T. Rowe Price®

2022 U.S. Retirement Market Outlook

Three Themes Shaping the Retirement Landscape

CONTENTS

INTRODUCTION

Three Themes Shaping the U.S. Retirement Landscape in 2022

Closing a widening retirement savings gap, improving financial wellness, and adjusting to lower return expectations

November 2021

KEY INSIGHTS

- The widening retirement savings gap that industry, legislators, regulators, and employers intend to address is playing a significant role in shaping the retirement landscape.
- Financial wellness, which recognizes that competing savings needs and debt are significant barriers to successful retirement outcomes, is now seen as a critical solution to helping workers and retirees meet their goals.
- Capital markets appear poised to enter a new era of lower expected returns, following more than 10 years of a bull market run and whipsaw in the past two years. Retirement savers and retirees will need to plan and adjust accordingly.

Significant global events often accelerate changes that were starting to gain momentum, when emerging trends move to long-lasting, widespread shifts in societal behaviors, expectations, and needs.

The past two years are no exception. How we work and live are forever changed.

T. Rowe Price's inaugural U.S. Retirement Market Outlook—and the three themes we have identified as shaping the retirement landscape in 2022 and beyond—provide yet another example of this phenomenon.

The events of the past two years have either accelerated the shifts within these themes or shined a spotlight upon them. How the retirement industry —ranging from individual savers to employers as well those who advise them—responds is starting to take shape.

For more than 80 years, T. Rowe Price has been helping investors plan and save for the retirement they envision. We currently support more than 6,000 plans and help more than 2.2 million employees[1] plan and save for the retirement they desire. Further, approximately two-thirds of the money we manage is attributable to retirement. In this outlook, T. Rowe Price draws on our recognized expertise gained from this experience to identify important themes, why they matter, and how the industry is or could be responding.

This U.S. Retirement Market Outlook complements our Global Market Outlook, focused on the key themes that will shape markets in 2022.

> "It is better to be too early than too late in recognizing the passing of one era... and the advent of a new era.
>
> — **Thomas Rowe Price, Jr.**
> *1968 Annual Report*

T. Rowe Price research shared throughout this report as "our research" was compiled from the sources listed on page 13–14.

[1] T. Rowe Price as of December 31, 2020

THEME ONE

Access and Adequacy: Closing a Widening Retirement Savings Gap

The retirement savings gap...is now approaching an estimated $4 trillion.

The retirement savings gap—the difference between what retirement savers need and what they have accumulated—is now approaching an estimated $4 trillion.[2] And it is widening in significant ways, exacerbated by the recent economic shocks, while the call to action to close the gap is more focused than ever. The retirement industry needs to be attentive to identifying ways to close the gap. At the same time, the response by institutions, legislators, regulators, and employers is playing a significant role in shaping the retirement landscape this year and well into and beyond 2022.

The traditional notion of a three-legged stool composed of Social Security, private pensions, and personal savings has been transformed, for most, with the replacement of private pensions by defined contribution (DC) plans. While Social Security still provides a meaningful benefit, DC plans, and the personal accountability inherent in them, are now firmly the vehicle for individuals to accumulate wealth for retirement. However, stools can only stand if they have a minimum of three legs, and only 64% of private industry workers have access to a DC plan, such as a 401(k).[3] Yet even those with access may come up short in meeting their retirement savings needs.

The sky certainly isn't falling. Individuals retire every day, and our research shows that 80% of retirees are enjoying their retirement. Our research also finds that the anxieties preretirees had while saving for retirement eased once they retired. The financial realities retirees face often prove to be much less daunting than they may have believed while working.

Still, we see a key theme of 2022 as addressing retirement plan access and adequacy.

Understanding Disparities

While the headline may be that almost 40% of workers are not covered by workplace retirement plans, there are notable differences. For example, larger businesses are more likely to offer DC plans than smaller businesses —according to our research, 78% of workers at companies with more than 100 employees are covered by DC plans compared with 51% of those who work at employers with less than 100.

Also, businesses that pay higher wages and benefits are more likely to offer DC plans to their employees than those in lower-paying industrial sectors. Specifically, the top 20% of wage earners making an average of $140,000 per year is twice as likely to be covered by a DC plan than the lowest-earning 20% and making an average of $27,000 per year.[4] Similar disparities exist when comparing the availability of workplace savings plans based on the highest level of education achieved.

