

# WORKING PAPER

## *Executive Summary*

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## HOW PORTFOLIOS EVOLVE AFTER RETIREMENT: THE EFFECT OF HEALTH SHOCKS

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For older households, assets held at retirement represent a resource that may be used to help finance routine consumption during retirement and to weather financial risks in old age, such as out-of-pocket hospital or nursing home expenses that may follow a health shock. The value of these assets may be even greater for coming generations, thanks to the expansion of retirement savings programs and strong returns in housing and equity markets over the past several decades.

Despite the potential importance of non-Social Security assets for the financial security of older households in retirement, relatively little is known about how these assets evolve during retirement. In this paper, we use data from the Health and Retirement Study to investigate the effects of aging and health shocks on the household portfolios of the elderly.

Specifically, we address two related questions. First, how does the allocation of household assets across broad categories change as households age? Second, can health shocks help to explain the observed age-paths of asset choices? In our analysis, we take care to distinguish the true effects of aging from differences across birth cohorts. We also examine numerous definitions of a health shock, such as having a spouse die, experiencing an acute shock such as a heart attack or stroke, or being diagnosed with a new chronic illness.

On the first question, we document a sharp decline in home and vehicle ownership with age. For example, the fraction of households that owns a principal residence fall from 79% at ages 75-79 to 54% at ages 90 and above, and the fraction that owns a vehicle falls from 82% to 40% over the same age range. The fraction of households that own a business, other real estate, or financial assets falls with age as well. While the dollar value and share of total assets held in most categories falls with age, the share of total assets in bank accounts and CDs rises with age. This shift likely occurs when households liquidate other assets and move them to these accounts, but may also reflect the household's desire to have a portfolio that is more liquid, less risky, or easier to manage at older ages.

On the second question, we find that health shocks have significant effects on asset holdings and that these effects can vary with the type of health shock. Most health shocks are associated with significant drops in principal residence and vehicle ownership. The effect is immediate and strongest in the event that one of the spouses dies; however, the same effect is seen in the event that one of the spouses

suffers an acute health shock or is diagnosed with a new chronic illness, although the response occurs more gradually in these cases.

Some health shocks, such as an acute shock or a change in one of the spouses' ability to perform activities of daily living (ADLs), are also associated with decreases in the ownership of a business or other real estate. This could indicate that these assets become too difficult to manage after such a shock. The share of assets in bank accounts and CDs frequently rises after a shock, as families liquidate other assets and move the proceeds into these accounts.

Our findings research indicate that both age and health shocks are important factors in explaining changes in households' portfolios during retirement. A natural next step for future research will be to learn more about *why* households respond to shocks in the way they do – for example, is it because they have experienced large out-of-pocket medical expenditures, have physical or cognitive difficulty managing the asset, or for other reasons? This line of research will help us to better understand the portfolio allocation and asset decumulation decisions of older households, which have important implications for the ability of these households to support themselves adequately during retirement.

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