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WEALTH MANAGEMENT

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Monthly Insight

Sailing into a Headwind? Retiring during a Bear Market

People who have been disciplined about saving for retirement are typically looking forward to the day when they can stop working (or at least, stop working full-time) and allow their money to work for them. Having spent decades in the "accumulation" phase, they are eager to enter the "decumulation" phase.

This can be a pretty rose picture when the financial markets are in growth mode; retirees and those nearing retirement enjoy watching the balances in their accounts increase, even when they withdraw modest amounts to supplement pension and Social Security income.

But when you are in or near retirement during a bear market, the picture looks very different. The chief fear of most retirees is outliving their money, and when you're having to spend money from your account at the same time the value is dropping because of a declining market, feelings of anxiety start to come to the forefront. Is it possible to retire during a bear market and still maintain your financial health?

The answer lies in understanding and assessing a risk we typically hear less about: sequence-of-returns risk, or sometimes called simply "sequence risk." This type of risk describes what happens to a portfolio during periods of declining markets, when the account owner is also withdrawing retirement income from the account. The early years of retirement are the most critical period for assessing sequence risk, as this is when retirement withdrawals, combined with negative investment returns, can have the greatest impact on the longevity of the retiree's income stream. Simply put, a retirement portfolio that happens to experience positive returns early in retirement will outlast an identical portfolio that must endure negative returns early in retirement, even if their long-term rates of return end up the same.

As an example, suppose we have two identical portfolios, each with a starting balance of $100,000. Over a five-year period, the portfolios experience the same average overall return, but the returns for each year vary as shown in this table:

	Portfolio A	Portfolio B
Year 1	25%	-20%
Year 2	15%	-5%
Year 3	5%	5%
Year 4	-5%	15%

Year 5	-20%	25%

If the portfolio remains undisturbed during the period, both accounts would experience the same five-year compound annual growth rate and would have identical balances of $114,712.50. But suppose that $10,000 is withdrawn from each account, each of the five years. Portfolio A, because of experiencing higher returns in the first three years of the period, would have a little over $70,000 at the end of the five years. But Portfolio B, experiencing negative returns in the early years, would have a balance of slightly less than $47,000. The difference is explained by sequence risk.

How have retired investors fared who have experienced the negative effects of sequence risk? The answer depends on how those investors managed their withdrawals and expenses during the crucial early years of retirement. Research shows that if retirees follow certain rules, their funds can still last 30 years or more, even if they retire at a particularly bad time for the markets.

For example, those who retired in the late 1960s had the misfortune of encountering back-to-back bear markets in 1969 and 1973, coupled with years of high inflation. While many had pensions and Social Security benefits to stabilize their retirement income, by following the 4% rule—withdrawing only 4% of retirement savings in the first year and adjusting the amount for inflation in subsequent years—research indicates that their portfolios would have served them for the rest of their lives, according to Wade Pfau, financial planning educator and author of *Retirement Planning Guidebook*.

Some experts advocate an even more conservative approach in the current environment. A recent report from Morningstar recommends that those entering retirement draw no more than 3.3% in the first year. And the fact is that even a small adjustment to withdrawals in the first years of retirement can make a big difference in the lifespan of a retiree’s savings. According to Pfau, someone who retired in 1966 and followed the 4% rule could have exhausted their funds in 30 years, while another retiree who withdrew 3.8% instead of 4% would still have most of their nest egg remaining after 30 years. Pfau further suggests that a hypothetical investor with a 50-50 portfolio who retired with $1 million in 2008—during the Great Recession—and followed the 4% rule would have about $1.63 million today.

Obviously, no one can control what the markets are like when they retire. But there are some steps that can be taken, even in a bear market, to extend the life of retirement savings.

1. Cut spending. As indicated above, even a 0.7% reduction in the amount of withdrawals can mean many more years of available assets to support retirement. Since your portfolio is most vulnerable to negative sequence risks early in retirement, you may want to initially spend less than planned, to give your portfolio the fuel it needs to replenish itself when markets turn around.

2. Keep working. If you are willing and able, you might postpone retirement or even return to the workforce part-time. Any earned income can reduce the amount of assets you must sell in down markets to maintain your lifestyle. If your circumstances allow, you may be able to not only avoid spending retirement reserves during down markets, but even add more in (buying at bargain prices).

3. Tap other assets. When you retire, you typically have several sources of income to draw from. You may have traditional investment accounts, retirement accounts, Social Security, or pension plans. Your investments are usually divided between stocks and bonds. You may have equity in your home. You may have an annuity. You may have cash reserves. If you encounter negative market returns early in retirement, you might be able to tap a combination of your non-stock assets for initial spending needs. This can mitigate the hit your portfolio will otherwise have to take if you must liquidate shares of stock.

4. Consult with a financial advisor. Sequence risk is usually not the only consideration at play in retirement planning. There are taxes to consider, estate plans to bear in mind, carefully structured investment portfolios to maintain, and logistics to learn. All this speaks to the value an experienced advisor can add before, during, and after this pivotal time in your financial journey.

At Empyrion Wealth Management, we know that market volatility can create worrisome thoughts, especially when it comes to your retirement funds. That's why we help our clients build well diversified, properly balanced portfolios designed to weather all types of market conditions. To learn more, click here to read our article, "Recession or Blip?"

Stay Diversified, Stay YOUR Course!

SOCIAL MEDIA DIGEST

In case you missed them, here is a roundup of my latest posts on social media:

In honor of #InternationalLiteracyDay, we're spotlighting the importance of #financialliteracy. At Empyrion Wealth Management, we work with family stewards and others who are committed to the financial literacy and wellbeing of future generations.

Learn why a #financialeducation might just be the best gift you ever give your children.

September is #HealthyAgingMonth, an opportunity for people of all ages to focus on their health and take precautions to help them with some of the challenges that come with aging. At Empyrion, we specialize in assisting retirees plan strategically for their golden years. From a long-term retirement income strategy to ongoing personalized service and support, we're prepared to support your #retirement dreams. #wealthmanagement

Losing a spouse is wrenching no matter what stage in life it happens. However, the questions, emotional riptides, and life transitions facing #youngerwidows can be especially challenging. At Empyrion we offer individualized counsel for

#womenintransition. Learn more.

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"We understand that every person we serve has distinct values and ambitions, and they each need their own plan for wealth management."