These characteristics also correlate to racial, ethnic, and gender disparities within the private retirement plan system. In fact, the Federal Reserve's annual Survey of Consumer Finances found that white households were more than 60% more likely to hold retirement accounts than Black households and more than twice as likely as Latinx households.[5]

[2] VanDerhei, Jack, Ph.D., "Impact of the COVID-19 Pandemic on Retirement Income Adequacy: Evidence From EBRI's Retirement Security Projection Model®," ebri.org Issue Brief, April 21, 2020, No. 505, p.9, https://www.ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_505_2020crisis-21apr20.pdf?sfvrsn=b3423d2f_4

[3] Bureau of Labor Statistics, U.S. Department of Labor, The Economics Daily, https://www.bls.gov/opub/ted/2021/67-percent-of-private-industry-workers-had-access-to-retirement-plans-in-2020.htm

[4] 2020 U.S. Census–Household Income, Table A-4a, https://www.census.gov/library/publications/2021/demo/p60-273.html

[5] Survey of Consumer Finances, U.S. Federal Reserve, Survey of Consumer Finances, 1989–2019, https://www.federalreserve.gov/econres/scf/dataviz/scf table/#series:Retirement_Accounts;demographic:agecl;population:all;units:median

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

...39% of plan participants reported reduced pay or commissions, while 18% of participants said they reduced their retirement account contributions.

Women also face unique challenges in accumulating sufficient wealth for retirement due to historic wage inequality, fewer years in the workforce due to childcare and other care obligations, and greater longevity, among others. Collectively, these forces result in women often arriving at retirement with less wealth, being eligible for lower Social Security benefits, and the prospect of living longer in retirement than their male counterparts—all affirmed by our research. These examples and many more show that access to DC plans is unequal and that workers would benefit from greater, more equitable access to DC plans.

Plan Adequacy

The challenges posed by lack of access are significant, but they are not the only retirement savings challenges that workers face. In fact, our research reveals that all age groups leading up to age 60 fall short of the estimated necessary target savings rate of 15% (with combined employee deferral and employer contributions). This is a material insight because when we asked preretirees, "Which of the following worries you the most about your retirement?", 36% of respondents cited the possibility of running out of money.

Living longer in retirement is also putting pressure on workers to have more money put away. Retirees increasingly need their money to last longer. Longevity risk—defined as outliving one's assets in retirement—is the top concern both industry professionals and employers cite when evaluating retirement plan default investment options for participants, according to our research. Additionally, long-term care and health care costs continue to rise faster than inflation, increasing the risk that savings will be inadequate in retirement.

The events of the past two years have shined a bright light on just how fragile the environment is for retirement savers. Our research from the summer of 2020—at the height of the pandemic uncertainty—shows that 39% of plan participants reported reduced pay or commissions, while 18% of participants said they reduced their retirement account contributions. Employers felt the pinch of the pandemic, too. Our research shows that one in 10 plans changed or suspended their retirement contribution for participants. Such reductions have further widened the retirement savings gap for many participants, especially those working in sectors hit hard by the pandemic, such as hospitality and leisure.

There was good news, too. Many savers redirected attention to shoring up nearer-term goals while maintaining their retirement savings rate.

Yet, the pandemic highlights the gap in plan savings' adequacy that has been building for some time. As part of our annual retirement study, we ask those who are not saving enough the reasons why that may be. More than half cite that they are saving all they can afford. Further, other types of savings, such as building emergency funds, home purchase, or saving for a child's education, along with debt can hinder the capacity to save adequately for retirement.

The challenges of saving for retirement are not shared equally. Black and Latinx households have more challenges. In our research we found that not only were Black workers saving 44% less than their white counterparts, but they were more likely to also have student loan, medical, and other types of debt.

Addressing plan saving adequacy doesn't stop at retirement. Managing drawdowns, delivering retirement income, and maintaining a focus on spending during retirement all are essential. Retirement income is

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...plans with automatic enrollment have nearly twice the participation rate (82%) than plans with voluntary enrollment (42%).

a particular area of focus because retirees have a clear need to convert their retirement assets into income in retirement. Moreover, the savings gap illustrates both a current and future gap between what retirees currently receive in retirement income from their retirement savings and what they anticipate they will need for retirement income.

The implications of these gaps for the retirement industry will be significant.

To start, such gaps in access and adequacy are leading to policy responses focusing on several key issues:

- Building greater access to and participation in plans to close coverage gaps
- Boosting savings
- Increasing equity (race, ethnicity, gender, income, etc.)
- Improving financial resiliency
- Providing the means to create income in retirement

The Role and Impact of Public Policy

The Pension Protection Act of 2006 (PPA) institutionalized acceptance of best practices such as automatic enrollment, automatic escalation, and adoption of qualified default investment alternatives (QDIA), the most common of which are target date investments. This provided employers with safe harbors to automatically enroll eligible participants in retirement plans, increase their savings, and help ensure that they are invested in age- and risk-appropriate investment portfolios. However, the voluntary nature of these arrangements is showing its limit.

