Investing in Retirement

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There are numerous philosophies about the optimal way to invest during retirement. The traditional approach reduces a person's risk while accepting a lower overall return. In other words, this approach employs a mix of stocks and bonds (or stock funds and bond funds) that shifts from a heavier weighting in stocks to a lower weighting as retirement approaches. One example of a tool to achieve this goal is a target date fund (such as 2030) that is designed for an investor who will retire in the year 2030.

Another option is a balanced approach whereby a portfolio is made up of a blend of growth stocks and a select number of fixed -income exchange traded funds or individual bonds. This strategy is straightforward, contains no derivatives or outsized security weightings, and can hold a large cash position during difficult market environments. One difference from the target date fund example is that the weighting between bonds and stocks does not systematically change over time as a person approaches retirement. The rationale is history tells us that, if the investment time horizon is long enough, the returns from a diversified stock portfolio are sufficient to offset short-term volatility risk.

One of the better ways of justifying an investment plan is to test it over time. To provide a long-term perspective, we selected one of our private client accounts that has had 20-years being managed in this balanced strategy. In 2003, a retired person came to us with approximately $1 million dollars in their retirement plan. The retiree asked to withdraw $60,000 per year and this annual payout was increased over time. (The average withdrawals over twenty years was $67,761 per year.) Over those twenty years, the total withdrawal amount was $1,355,223 some 35% more than was deposited in 2003. Remember that this account was selected for analysis due to the length of time under management and the fact that this individual was already retired. This example is not a theoretical account in which results were back tested. The period includes three bear markets: the Great Recession of 2008-2009, the Covid-related plunge of 2020 and the bear market so far in 2022 with the measurement period ending August 30, 2022 -- close to the bear market low. Even with these major market declines, at the end of August, the portfolio value was $965,841 almost the same amount as was deposited twenty years earlier and after withdrawals of over $1.3 million! If we convert the dollar amounts to percentage gains of the portfolio for comparison purposes, the annualized return of this balanced portfolio was 6.9% -- after all trading and advisory fees.

Timing is also an important consideration. The management of this account began in 2003 just at the beginning of a bull market that lasted until 2008. If the balanced strategy is employed during or after a bull market advance, the results might be less than expected. For example, another account started in August of 2007 with an initial deposit of $454,000. After withdrawing $185,000, the value of the account at the end of August 2022 was $759,000 or an annualized gain of 5.1% over a 15-year period – again after all trading and advisory fees.

While investors fret about losing money in their retirement plans, history tells us that such paper losses can be recouped over reasonable periods of time and, in most cases, provide the gains necessary that can improve the possibility that a retiree's financials needs will be met. We all know that there is no guarantee that the past will be a good indicator of the future. However, history also tells us that investors with a long-term time horizon can achieve or exceed their retirement planning goals. To accomplish this objective, the management of a portfolio should employ a common-sense approach that includes reasonably valued securities and diversification to minimize the impact of short-term volatility on long-term returns.

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