Retiring in a Volatile Market

After decades of saving, investing, preparing and dreaming, the actual transition into retirement can be a daunting experience for many people. Even well-prepared individuals often feel anxious as they leave the workforce. While the investment realities each person faces may be unknowable beforehand, it is safe to assume there may be ups and downs in that experience. That's just the nature of life and the investment markets. While you can't take the volatility out of the stock market, you can take steps to manage your risk and help you feel more confident that your retirement savings will withstand the ups and downs.

What happens when retirement gets off to a bad start because of adverse market volatility? This is known as the ***sequence of returns risk***. It can be one of the most difficult adversaries unprepared retirees may face. Simply put, improving one's *average rate of return* during the accumulation years can be a powerful avenue to building wealth, but once you transition into the *decumulation years,* the average return over time is meaningless. The order or sequence that one experiences good or bad returns during retirement is what is most crucial. Significant losses at the start of retirement, right when one needs to draw on their retirement nest egg, may end up digging a hole that becomes impossible to climb out of.

There are various ways to mitigate different risks. You may be able to **transfer** some (think insurance), some you can **avoid** (such as avoiding the stock market by keeping everything in the bank), and some you may be able to **moderate** (think about diversification). Depending on your situation, each of these options may provide value when facing the potential for an adverse sequence of investment returns early in retirement.

Transferring risk

Risk transfer is a basic insurance concept. A significant drop in investment values can harm a portfolio's ability to sustain a desired distribution level in retirement. Once principal is invaded, assets may be depleted prematurely, and the income they were supporting will disappear. An effective way to transfer this risk, when necessary, is to incorporate various annuity strategies. The purchase of an annuity allows you to transfer the risk of depleting investments during retirement, therefore facing a disruption in income. An array of contract features and riders allow the risk of running out of income to be transferred to an insurance company – *for a cost*. These added costs will accelerate the depletion rate of those funds, but the adverse consequences will disappear because of the income guarantees in the contract.

Transferring risk with annuity contracts may be an effective way to shore up the need for additional *lifetime guaranteed* income to supplement your Social Security or pension. However, purchasing annuity guarantees can be costly, so it should generally be limited to helping bridge the gap between lifetime guaranteed income and essential spending needs.

Avoiding risk

You lower the risk of a negative investment returns by choosing to invest in non-market alternatives such as bank deposits or fixed annuities. However, doing so means accepting *other* risks instead. While you may avoid significant dips in investment returns, the risk that inflation will outstrip purchasing power, or that you may accelerate principal consumption, increases. There may also be liquidity risks from things like surrender charges or penalties for early withdrawal.

Non-market assets are best suited for goals such as an emergency fund or large expenditures that will occur in the near future. For example, it's not wise to risk being able to pay for a daughter's wedding that's happening next year. Funds for

short-term goals like that should be kept in assets that avoid market exposure, such as common savings, checking or money market accounts. In some cases, even a short-term certificate of deposit may make sense.

Moderating risk

We're all familiar with the advice to "not put all your eggs in one basket." Diversifying investment holdings can reduce the risk associated with potential negative outcomes for any one particular investment. This concept has been refined into the art and science behind different *asset allocation* strategies. When skillfully implemented, well-rounded asset allocation strategies can create a favorable "risk/reward" tradeoff.. It does not ensure that losses won't occur, but instead it aims to moderate the consequences of negative markets through a proper mix of higher and lower risk investment assets.

Moderating risk through asset allocation strategies is particularly effective for long-term investing goals, when the need for income from those investments is more discretionary, or when the amount of income required from your investments is *very* modest. Variations of this can include *bucket strategies* where assets are "time-segmented" to match anticipated future spending needs. This may provide valuable psychological benefits in addition to those derived from a diversified and well-managed asset allocation.

Other ways to deal with the risk

Transferring, avoiding, and diversifying away risk aren't the only approaches. Many individuals find additional value by having non-market resources they can tap into during periods of market volatility. These could include permanent life insurance cash values or the equity in one's home through a Home Equity Conversion Mortgage.

Maybe some of each

Because each person comes into retirement with different resources and needs, there is no one-size-fits-all solution. Individuals with robust sources of lifetime guaranteed income, such as those with pensions and Social Security, may be less susceptible to the sequence of returns risk. Individuals with fewer lifetime guaranteed income resources may be much more dependent on their assets to generate retirement income, leaving them more exposed to a possible negative sequence of investment returns. Talk with a financial advisor to determine the right strategy for you.

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