For example, our research and analysis of plans with more than $25 million reveals that the percentage of plans that have adopted automatic enrollment and automatic escalation features remains at 81% and 62%, respectively, and have not materially increased in recent years. Moreover, adoption of these features by smaller plans is significantly lower.

The features, when adopted, can have a profound and lasting effect.

According to our research, plans with automatic enrollment have nearly twice the participation rate (82%) than plans with voluntary enrollment (42%). The effects of plans additionally adopting automatic escalation can also be significant. The average account balances of savers in plans with both automatic enrollment and automatic escalation were 8% higher than those who had only adopted automatic enrollment—an effect that would only increase with compounding returns and time.

Last, the effects of QDIA adoption should not be underestimated. During the coronavirus pandemic, the behavior of target date investors was markedly different than that of those who constructed their own investment portfolios. Specifically, our research shows that participants who were invested solely in target date investments were eight times less likely to make exchanges compared with those who did not invest in target date investments—a significant benefit considering how quickly the markets rebounded from their lows in April 2020.

Three key retirement reforms, the Economic Growth and Tax Relief Reconciliation Act in 2001, PPA in 2006, and the SECURE Act in 2019, reshaped—or have the potential to reshape—the retirement savings plans employers offer and the variety of services industry stakeholders provide. While millions have benefited from some of these reforms, a large percentage of workers still have not.

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As retirement nears, there is a growing recognition that the needs of retirees are complex because every retiree will have personal financial needs, spending behaviors, and risk tolerances.

There are several additional legislative proposals that could potentially improve both access and adequacy in the private DC system. Some have strong bipartisan support, including the incentives for auto-enrollment and auto-escalation features in the Retirement Security and Savings Act in the Senate and the Securing a Strong Retirement Act in the House of Representatives. Others have more narrow support, like the requirement that was in an early House version of the Build Back Better Act for most employers with more than five employees to offer a DC plan or IRA.

Regardless of whether the approach relies on further incentives to induce voluntary change and adoption or mandates, most of these proposals share similar policy objectives: to get more people into the system, enable them to save at adequate rates to impact their retirement outcomes, and ensure that the money they save stays invested for its intended purpose and that workers do not outlive their saved wealth.

While it is difficult to predict the ultimate shape and form that legislative reform will take, it is fair to expect that the support from both parties for addressing retirement access and adequacy will translate, in the relatively near term, into new opportunities for retirement savers and new requirements on employers.

In addition to policy responses, improvements are being addressed at the plan level, too. We see employers and those who advise them addressing savings adequacy and access in several ways. It starts with savings through the first 30-plus years with a shared goal of accumulating and growing assets. As retirement nears, there is a growing recognition that the needs of retirees are complex because every retiree will have personal financial needs, spending behaviors, and risk tolerances.

We see plans that have a fuller understanding of their employee needs, as well as defining what role a company intends to play in defining and achieving adequate outcomes and having a better likelihood of success.

Emerging best practices we see among plans include:

- Improving communications, such as leveraging data from the recordkeeping system to identify pockets of needs and targeted campaigns that are timely, relevant, and actionable.
- Expanding access by eliminating or broadening eligibility requirements.
- Designing plans and participant experiences to improve financial behaviors. This includes creating speed bumps to preretirement withdrawals, such as limiting loans, and adding nudges to improve participant behavior, such as establishing default contribution rates, automatic savings increases, and default investment options with an emphasis on target date funds.
- Simplifying processes to facilitate greater plan participation and driving engagement by tapping in to other moments of high engagement, such as health plan reenrollment.
- Embracing metrics that track progress holistically. This includes considering sentiment as well as financial progress, establishing diversity, equity, and inclusion objectives specific to employee success with retirement programs and monitoring different groups separately because averages can mask issues among different populations.
- Providing or utilizing tools with a focus on financial wellness to facilitate a better balance of managing day-to-day expenses, saving for both short- and long-term financial goals—such as emergency and retirement savings—and managing debt.

“Our research” refers to the T. Rowe Price sources listed on page 13–14.

THEME TWO

Financial Wellness: Redefining the Path to Retirement Success

...78% of employees rely on their workplace for advice and support on how to achieve lifetime financial goals.

Financial wellness is now recognized as a critical solution to helping workers and retirees meet their goals. This has accelerated the shift to measuring retirement success holistically and recognizing that competing savings needs and debt are significant barriers to successful retirement outcomes.

There are several reasons why we see financial wellness as one of the critical trends for the retirement industry right now. One is a recognition that the retirement savings gap that plan participants face is unlikely to be erased without simultaneously improving the financial wellness, or the financial resiliency and well-being, of those enrolled in defined contribution plans such as 401(k)s. There's also a growing recognition of workers' financial fragility (defined as the inability to come up with $2,000 within 30 days to meet an unexpected expense).[6]

At the same time, the pandemic has woken up the industry to the importance of financial wellness, demonstrating the direct connection between saving and spending. Those who needed financial help may have tapped in to retirement savings that they may struggle to replace or incurred debts that will impair their ability to save.

