Go Ahead, Take That Vacation. You May Be Spending Too Little in Retirement.

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The Chateau de Chambord in France might make for a fun visit. (THIBAUT DURAND / HANS LUCAS / AFP VIA GETTY IMAGES)

An Alaskan cruise or a Scottsdale swing? Whatever's on your bucket list, chances are that you can go ahead and enjoy it.

New research on retirement spending shows retirees may have more wiggle room to spend than they think, assuming they have savings and aren't primarily relying on Social Security.

Financial models tend to assume that spending increases through retirement in a linear, inflation-adjusted way. But that isn't what the data show, says David Blanchett, head of retirement research at Prudential Financial. In a study slated for publication in the Financial Planning Review, an academic journal, Blanchett found that for many people, spending actually declines through old age.

The findings put a new twist on the "retirement spending smile" that Blanchett introduced more than a decade ago. In that model, spending in retirement starts out high as people travel and pursue hobbies. Then it dips as they slow down, before rising in later life as healthcare costs mount.

The research shows that for many people, spending in retirement actually takes the shape of a "smirk," declining over time. With that trajectory, people with adequate savings don't need to be as conservative starting out. "It can free up money in early retirement, when you can enjoy it," Blanchett says.

The big wild card—the difference between a smile and a smirk—is healthcare costs. People with serious needs will see their spending rise in later life.

This variability can make it hard to plan, but there are some practical steps to take in light of the new research.

Work With an Advisor

It's good to take the guesswork out of how long your savings might last. Financial advisors can do that with software that stress-tests clients' portfolios under various scenarios, including a severe market downturn or long-term-care event. Medicare doesn't cover long-term care, which can quickly deplete a nest egg.

A 2022 government report estimated that 56% of Americans turning 65 that year would develop a disability serious enough to require long-term services and supports, although many will need assistance for less than three years. However, about 1 in 5 of all adults, or 22%, would likely have a disability for more than five years. Dementia care, in particular, can be a costly "killer" for retirement budgets, says Rand Spero, president of Street Smart Financial in Lexington, Mass.

Kelly Regan, a financial planner with Girard in King of Prussia, Pa., talks with clients about how to address potential long-term care needs. To model costs, she might plug an additional $12,000 a month into the software for several years. If one spouse moves into a facility and the other stays at home, for instance, then a home sale couldn't fund the expense, though there may be other ways to tap the asset.

Don't Be Too Cautious

When modeling retirement spending, some advisors attach a higher inflation rate to healthcare costs, which tend to rise more sharply than other spending categories. Blanchett says it isn't necessary to bake in such higher estimates, since lower leisure spending tends to offset higher healthcare spending in later life.

What's more, it would be a mistake to take, say, a 5% healthcare inflation rate and apply it to overall spending, Blanchett says. He has seen some advisors do this out of an abundance of caution, and it restricts spending more than necessary in early retirement.

Consider an Annuity

Ideally, you would hedge the possibility of a low-likelihood, catastrophic event like an extended long-term-care need. But traditional long-term-care insurance is prohibitive, and hybrid long-term-care and life insurance is limited.

One option to consider instead is an annuity, Blanchett says. Not all annuities have the complexity and high fees that have given the category a bad rap. Buying an income annuity with a portion of your retirement portfolio can help reduce the risk of outliving your savings. Not only does this give you guaranteed income for life, but it also allows you to take more risk in your stock portfolio, which will help your savings keep up with inflation.

Inflation riders aren't common these days, but they're not a must-have, since spending doesn't rise predictably with inflation, Blanchett notes.

Spending in retirement is always a balancing act, but you can probably afford to live a little larger.