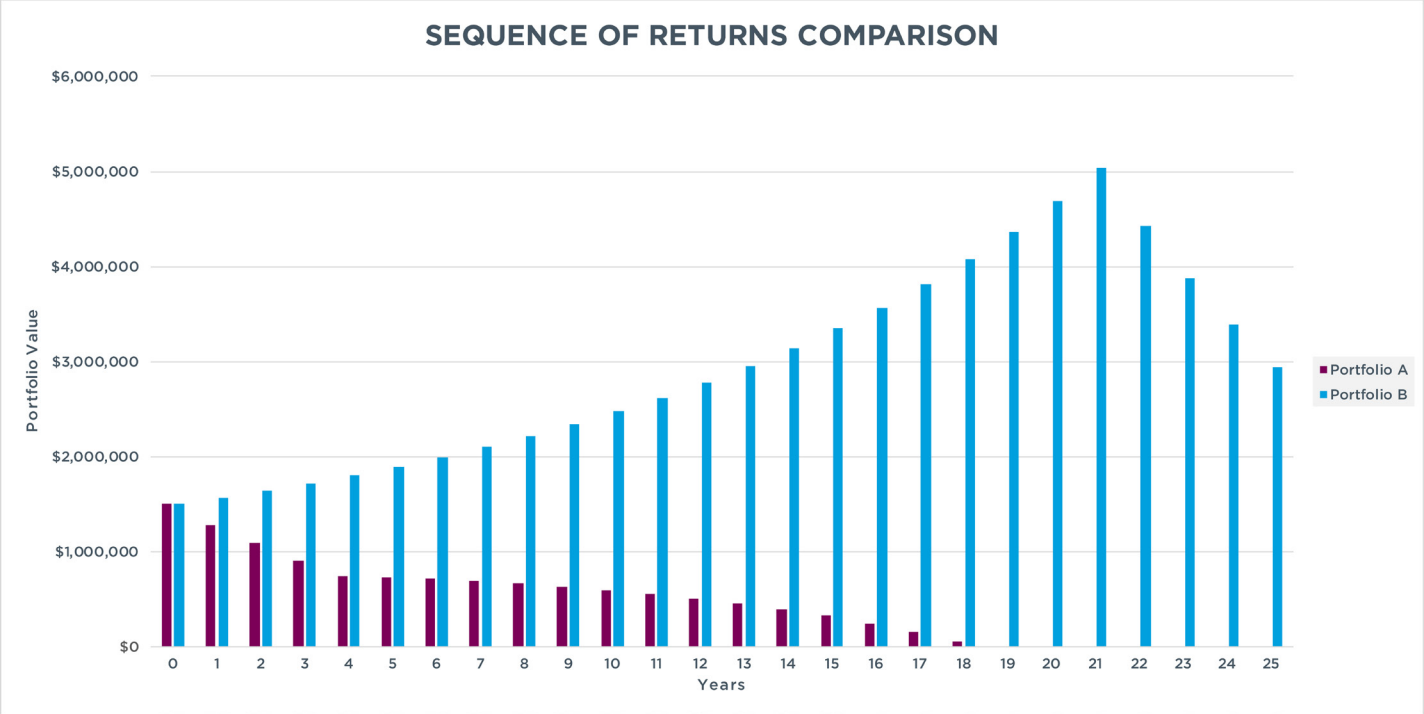
DEVELOP A BALANCED SAVINGS STRATEGY TO MINIMIZE RISK

When you retire, you hope to have enough savings to last as much as 30 years or more. But as you start to withdraw money from your retirement accounts, you could experience "sequence of return" risk, meaning, the markets generate a sequence of negative returns over several years as you begin to take withdrawals. This risk may result in you not having enough savings to last throughout your retirement.[1]

In fact, as the illustration demonstrates, hypothetical Portfolio A, which had four initial years of negative returns, runs out of money 19 years into retirement. However hypothetical Portfolio B, which experienced negative returns in the last four years, had sufficient funds throughout retirement. Both portfolios started with the same balance and have the same average return during the overall time period but end up with very different results.



For illustrative purposes only.
Starting balance for both portfolios: $1.5M. Ending balance at year 25: Portfolio A: $0; Portfolio B: $2,937,954. Average return: 7 percent.

Strategies to Help Mitigate Risk

How can you minimize sequence of return risk as you near retirement or during retirement? Consider the following strategies to help add protections and reduce your portfolio's potential risk without reducing its potential for growth.

