EDITOR'S NOTE

Charles Rotblut, CFA
Editor of the *AAII Journal*
@charlesraaii

The Importance of Financial Literacy

April is National Financial Literacy Month. While many of you reading this are financially literate, a significant number of Americans are not. Financial illiteracy is not limited to the U.S., it has been documented in several other countries too.

Tests on financial literacy revolve around a few key concepts, compounding being one. Compound returns are why investors are encouraged to allocate to stocks. Realizing returns on capital appreciation and reinvested dividends is what makes stocks a key creator of wealth. Small starting amounts can grow to large sums when invested in a disciplined manner over a sufficiently long enough period of time. Debt has the opposite impact on wealth. Fail to pay down the principal, and the interest charged on interest will put you into a bigger hole. Hence, the concerns with credit card debt and, even worse, payday loans.

APRIL IS: Financial Literacy Month

We address the concept of compounding in this month's InvestoGraphic on page 24. If you have a child, grandchild or friend who doesn't understand the concept, show it to them. Better yet, buy them a membership to AAII; we'd like to help educate them.

Those who want to test your financial literacy skills should see "Five Key Financial Concepts" in the October 2015 *AAII Journal*. You can find it in our online archives if you no longer have the issue. It lists five questions commonly asked to test literacy.

There's another aspect to financial literacy: retirement readiness. Out of more than 1,200 adults ages 60–75 surveyed by The American College New York Life Center for Retirement Income, just 5% scored the equivalent of a B grade or higher (answering at least 80% of responses correctly). Worse yet, nearly three-quarters of respondents failed this quiz. With millions of baby boomers retiring or getting close to retirement, this is troublesome.

What's on the quiz? Topics include when to claim Social Security, the relationship between yields and risk, the relationship between the cost of an annuity and how early payments start, and how much long-term care Medicaid pays for. We discussed the 2016 version of it in the Dispatches/Briefly Noted section of the March 2016 *AAII Journal* ("The Financial Literacy Quiz That Many Retirees Flunked"). Those of you who want to try it can find an updated link to the quiz in the online version of the article.

Think for a moment about the 64-year-old person who hasn't spent time educating themselves about how best to transition into retirement. They must soon make decisions about Medicare—decisions that could have potentially large ramifications depending on their current and future health. They need to consider when to begin claiming Social Security benefits, as well as coordinating the filing of claims with their spouse, if married. On the portfolio side, they need to consider allocations, withdrawal strategies and the tax impacts of required minimum distributions (RMDs). Then there is the subject of retirement income, specifically how much they can realistically expect to have without exhausting their savings prematurely.

These are big issues. They also don't address many other considerations. What activities are planned for retirement? Is the intent to age in place or move? Is the envisioned retirement something that is actually realistic based on financial means or pure interest? (Travel can be fun but may lose its appeal for some if done too frequently.)

A lot of people are going to head into their retirement years without a plan. They're going to make mistakes. Some mistakes may be correctable (e.g., changing what they thought their regular activities would be), while some mistakes will have consequences for the remainder of the retiree's life (e.g., claiming Social Security too early or withdrawing too much money during the first few years of retirement).

We've addressed some of these issues before. This month, we're revisiting a big challenge: making the right decisions about Medicare. Though not investing per se, what you spend on health care affects how much income you will need in retirement. Making the best possible decisions on Medicare given what you know about your (and your parents') medical history can help you extend the life of your portfolio.

The article is an excerpt from Steve Vernon's latest (and excellent) book, "Retirement Game-Changers" (Rest-of-Life Communications, 2018). Vernon is a research scholar at the Stanford Center on Longevity. If you are nearing age 65 or are already enrolled in Medicare, I suggest reading his article. It will help you better understand your options.