

The Biggest Risk Retirees Face Right Now

My Comments: On TV and in murder mysteries, there's often a reference to 'being in the wrong place at the wrong time'. Well, it can happen to any of us planning to retire, but it reads this way; 'being born at the wrong time...".

These words from Michael Aloï a few years ago show what this means. And it has special meaning for any of you planning to retire any time soon. As I write this, I think we're close to the end of an historic bull market and for some of us, it will be painful.

[Michael Aloï, CFP](#) | March 23, 2018

Those planning to retire face many risks. There is the risk their money will not earn enough to keep up with inflation, and there is the risk of outliving one's money, for example. But perhaps, the biggest risk retirees face now is more immediate: Retiring in a bear market.

To put this in perspective, First Trust, an asset manager, analyzed the history of bull and bear markets from 1926-2017 and found bull markets — which are up or positive markets — lasted on average nine years. If that is the case, this bull market should be ending right about now, as it just turned 9 on March 9, 2018. Consider also the study found that the typical bear market lasts 1.4 years, with an average cumulative loss of 41%.

Not to be all doom and gloom, but the chart below illustrates why the biggest risk retirees face right now is a bear market. It shows what happens to two identical \$1 million portfolios, depending on the timing of bad stock market years.

Age	Market gain/loss	Mrs. Jones Portfolio value	Market gain/loss	Mr. Smith Portfolio value	Annual Withdrawal*
66	0.22	\$1,160,000	-0.07	\$870,000	\$60,000
67	0.15	1,272,200	-0.04	773,400	61,800
68	0.12	1,361,210	0.12	802,554	63,654
69	-0.04	1,241,198	0.15	857,373	65,564
70	-0.07	1,086,784	0.22	978,465	67,531
71	0.22	1,256,320	-0.07	840,416	69,556

Age	Market gain/loss	Mrs. Jones Portfolio value	Market gain/loss	Mr. Smith Portfolio value	Annual Withdrawal*
72	0.15	1,373,124	-0.04	735,156	71,643
73	0.12	1,464,107	0.12	749,583	73,792
74	-0.04	1,329,536	0.15	786,014	76,006
75	-0.07	1,158,182	0.22	880,651	78,286
76	0.22	1,332,348	-0.07	738,370	80,635
77	0.15	1,449,146	-0.04	625,781	83,054
78	0.12	1,537,497	0.12	615,329	85,546
79	-0.04	1,387,886	0.15	619,517	88,112
80	-0.07	1,199,978	0.22	665,055	90,755
81	0.22	1,370,495	-0.07	525,023	93,478
82	0.15	1,479,787	-0.04	407,740	96,282
83	0.12	1,558,191	0.12	357,498	99,171
84	-0.04	1,393,717	0.15	308,976	102,146
85	-0.07	1,190,947	0.22	271,741	105,210
86	0.22	1,344,588	-0.07	144,352	108,367
87	0.15	1,434,659	-0.04	26,960	111,618
88	0.12	1,491,852			114,966
89	-0.04	1,313,762			118,415
90	-0.07	1,099,831			121,968

* Adjusted for 3% inflation

Mr. Smith and Mrs. Jones start off with the same \$1 million portfolio and make the same annual \$60,000 annual withdrawal (adjusted for 3% inflation after the first year). **Both experience the same hypothetical returns, but in a different sequence.** The difference is the timing. Mrs. Jones enjoys the tailwind of a good market, whereas Mr. Smith's returns are negative for the first two years.

The impact of increasing withdrawals coupled with poor returns is devastating to Mr. Smith's long-term performance. In the end, Mrs. Jones has a healthy balance left over, whereas Mr. Smith runs out of money after age 87.

With stock market valuations higher and this bull market overdue, by historical averages, retirees today could be faced with low to poor returns much like Mr. Smith in the first few years of retirement. However, retirees like Mr. Smith still need stocks to help their portfolios grow over time and keep up with the rising costs of living. Unfortunately, no one knows for sure what the equity returns will be in the next year or the year after.

This is the dilemma many retirees face. The point is to be aware of the sequence of return risk, illustrated in the chart above, and take steps now if retirement is in the immediate future.

Here are two of the many planning possibilities retirees today can use to avoid the fate of Mr. Smith:

1. Use a “glide path” for your withdrawals

In a study in the [*Journal of Financial Planning*](#), Professor Wade Pfau and Michael Kitces make a compelling argument to own *more* bonds in the first year of retirement, and then gradually increase the allocation to stocks over time. According to the authors’ work, “A portfolio that starts at 30% in equities and finishes at 60% performs better than a portfolio that starts and finishes at 60% equities. A steady or rising glide path provides superior results compared to starting at 60% equities and declining to 30% over time.”

The glidepath strategy flies in the face of conventional wisdom, which says people should stay balanced and gradually conservatize a portfolio later in retirement.

The glidepath strategy is a like a wait-and-see approach: If the stock market craters in the first year of retirement, be glad you were more in bonds. Personally, I would only recommend this strategy to conservative or anxious clients. My concern is what if markets go up as you are slowly increasing your stock exposure — an investor like this could be buying into higher stock prices, which could diminish future returns. An alternative would be to hold enough in cash so one does not need to sell stocks in a down year per se.

Though not for everyone, the glide path approach has its merits: Namely not owning too much in equities if there is a bear market early on in retirement,

which coupled with annual withdraws, could wreak havoc on a portfolio like Mr. Smith's.

2. All hands-on deck

The second planning advice for Mr. Smith is to make sure to use all the retirement income tools that are available. For instance, if instead of taking money out of a portfolio that is down for the year, Mr. Smith can withdraw money from his whole life insurance policy in that year, so he doesn't have to sell his stocks at a loss. This approach will leave his equities alone and give his stocks a chance to hopefully recover in the next rebound.

The key is proper planning ahead of time.

The bottom line

Retirees today face one of the biggest conundrums — how much to own in stocks? With the average retirement lasting 18 years, and health care costs expected to increase by 6%-7% this year, retirees for the most part can ill afford to give up on stocks and the potential growth they can provide. The problem is the current bull market is reaching its maturity by historical standards, and investors who plan on retiring and withdrawing money from their portfolio in the next year or two may be setting themselves up for disaster if this market craters. Just ask Mr. Smith.

There are many ways to combat a sequence of poor returns, including holding enough cash to weather the storm, investing more conservatively in the early years of retirement via a "glide-path" asset allocation, or using alternative income sources so one doesn't have to sell stocks in a bad market.

The point is to be mindful of the risk and plan accordingly.