



Retire Utilizing Buckets of Money

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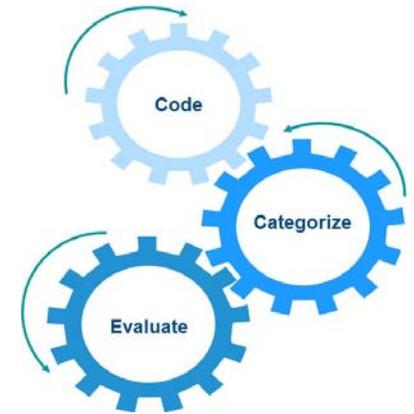
BUILT TO PERFORM.

CREATED TO SERVE.

Mental Accounting



Decision making is exhausting..So we cheat!
Our minds code, categorize and evaluate economic activities



Housing



Food



Savings



Entertainment

Mental Accounting can have tremendous benefits

Save precious time 

Economize our thinking 

Increase self control 

Why don't we reap these benefits?
Rather than apply pure logic, we use subjectivity

Subjectivity in Mental Accounting



Typically we do not lead with the analytical component of our minds

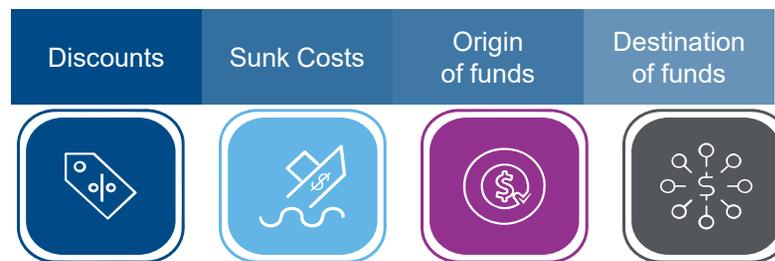
Prefrontal cortex associated with complex decision making, problem solving

Mental Accounting, especially initially, is designed with an emotional emphasis

Focus on the perceived value that others attribute to us

Emotions lead to us to use subjective criteria

Not necessarily the best architecture for happiness



Examine these one at a time and conduct a fun experiment (or two)



Discounts

Not all discounts are created equal

Imagine that you are about to purchase a calculator for \$15. The salesman informs you that the calculator is on sale for \$10 at the other branch of the store, located 20 minutes away.

Would you make the trip to the other store?

Imagine that you are about to purchase **a jacket for \$125**. The salesman informs you that the jacket is **on sale for \$120** at the other branch of the store, located 20 minutes away.

Respondents	Save \$5 on \$15	Save \$5 on \$125
Yes	55%	23%
No	45%	77%



\$5 for a 20 minute ride

Source: Science, New Series, Vol.211, No.4481, January 30,1981, Tversky Kahneman

Sunk cost fallacy



Discounts

Sunk Costs

We continue to invest time, money, and effort simply because we already made the investment

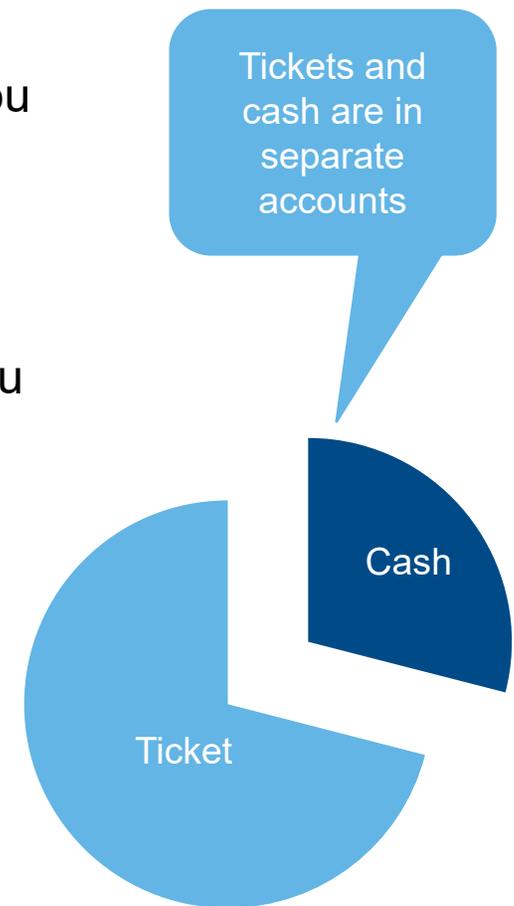
Imagine you paid \$100 for a ticket to a Broadway show. You arrive at the theater only to discover you lost your ticket.