Another impact is that employers are struggling to recruit and retain workers who are now emboldened to look for new employment, either due to economic need or opportunity. The competition for labor is intense and will only become more so, at least in the short to intermediate term. This shines a spotlight on the need for more competitive benefits for employers to offer, including those tied to a more comprehensive set of financial wellness solutions.

As a result, there has been an acceleration in the adoption of financial wellness programs to help employees or to provide benefits they have stated they want or need. Indeed, 59% of industry professionals expect the demand for financial wellness programs to grow, according to our research.

The Case for Financial Wellness

The opportunity to tackle financial wellness going forward will be within workplace retirement plans. Indeed, our research shows that 78% of employees rely on their workplace for advice and support on how to achieve lifetime financial goals. Employers will need to decide what role they need to play in the financial lives of their employees. These are not mere philosophical questions.

The case for financial wellness programs is compelling. Each year, T. Rowe Price conducts studies of workers saving for retirement in 401(k) plans and retirees. Our research reveals that about half of workers reported high to moderate levels of financial stress (ranging from 45%–60% of those responding) relating to managing debt and health care expenses, budgeting, saving for retirement and other goals, and managing their investments. Unfortunately, financial stress has real consequences to both the worker who is struggling financially and to their employer.

[6] Schneider, Daniel; Tufano, Peter; Lusardi, Annamaria, "Household Financial Fragility during COVID-19: Rising Inequality and Unemployment Insurance Benefit Reductions," Global Financial Literacy Excellence Center, December 21, 2020, p. 3

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

Views of digital educational content on financial wellness topics...increased 20% year over year...

A study by Willis Towers Watson[7] found:

- Workers who are struggling financially lose 44% more work time to absence than peers without financial worries.
- Workers who are struggling financially have lower engagement levels than peers without financial worries (24% versus 46%).
- Of all workers surveyed, 53% indicated that saving for retirement is the area where they most want help from their employer.

Employers say that reducing employee financial stress and improving overall worker satisfaction and retention are the top motivations for investing in financial wellness programs, according to our research.

Nevertheless, our research suggests that many savers not only struggle with achieving financial wellness today, but they may also more fundamentally struggle with connecting the dots between the actions they take today and how those actions will affect their future retirement outcomes. We believe that individuals may not fully appreciate and correctly value the impact of their present actions. One notable observation we've seen is that workers' financial capabilities and progress toward financial goals increase with age, while their optimism about their retirement decreases as retirement approaches.

Employers Can Help

Employers are well positioned to help their workers if they so choose, because workers said they look to the workplace for advice and support about how to achieve their lifetime financial goals. Demand for these services is expected to grow.

The effects of the coronavirus pandemic offer further evidence of the value workers find in these programs and the degree of urgency of need. Our research shows that during the early days of the pandemic, 47% of the workers surveyed said that their level of financial stress increased, with 39% seeing a reduction in pay, 23% missing one or more monthly bill payments, and 23% of savers tapping in to retirement savings to pay for day-to-day expenses.

We see this in the participant behavior in the retirement plans for which T. Rowe Price is a recordkeeper, reflective of workers' financial fragility. For example, 9% of all participants used at least one of the Coronavirus Aid, Relief, and Economic Security (CARES) Act provisions that allowed workers to withdraw monies from their retirement accounts without penalty. Of those who did so via a coronavirus-related distribution, 23% claimed they would repay the amount withdrawn, as allowed under the CARES Act, but less than 1% had done so by the end of 2020. Most worrisome is the fact that those who withdrew money were between the ages of 40 and 50 and will struggle to make up for lost savings.

Financial stress due to the coronavirus pandemic was also evident in the ways that 401(k) plan participants sought help. Views of digital educational content on financial wellness topics increased from 15% in 1Q20 to 49% to 2Q20 and increased 20% year over year, according to our research. Content on managing debt and emergency savings and tools like financial wellness checklists were of particular interest. While engagement of this content is encouraging, it also highlights the dilemma many workers face. While participants viewed more content on financial wellness, they viewed less content on retirement savings. The assistance workers sought and continue

[7] 2020 Willis Towers Watson Global Benefits Attitudes Survey, https://www.willistowerswatson.com/en-US/Insights/2021/02/financial-wellbeing

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

Balancing all the competing financial needs is a complex challenge that is having a significant impact on the retirement landscape.

to seek bring into focus the push and pull between present financial needs, short- and long-term financial goals, and how the management of the two affects one's future.

