Bonsai

An Obsession for Determined Outcomes

NAVIGATING THE FINANCIAL OUTCOME PUZZLE

Timing Is Everything

Your client is getting ready to retire. His/her career and investments—thanks to a well-designed Investment Policy Statement—have been good to him/her. Now he/she's looking forward to a point in his/her life when he/she no longer has to worry about IRA contributions, asset allocation, or stock market ups and downs but instead will enjoy the stream of income he/she—and you, as his/her financial advisor—have worked hard to generate. It's time for both of you to relax, right?

Wrong. More people die climbing down Mt. Everest than climbing up. Likewise, planning the decumulation phase may require the most care of any period in one's lifetime investment cycle.

The risks we face in retirement are dramatically different from the risks that command our attention during our working years, but just as important. Timing, which we largely ignored pre-retirement, is suddenly everything, particularly the decision when to begin drawing from our investments and at what rate. As an advisor, all of the lessons we reviewed in the first four papers of this series come back into play as you help your clients devise their plan for income in retirement. And you'll be applying them more often in the coming years.

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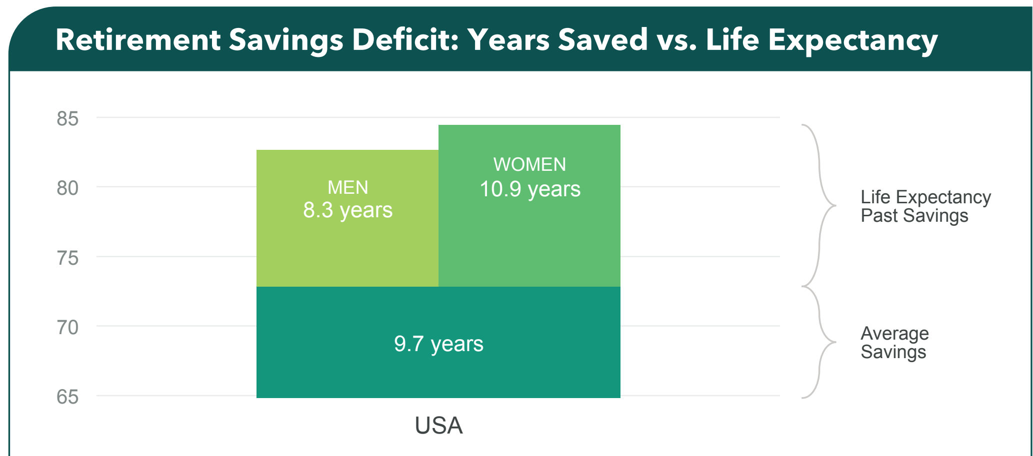
In 2011, the first cohort of Baby Boomers—the largest generation in U.S. history—began to retire. Until the age wave breaks in 2030, 10,000 Boomers will be reaching retirement age every day 1. It's estimated that the Boomers, and the remainder of the Silent Generation that directly preceded them, will decumulate or bequeath $80 trillion by the time they pass on 2, according to Federal Reserve data.

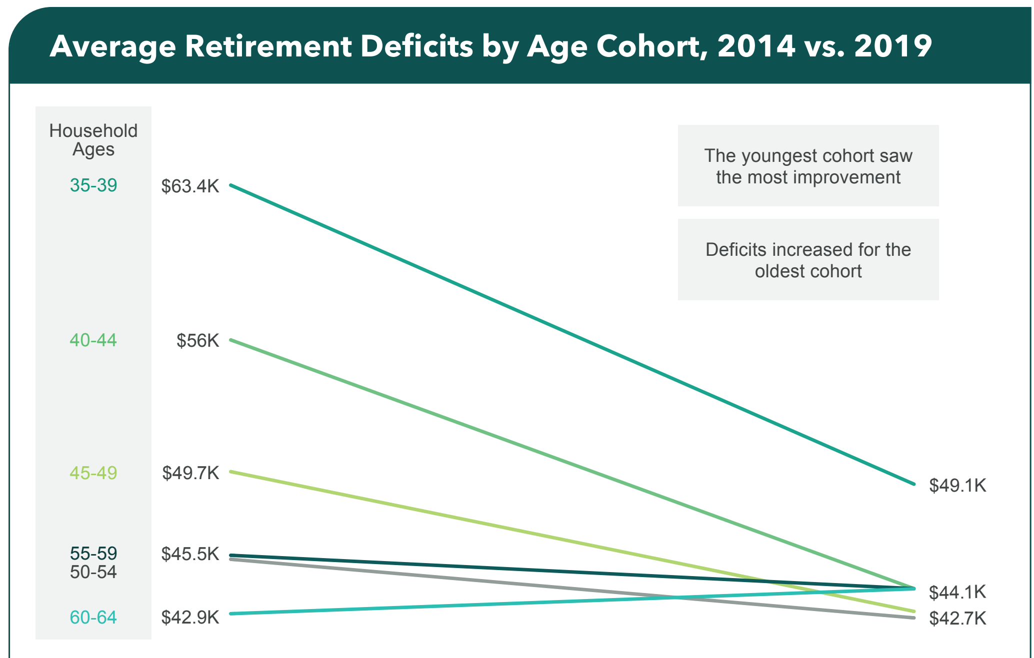
Helping them navigate a comfortable, low-risk retirement won't be easy, however. According to an analysis by the World Economy Forum, on average, Americans can expect to live roughly twice as long after they stop working as their savings will cover.

