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Retirees Can't Underestimate This Stock Market Risk

If the market tumbles right around the time you're retiring, it can have a powerful impact on how long your retirement assets will last. While you can't control the market, there are other factors that are in your own hands.

By David Hickey, CPCU | Your Own Retirement
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If you've been saving for retirement for many years, you've probably noticed that, in so many cases, time really does have the ability to heal wounds.

There can be long and short periods when returns in the market are mostly negative. But if you save consistently during your working years and stay invested through up and down markets, you can be pretty confident your nest egg will continue to grow. It may take awhile to recoup the money you lose, but even the train wreck that was 2008-2009 has been forgotten by many investors, thanks to this record-setting bull market.

Nerve-racking as it is, the market really is the best place for many investors during their accumulation years.

Things can get a little shakier, though, when you retire and start taking income from your portfolio.

If you withdraw 4% yearly from a portfolio that's still appreciating in value, in theory you'll be fine; those withdrawals should have little effect on your remaining balance. But if you take that withdrawal from a portfolio that's depreciating – especially in the early years of your retirement – the results could be devastating.

Financial professionals call this "sequence of returns risk," and it means the order in which good and bad years occur during the distribution stage of your financial life can have a powerful impact on how long your retirement assets will last. Any market volatility at all is going to hurt, but if it occurs in the first five years after you begin taking income, there's a significant chance you could run out of money much faster than you planned. Your account just won't have enough years to recover.

Now, there's a tendency by some to paint this point as though it's all about bad timing: You might get lucky and dodge the bullet. Or maybe you'll just get grazed.

But it's not nearly as serendipitous as that.

You can't treat major market fluctuations as some rare occurrence that you can avoid with just a little luck. They happen more often than we like to think. (Check any period from the Great Depression until today and you'll see what I mean.) This is just the reality of what the market does. It goes up and down.

We're increasingly seeing people who are retiring without an employer pension – which means they're largely in charge of their own future financial security. The decumulation dance has always been made up of complicated steps. But now it's even more difficult.

So, as tempting as it is to grab onto the potential growth of the market and hold on tight, if you're depending on your own savings for a good chunk of your retirement income, you must give serious thought to your exposure. For example, you might want to consider dialing down the risk in your portfolio and look at alternatives to the stock market. This is simply a matter of making sure your asset allocations align with your tolerance for risk.

While no strategy assures success or complete protection against loss, there are a number of products and techniques – index funds, annuities, interest-bearing bank accounts, trusts, etc. – that can help mitigate sequence of returns risk, and some guarantee income for as long as you live. They may provide the buffer you need to avoid selling equities at a reduced price.

Consider financial vehicles that can help reduce risk during retirement, and then you can have fun with what's left to invest. If you do well with your investments, you may be able to take a cruise or buy a vacation home. That could provide some proper healing for just about any wounds.

Kim Franke-Folstad contributed to this article.

David Hickey is a managing director at Your Own Retirement in Cranberry Township, Pennsylvania. He has over 30 years of experience in the insurance, finance and investment industry. Hickey has earned the Certified Property and Casualty Underwriting designation from the American Institute. He has a Bachelor of Arts degree in English from the University of Pittsburgh. Hickey has contributed his time to coaching baseball and ice hockey; part and parcel of raising five children with his wife of 31 years, Susan.