Balancing all the competing financial needs is a complex challenge that is having a significant impact on the retirement landscape. Savers face a wide variety of stresses, and the way each participant prioritizes these stresses varies as well. Many employees say they are not saving 15% of their wages, according to our research, and provide different reasons. Of those respondents, 31% cite day-to-day living expenses, 14% cite credit card debt, and 11% cite student loan debt. Financial wellness solutions can help address all of these concerns.

Against this backdrop, there is a lot that employers and financial professionals can do. There are multiple avenues to address savers' needs—be it through plan design, the use of personalized communication and messaging, or simplifying processes and making transactions that will benefit retirement savers less onerous. All these strategies play a part in meeting savers where they are.

Employers and Financial Professionals Can Incorporate Financial Wellness by:

Choosing plan design features (e.g., auto-enrollment, auto-escalation, matching formulas, vesting, employer contributions, etc.) that both nudge and incentivize plan participation and saving among the employee populations least likely to do so.

Offering programs that help employees assess their point-in-time financial health and set, monitor, and prioritize meaningful financial goals, such as:

- Targeted, personalized communications to engage nonparticipants and participants to inspire them to take financially healthy actions, such as increasing savings or paying down high-interest rate debt.
- Educational programs and tools that help employees budget their monthly living expenses to align the income with both debt management and savings goals (e.g., emergency savings, retirement, home purchase, etc.).

- Offering services (e.g., emergency savings, consumer debt management, student loan repayment assistance, and financing, etc.) that help savers overcome the behavioral friction and automate emergency savings and/or debt repayment.
- Delivering services through multiple modes of engagement that span from digital to in-person so that those who seek counseling or coaching can do so in a manner that best meets their needs.
- Ongoing measurement and assessment tools that reinforce healthy behaviors and highlight the long-term benefits of healthy financial actions taken today and their impact on future outcomes.

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

Several shifts are occurring already, and more are on the way.

For one thing, there are several bipartisan legislative initiatives that, if passed, may help increase the adoption of programs or plan features related to financial wellness, such as the ability to match student loan payments or create emergency savings accounts.

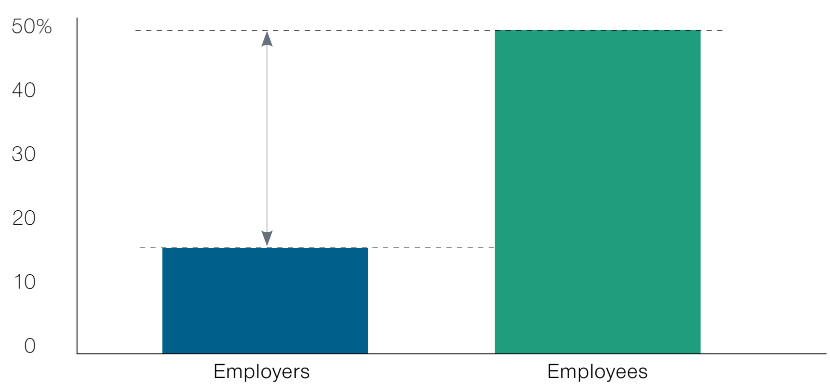
At the same time, plans are starting to increase their financial wellness offerings, recognizing that there appears to be a gap between what employees want and need versus what they are being offered. As one example, just 16% of employers offer student loan evaluation and refinancing tools, according to research from Financial Health Network (FHN), but 49% of employees would use these tools if offered.[8] See Figure 1.

At T. Rowe Price, we see financial professionals, consultants, and employers who are successfully embracing financial wellness focused on these actions:

- Taking a holistic approach to financial wellness, recognizing the competing priorities to savings, spending, and debt.
- Utilizing or offering integrated education, tools, and advice across both investment guidance and financial wellness with a focus on driving behavioral change. Focusing on ease, automation, and personalization to optimize impact.
- Being nimble. Success is often predicated on putting the right messages in front of the right people at the right time. Being timely with prompts that anticipate and respond to both life and market events will increase engagement.
- Recognizing that financial wellness extends well into retirement. Retirees have a need for financial wellness just as workers do. Consider what needs are common and where their need for guidance and advice may diverge from that of workers.
- Adopting a framework that not only measures retirement outcomes but workers' ability to manage their day-to-day finances and the progress made toward financial goals that workers set for themselves.

A Gap Between What Employers Offer and What Employees Need

(Fig. 1) 16% of employers offer student loan evaluation and refinancing tools; 49% of employees would use the tools if offered



Source: The Case for Employers to Invest in Employee Financial Health, Financial Health Network, 2019.