[1] Senior Living: "The Baby Boomer Generation"
[2] Forbes: "Why Retirement Decumulation is the New Accumulation"



World Economic Forum: Investing in (and for) Our Future, June 2019

Not everyone faces the same level of risk, but the Employee Benefit Research Institute projects that a substantial 40.6% of all U.S. households where the head of household is between 35 and 64 years of age, will run short of money in retirement. For individuals in the oldest age cohorts, the deficit is as much as 50% higher, EBRI estimates[3].



EBRI: America's Retirement Deficit: EBRI Projections Show Improvements, March 2019

To navigate the risks they will face, you'll need to refocus your clients on the things they can do with their retirement savings—continue to save, invest, spend it, pay taxes, and give it away—and the tradeoffs involved with each. You'll be far better placed to do so if you dynamically engage with your clients, reinforcing the kind of close personal relationship that encourages them to share their goals, give you a complete picture of their assets and liabilities, and discuss all of this frankly.

[3] EBRI: "Retirement Savings Shortfalls: Evidence from EBRI's 2019 Retirement Security Projection Model"

You'll want to revise your client's investment policy statement, this time with a smart decumulation strategy in mind. And remember, cash is still not king. It's understandable that your clients might want to retreat to safety once they are relying to a great extent on their savings to get them through the coming decades, so it's up to you to remind them how risky this can actually be.

As in the accumulation phase, your job is to act as your client's CFO, not as a salesperson. Your goal, as before, is to analyze your clients' circumstances and help them build a strategy. Their personal circumstances may be quite different from when you first got to know them, and some aspects may now be more important than others that once loomed larger. Is your client still married, or divorced? Does he/she still have minor children, or perhaps older relatives depending on him/her? Is he/she disabled or unable to find work, which may force him/her to start collecting Social Security early—and reduce his/her income from that source over time? What are the tax rules in the state where he/she is domiciled? His/her current asset allocation is still Important, but once he/she is no longer working, these factors will become critical.

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The strategy you help him/her develop will need to address three key issues:

- How long he/she expects to live,
- What impact inflation can be expected to have over that period, and
- Sequence in retirement—i.e., how much he/she can safely withdraw from his/her nest egg each year, given the ups and downs of the market.

In addressing each of these, timing matters. If your client expects to live longer than average—or, if she's a woman and can be forecast statistically to do so—he/she may want to continue working a few years longer as well, to assure he/she has a sufficiently large nest egg to avoid running out of assets.

Then there's inflation. In the 1970s and early 1980s, U.S. inflation could run as high as 13% annually. Currently the risk of inflation is as high as it has been for decades. Since your clients will no longer be earning income from work, and a larger portion of their assets will likely be in fixed income securities, a return to even slightly higher levels can powerfully affect their income from those investments. Likewise, despite some fluctuations, the benchmark Fed Funds rate has remained low for the better part of a decade, whereas it typically remained above 5% in the 1980s. If interest rates revert to a higher level, it could have a positive impact on your clients' fixed-income investments.

Timing is especially important in tackling sequence in retirement, since much will depend on where the market stands in its cycle at the time your client stops working. This, too, can make it necessary for you to discuss whether your clients should work a few years longer, or lower their income expectations going forward, or perhaps move to a more tax-favorable state.

Their goals must match their overall situation in retirement, not just their portfolio. As a result, some plans, such as to help put a grandchild through college or help a child start a business, may have to be scaled back or abandoned. Again, you can help your clients create a successful retirement strategy only if you have a full and clear picture of their assets, liabilities, and other obligations, since all of these are inextricably tied together.

There are things your clients can do, however, that will help them make the most of their assets, manage their risks prudently, and thus achieve more of their desired goals. In our last paper, we noted three ways to address risk: accept it, which can be dangerous in the post-working years; avoid it, which means accepting a safer but much lower income flow; or transfer it. Transferring risk, for example by purchasing an annuity, could help your clients to address longevity risk by assuring them of a consistent income flow in retirement.

A revision of your clients' investment policy statement heading into retirement must center not on the factors they can't control but on the choices they can make.

Another way to transfer risk is to make sure your clients rebalance their portfolio regularly, maintaining exposure to each asset and asset class at the level specified in their investment policy statement. That means they continually transfer out risks they didn't intend to take.

A revision of your clients' investment policy statement heading into retirement must center not on the factors they can't control but on the choices they can make. For instance, set a target withdrawal rate, say 4-5% per year. Controlling tax exposure, by creating a plan for which savings accounts—401(k), IRA, Roth IRA, etc.—to withdraw from first, should also be on the checklist. So is deciding when your client, and his/her spouse, should begin receiving Social Security. And so is reviewing all of your client's bills once a year—especially related to health care—to determine if more economical deals aren't available.

Remember that for your clients, discussing these options and contingencies can be at least as uncomfortable if not downright fearful as their earlier efforts to decide how much they needed to accumulate to retire. But understanding the risks involved—longevity, inflation, sequence in retirement—and their interdependencies, can also be empowering, since it removes the mystery from what might otherwise seem like an unfathomable set of decisions. With your help in tackling these issues, your clients can become stewards of their own pension plan, rather than passive recipients.