Would you pay \$100 for a replacement ticket?

Imagine that you **planned to buy a ticket** to a Broadway show for \$100. You arrive at the theater only to discover you **lost \$100 in cash.**

Respondents	Lost the Ticket
Yes	42%
No	58%

Source: Kahneman Tversky, 1984



Origin of funds



Discounts

Sunk Costs

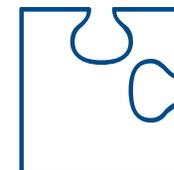
Origin of funds

We categorize funds differently based on where they originated from

We apply different levels of risk based on the “logical to emotional” spectrum

Consider the source	Category	Risk	Logical
Earned Income			

Source: TIAA



Destination of funds



Discounts	Sunk Costs	Origin of funds	Destination of funds
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Our willingness to pay shifts with a reference point

How much would you pay for floor mats on your new car?

Generic floor mats from a discount store	Brand car floor mats from online retailer	Brand floor mats from dealer	Brand floor mats in a package deal
\$11.95	\$93.55		
\$18.95	\$99.00	\$143.00	\$?
\$19.99	\$118.36		

Spending in one category lowers future spending in that category

	Housing	Food	Transportation	Savings	Entertainment
Amount to spend	\$2,000	\$500	\$300	\$750	\$500

Mental Accounting is instinctual



Three possible outcomes:

Status Quo

Fight instincts

Start anew for retirement

Continue with our existing Mental Accounting system

Downside is limited when the stakes are low (early career)

Fight our instincts and continually apply logic

Complexity, fatigue, and even aging will work against you

Slow down, develop a new system for retirement then rely on habits

Select a time with low emotions, high intellect (in your 50s)

Design with precision



We use the slightest imprecisions to uncover loopholes that work in our favor

Example: Airline, hotel, & food are bundled into one; clearly vacation

Grocery budget is \$800 month, after a two week vacation, \$0 has been spent on groceries

Example: A gardener realizes the hobby funds have been entirely spent

Goes grocery shopping and uses trash to create a garden– Which account gets charged?



Example: Eating out with friends at a piano bar; food or entertainment?

What if the friends came over to your home and food was delivered

Mental Accounting in retirement key switch



Early career results in small contributions to many different buckets



Retirement is the time to completely fund one bucket before moving to the next



Mental Accounting in retirement



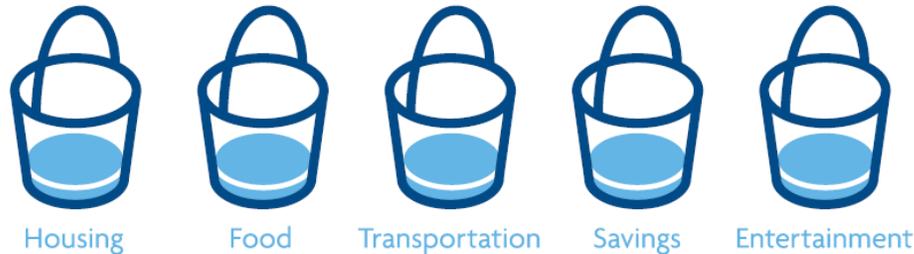
Unlike the first time around, retirement stakes are higher

Larger assets to work with (hopefully)

Less time to make up for mistakes we make

One strategy is to stop contributing a small amount to many categories

Instead completely fund one category before moving on to the next



Category	Fund in Order
Necessities	1st
Healthcare	2nd
Emergencies	3rd
Fun	4th
Bequest	5th

Mental Accounting in retirement



Necessities

Many necessities are clear

Others are subjective; Grandchildren expense

Certain necessities, no matter how we personalize them, are critical

Having several sources of income in retirement can help eliminate the risk of outliving your assets

Before moving on to the next category, ensure these needs can be met

Housing	Transportation	Personal Items	Entertainment	Taxes
Mortgage /Rent	Car payments (Loan or lease)	Clothing	Dining out	Federal
Real estate Taxes	Gas/Oil	Shoes	Club dues/ Memberships	State
Homeowner's insurance	Maintenance	Personal care products	Leisure travel	Local
Phone/Cable	Insurance	Personal services	Theatre & Art	
Utilities	Parking/tolls	Food		