[8] The Case for Employers to Invest in Employee Financial Health, Financial Health Network, 2019, https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2019/05/24163214/FHN-MorganStanley-Infographic-FINAL.pdf

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

THEME THREE

The Investment Landscape: Implications for Retirement Savings and Spending

> **...we expect returns in many large markets such as the U.S. to be restrained relative to recent history.**

Global markets have staged a remarkable recovery from the historic pandemic-induced sell-off in 2020. While the virus remains a key risk to public health and economic activity, significant progress in the distribution of vaccines and the loosening of government restrictions has contributed to improved economic sentiment. Moreover, central banks and governments have taken aggressive monetary and fiscal stimulus measures, which have offset economic damage and provided a potent tailwind for returns.

However, we believe midterm returns will be lower than those seen in previous periods—in some cases considerably lower. This has significant ramifications for retirement plans and whom they benefit.

This shift in the investing landscape is why we think the longer-term outlook will be a significant theme in 2022 and beyond.

A large measure of financial success in retirement stems from the effects of compounded investment returns and its sources both prior to and after retirement. The unpredictable nature of markets is one of many factors that shape the retirement landscape. Just as important are investor behaviors, longevity, and both the access to and adequacy of retirement savings plans. Still it's important to understand what is driving our lower capital markets assumptions.

What's Driving Our Assumptions

In fixed income markets, lower expectations reflect levels of expected risk-free rates that are close to historic lows. We expect yields to rise in key government bond markets over the midterm, with higher yields overall, particularly at the long end of the curve. Low rates today and rising yields in the future are likely to result in relatively low positive or negative total returns for many types of bonds.

In equity markets, there is a positive outlook for earnings growth as economies put the impact of the pandemic behind them, but this is offset by elevated valuations for many markets. As a result, we expect returns in many large markets such as the U.S. to be restrained relative to recent history. While valuations across asset classes vary, and some assets are attractively valued, the valuations of most assets are elevated on these measures.

What's more, in our view, there are several risks on the horizon that have yet to be fully appreciated.

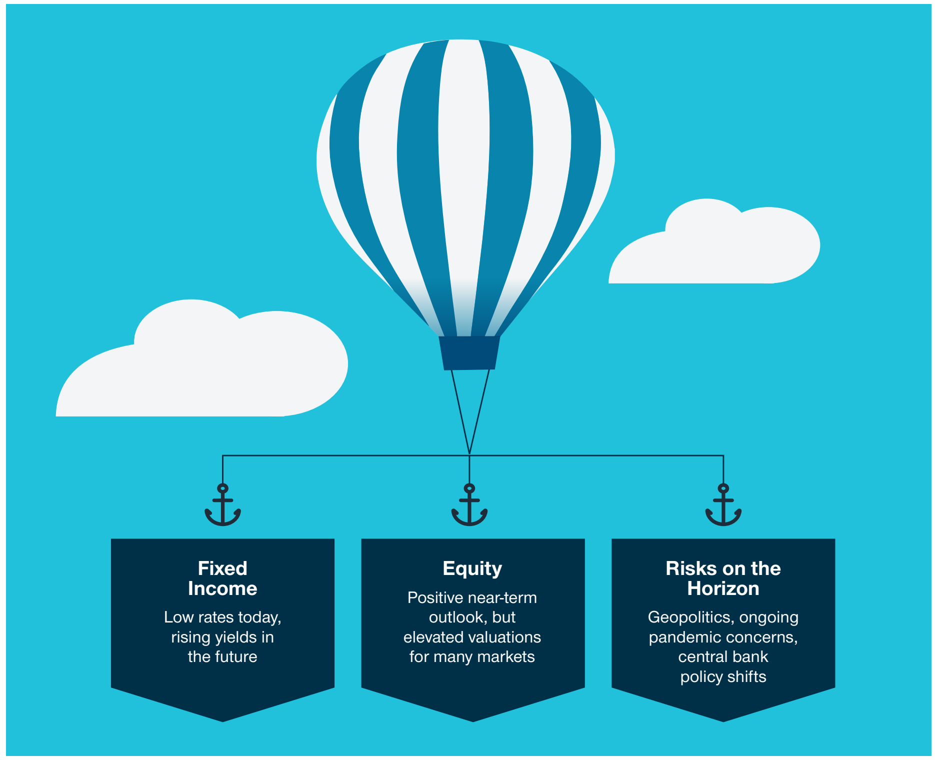
Strong earnings reports, unprecedented fiscal stimulus, and indications of significant pent-up demand have bolstered expectations for accelerated economic activity but have also given rise to inflation fears. In the U.S., proposals for further stimulus and infrastructure spending are likely to be married to an increase in corporate tax rates. China faces pressures from supply chain disruptions, rising commodities costs, moderating growth, and fading stimulus, while in certain other regions, virus mutations and significant struggles with vaccine distribution pose challenges. While the global economy has been buoyed by a period of extreme liquidity driven by fiscal and monetary stimulus, these tailwinds are likely to fade as central banks begin to pursue more moderate policies. Although these conditions may not materialize as significant headwinds for growth, we believe they contribute to a less compelling risk/reward profile going forward. Retirement investors will need to be positioned accordingly.