Mariner WEALTH ADVISORS

Estimate Your Income Vs. Expenses

Most of us tend to focus on how much to accumulate for retirement but may spend less time on how much we'll spend in retirement. Since most individuals want to maintain their current standard of living in retirement, it's a good idea to do a personal cash-flow analysis to review current sources of income versus expenses. Work with your advisor to estimate how much you spend now on essentials, such as mortgage or rent, and on discretionary items, such as travel. This will give you a reference point for projecting future spending. If the market is down as you start to withdraw funds in retirement, you may choose to reduce discretionary spending and focus on covering the essentials. It's a good idea to consider using liquid assets, such as cash and CDs, to pay for the essentials, and other income generated from investments for discretionary items.

Plan for Charitable Giving

As an additional estimate of expenses, it's a good idea to review your plan for charitable giving, investments into a 529 plan for your child or grandchild and any other charitable gifts you may be planning on in retirement. As you work with your advisor, you may be able to benefit from certain tax deductions and gift tax exemptions.

Stress Test Returns

According to Justin Richter, senior wealth advisor at Mariner Wealth Advisors, it helps to review historical returns and test volatility, because expecting a steady, six percent annual return on your retirement investments, for example, is not realistic. Markets are volatile, sometimes returning 20 percent in a year and a negative 5 percent the next year. By running a "stress test" to factor in different volatility scenarios, you can better prepare a withdrawal strategy in anticipation of potential future market uncertainty.

Apply the "Four Percent" Withdrawal Rule

You often hear about the four percent rule — withdrawing four percent of your retirement portfolio annually to cover your expenses and lifestyle. For this method to work, it's important that your projected average portfolio returns are above four percent so that, over time, your earnings and growth in the portfolio exceed the amount being distributed to you to account for inflation. In years where returns are above four percent, you could have excess income and returns. In years where returns are below that amount, your portfolio may be reduced, but future returns may be able to overcome that deficit. It's a simple rule that can be a good guide for what recent and future retirees might expect to spend in retirement, but can potentially be improved upon with the cash flow and budgeting guidance that a wealth advisor can provide.

Take the "Bucket" Approach

Richter also suggests a "bucket" approach to asset allocation in retirement for the purposes of planning and risk management, not just for asset allocation.[1] You would have a short-term bucket, using cash and cash equivalents, such as CDs, for liquidity so you can cover an extended period of living expenses.

These types of investments could help prevent you from having to sell securities for cash at a potentially inopportune time. Your mid-term bucket could include combining capital with liquid investments, such as a diversified bond ladder in which bonds or bond funds mature quarterly or annually to gradually provide cash flow. Your long-term bucket could be designed to keep your portfolio growing, so might include investments such as stocks, equity mutual funds and ETFs, as well as real estate investment trusts (REITS).

Hypothetical Portfolio with a traditional 60/40 split[1]

Investment	Amount ($)	Percentage of Portfolio
Cash	$100,000	5%
Short-term bonds	$200,000	10%
Intermediate-term bonds	$400,000	20%
High-yield bonds	$100,000	5%
U.S. stocks	$900,000	45%
International stocks	$300,000	15%
Total	$2,000,000	100%

For illustrative purposes only. The amounts and percentages shown are fictitious and not an investment recommendation.

Revisit Your Asset Allocation

As you near retirement and in retirement as you begin to withdraw funds, it's a good idea to revisit your asset allocation — are you overly invested in equities? Or are you overly invested in fixed income and cash, not allowing for growth in your portfolio? Does your risk tolerance match your asset allocation? In other words, if the stock market were to experience a 20 percent correction, would you be comfortable with the resulting impact on your overall portfolio across different accounts?

Keep in mind that, as it relates to risk, during significant market corrections or recessions, such as in 2008 and early 2009, most asset classes fall in tandem.[1] So while asset allocation can help, you may need other strategies to manage downside risk during significant market downturns.

Consult With Your Advisor

Work with your advisor on an appropriate strategy for you to create a balanced retirement portfolio that helps minimize potential sequence of return risk. If you haven't retired yet, track your expenses so you have a better estimate of income versus expenses in retirement. Partner with your advisor on a withdrawal and budget strategy that will help ensure that you have enough savings to last throughout your retirement.

Footnotes

[1] "Nearing Retirement? Assess Downside Risk, Upside Potential," Charles Schwab PDF

Sources

"Income Diversification," Fidelity PDF, 2018.
"Sequence of Returns Risk," Your Life, Simplified podcast, Nov. 2019. Mariner Wealth Advisors.