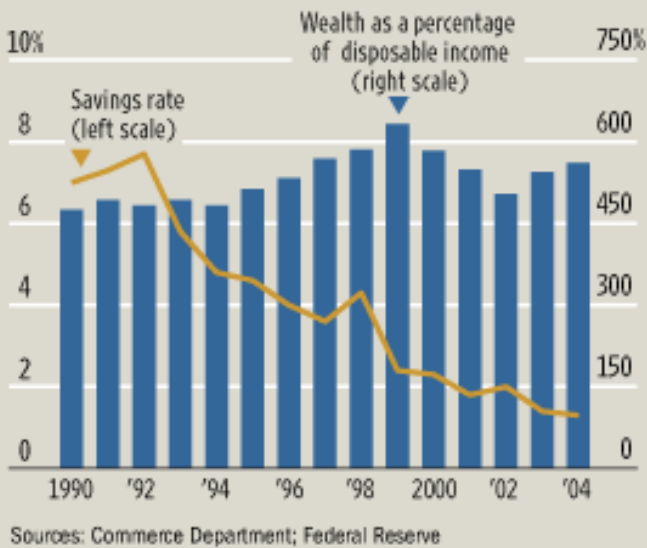
ABOUT THE AUTHOR

Jonathan Clements has written The Wall Street Journal's Getting Going personal-finance column since October 1994. Born in London, Jonathan is a graduate of Emmanuel College, Cambridge University, where he edited the student newspaper. He was a writer and researcher for Euromoney magazine in London before moving to the New York area in 1986. Prior to joining the Journal in January 1990, he covered mutual funds for Forbes magazine.

Jonathan is the author of "You've Lost It, Now What? How to Beat the Bear Market and Still Retire on Time," published in 2003. His earlier books include "25 Myths You've Got to Avoid -- If You Want to Manage Your Money Right" and "Funding Your Future: The Only Guide to Mutual Funds You'll Ever Need." He has two children and lives in Metuchen, N.J.

Poor Planning

As their net worth ballooned in the 1990s, Americans saved less. But when their wealth declined in 2000-2002, they didn't boost savings to compensate.



Other criticisms are more valid. For instance, stock-market gains don't count toward the official savings rate, which strikes me as the right way to do it. Problem is, under the BEA's methodology, if a winning stock is sold and capital-gains taxes are paid, that tax payment reduces the savings rate.

Still, the impact isn't huge. Even in a big year for capital-gains taxes, like 2000, removing the tax impact would boost the savings rate by a mere 1.7 percentage points, calculates BEA research economist Marshall

Reinsdorf.

More important, just because the true savings rate is a tad higher is hardly cause for celebration. The fact is, we should still be mighty worried, for two reasons.

- **Double trouble.** First, the official methodology may be flawed, as critics charge. But it is applied consistently. In other words, if the methodology is understating savings today, then presumably it's also understating savings in earlier years, suggesting we have indeed become more profligate.

Last year's 1.3% savings rate was the lowest since 1934 and well below the 8% to 10% of disposable income that was typically saved in the 1960s, 1970s and 1980s. The decline in the savings rate is "too big to explain away," Mr. Reinsdorf argues. "The overall conclusion, that people are saving less than they used to, doesn't change."

That brings us to the second problem: Instead of saving less, we ought to be saving more. After all, traditional defined-benefit pension plans are disappearing, even as we face a longer retirement.

Today, a 65-year-old man can expect to live an additional 17 years. That compares with 13 years for a man who turned 65 in 1950. Meanwhile, a 65-year-old woman can now expect to live 20 more years, versus 16 years in 1950.

Adding to our financial difficulties, we are looking at modest investment returns, especially after the heady gains of the past quarter century.

Consider bonds. The yield on the 10-year Treasury note went from almost 16% in 1981 to 4% today, driving up bond prices along the way. That's a one-time gain that won't be repeated. Yields can't fall another 12

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percentage points.

Similarly, the stock market went from less than eight times trailing 12-month reported earnings in 1982 to 20 times earnings today. Stocks can't repeat the climb from eight to 20 times earnings (unless, of course, we get a big crash first).

Yet, oddly enough, the savings rate has been criticized because it doesn't include these increases in household wealth. True, when their investments appreciate, folks may feel wealthier and that may explain the low savings rate. But capital gains don't regularly add to wealth, the way regular savings do -- and big gains may, in fact, augur badly for the future.

In recent years, Americans have also seen their wealth balloon because of the booming real-estate market, and pundits have cited those gains to explain the low savings rate. But this strikes me as a dubious reason to save less.

Sure, upon retirement, you could take out a reverse mortgage or sell your San Francisco townhouse and buy cheaper digs in Des Moines. But let's be realistic: How many folks are going to adopt these strategies?

- **Saving yourself.** Whenever I decry the low savings rate, I get email from folks who note that, if everybody saved like crazy, the U.S. economy would grind to a halt.

OK, we'll make it our little secret. We won't tell the neighbors that they are saving pathetically little and that they probably won't retire until age 76. Let them do their patriotic duty by storming the shopping mall on the weekend.

But for goodness sake, save yourself. The figures suggest there's a lot of saving needed. According to AARP's analysis of the Federal Reserve's 2001 Survey of Consumer Finances, households headed by baby boomers had median financial assets of just \$50,700. Based on a 5% withdrawal rate, that would generate a meager \$2,535 of annual retirement income.

What to do? Forget the old rule of thumb that says you should sock away 10% of your pretax income every year. Today, folks need to save a lot more than that, argues Frank Moore, a financial planner in Ann Arbor, Mich.

"The 10% goes back to the days when most people had a defined-benefit pension plan," he notes. "The idea was that, if you saved 10% and you had a pension and Social Security, you'd be in great shape. But today, many people have lost that defined-benefit pension plan. I think people should be saving at least 15% or 20%."

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