A consistent, long-term investment focus is crucial. Short-term market fluctuations generally need to be tuned out, though they can be more significant for those who are much closer to retirement. But the shifting paradigm isn't just a blip. We believe that multi-asset portfolios in the midterm will be notably below those of recent periods. See Figure 2.

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

What's Driving Lower Expectations

(Fig. 2)



For illustrative purposes only. This is not intended to be investment advice or a recommendation to take any particular investment action.

There are several implications for those saving for and spending in retirement. Individuals now have a greater personal responsibility, as predictable income from defined benefit pensions increasingly gives way to wealth accumulated by saving in defined contribution plans. Moreover, unlike pensions, DC plans require the individual to convert their wealth to income.

While lower return expectations do not paint an optimistic picture, there is a fundamental way to potentially improve outcomes. Specifically, investors may see an increased role for active management in the pursuit of higher returns. New trends and creative disruption following the coronavirus pandemic have created a fertile environment for skilled active managers to add value.

Responding to Headwinds

Investors have three basic alternatives to meet the challenge of lower return expectations. The first—and likely least attractive—is to simply save more. Investors can save more or delay retirement, which in effect will decrease the level of wealth required in retirement.

The second option is to focus on increasing exposure to growth-seeking assets, either through more equity or higher-returning segments of the fixed income market. This approach has the potential to boost long-term portfolio return potential by increasing the level of market risk within a portfolio either through adjusting the balance of assets between equity and fixed income or adjusting within asset classes. Utilizing target date strategies with underlying actively managed components is

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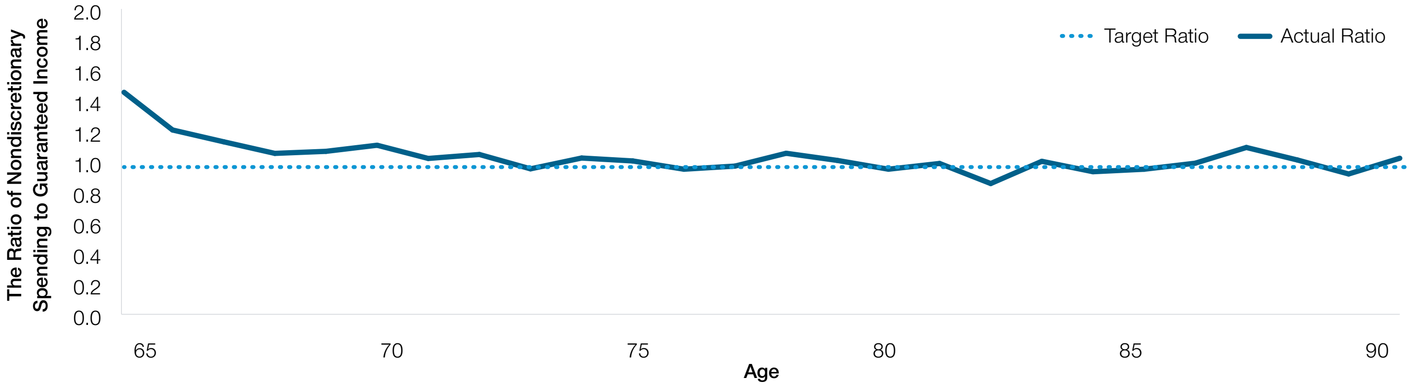
Retirees Adapt Spending to Their Income

(Fig. 3) The ratio of nondiscretionary spending to guaranteed income quickly approaches 1:1 after age 65



Source: T. Rowe Price estimates from Health and Retirement Study (2001–2015).

one way to achieve this. Target date glide paths typically begin with higher allocations to equities and then gradually rebalance into fixed income assets so that the portfolio becomes more conservative over time. This could reduce market risk for those just a few years from retirement. At the same time, for investors with more time before they intend to retire, the benefits of a growth-oriented glide path, including a more diversified fixed income opportunity set, could outweigh the impact of even a large market decline near retirement.

A third option to address lower return expectations is to adjust spending in retirement. T. Rowe Price analysis of retirees' spending habits reveals that retirees tend to adjust their spending to their income. See Figure 3. Most of the retirees who do adjust their spending have the means and flexibility to do so. The poorest households, however, cannot spend less.

Investors have choices, and possibly the simplest response is to accept that the investment environment has changed and that returns on multi-asset portfolios are likely to be lower than they have been in the past. For investors, this may mean recalibrating their behavior, as previously discussed.