Mental Accounting in retirement



Necessities

Healthcare

Healthcare can quickly become a dominant player in retirement budgets

Unlike necessities, there is a wider range between needs and wants

Tendency to anchor around healthcare costs while working

Code for “young” and often healthier

Married couple will need \$250,000 in retirement in addition to Medicare & LTC

Consider tax deferred retiree healthcare savings plans as an important tool

Insurance	Doctor visits	Medical	Uncovered	Unexpected
Medicare	Co payments	Medic Alert	Specialists	Accidents
Supplemental	Cash outlays	Wheelchair	Quality of life	Rehabilitation
Dental	Transportation	Tests	Assistance	Dementia
Long term care	Pharmaceutical	Personal nursing	Cosmetic	

Source: Employee Benefit Research Institute, Note 10, 2015

Mental Accounting in retirement



Necessities

Healthcare

Emergency

Spending in retirement rarely goes exactly as planned

Losses have a bigger impact on us than gains

Dedicate funds to a charity or endowment

Pay for unexpected emergencies from that account

Lessens the pain of loss when unforeseen events occur



Charitable Donation



Whatever remains at year end, actually goes directly to the charity

Mental Accounting in retirement



Necessities

Healthcare

Emergency

Fun

Bequest

Luxury

The final three categories are what we think retirement is all about

By the time this category is reached, guilt-free spending is at hand

Spending can be lumpy

Unlike other categories, consider incorporating high front end costs

Many top passions require physical stamina; sports, outdoor activities, travel

Fix a bequest; intergenerational transfers are often passively managed

Whatever is left when I'm gone is yours

Transparency to beneficiaries enables them to plan better

One issue rarely discussed is underspending

Our children might rather see us enjoying life than leaving them assets

Summarizing Mental Accounting



Early career:
Small amounts to many buckets

Retirement:
Fill one bucket entirely before moving on

Category	Fund in Order
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"We can't solve problems by using the same kind of thinking we used when we created them." -Albert Einstein, TIAA Participant

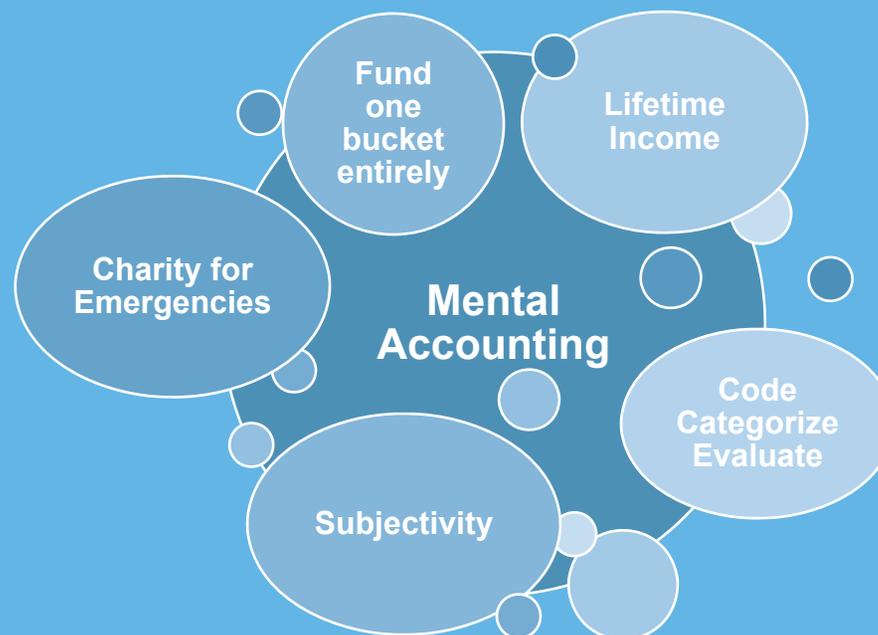
Q&A

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Important information



Journal of Behavioral Decision Making, 12: 183~206 (1999), Mental Accounting Matters, Richard H. Thaler, Graduate School of Business, University of Chicago, USA

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