Still, getting investments right is critical. Moving into a period of lower expectations for returns reduces the margin for error. In our opinion, retirement investors can increase their chances of success by:

1. Understanding that successful retirement outcomes necessitate a long-term investment perspective.

2. Diversifying across both equities and fixed income to pursue excess returns.

3. Focusing on investment options that have the potential to perform well in both high- and low-return environments.

"Our research" refers to the T. Rowe Price sources listed on page 13–14.

T. Rowe Price Sources

T. Rowe Price research shared throughout this report as "our research" was compiled from the following sources:

The Retirement Savings and Spending Study

The T. Rowe Price Retirement Savings and Spending Study is an annual study that has been conducted online since 2014. The study annually surveys approximately 3,000–4,000 participants who are currently contributing to a 401(k) plan or eligible to contribute and have a balance of at least $1,000. The survey also includes an additional 1,000-1,500 retirees who have retired with a Rollover IRA or left-in-plan balance. Papers based on analysis of the most recent study include: Helping Savers Stay Focused on Retirement, Financial Wellness Through the Lens of Race and Ethnicity, and Financial Wellness in Retirement.

Is Student Loan Debt a Barrier to Retirement Savings?

T. Rowe Price fielded an online survey of over 2,400 workers employed by its retirement services recordkeeping clients. All the respondents were eligible for their employer's 401(k) plan, although not all participate. Those who are repaying student loan debt or saving for future or paying current postsecondary educational expenses were asked a series of questions about student loans and their perceptions around postsecondary educational expenses and retirement savings. Those not impacted by these expenses were only asked for basic demographic data for comparative purposes. The survey was fielded in December 2019, and T. Rowe Price was identified as the sponsor of the research.

Decoding Retiree Spending

This is an analysis of survey panels using data from the Social Security Administration-sponsored Health and Retirement Study (HRS) and its supplement Consumption and Activities Mail Survey (CAMS). CAMS started in 2001, and we used data from 2001 through 2015. Income data corresponding to each CAMS wave are used from HRS. More importantly, we used data only from the original CAMS cohort first interviewed in 2001 and then every other year since then. Therefore, this is a panel data analysis as we follow the same group of retirees from 2001 to 2015. Our final analysis sample consisted of 1,470 households. All spending and income numbers were inflation adjusted using the consumer price index and presented in 2019 dollars.

Breaking Down Healthcare Expenses in Retirement and a New Way to Calculate Retirement Health Care Costs

This is research that presents a new approach to estimate retirement health care costs. Instead of estimating a lump-sum amount for the entire duration of retirement, we estimate the annual health care costs for retirees using empirical data from the Social Security Administration-funded Health and Retirement Study (HRS) and Medicare premiums. We argue that breaking down health care costs between insurance premiums and out-of-pocket expenses for different types of Medicare coverage is helpful to planning for such expenses.

T. Rowe Price Sources

Reference Point 2020

The data and insights in Reference Point 2020 are drawn from on the large-market, full-service universe—T. Rowe Price total—of T. Rowe Price Retirement Plan Services, Inc., retirement plans (401(k) and 457 plans), consisting of 674 plans and over 2 million participants.

2020 Defined Contribution Consultant Study

The 2020 Defined Contribution Consultant Study was conducted by T. Rowe Price in partnership with Schaus Group. The survey population includes 20 defined contribution consulting firms responding to a total of 41 questions from January 7, 2020, through February 13, 2020, and April 8, 2020 through April 21, 2020.

What DC Plan Sponsors Prefer Retiring Participants Do and Why It Matters

T. Rowe Price's survey was sponsored by Pension & Investments (P&I) and conducted during September and October 2018 by Signet Research, a marketing research firm. The survey universe is a list of plan sponsors and consultants selected from the P&I database. Responses were received from 210 plan sponsor officials.

T. Rowe Price Capital Market Assumptions

T. Rowe Price Capital Market Assumptions are published annually and are best understood as forecasts for the central tendency of forward returns. We do not seek to predict actual or realized returns. Our baseline forecasts incorporate the insights of senior portfolio managers and analysts across our equity, fixed income, and multi-asset divisions. The foundation of our capital market assumptions is a survey provided to a wide range of senior T. Rowe Price portfolio managers, economists, and analysts across our equity, fixed income, and multi-asset divisions. The survey requests forecasts for many inputs: GDP growth, inflation, commodity prices, equity valuations, earnings growth, fixed income yields, slopes of yield curves, and spread levels. After all surveys are collected, baseline forecasts are developed for each asset class. The Capital Market Assumptions Governance and Investment Committee then reviews the results for internal consistency and reasonableness.

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