WHY INVESTING IS DIFFERENT IN RETIREMENT

AAII HOUSTON RETIREMENT SIG

JANUARY 9, 2025

CAVEAT

- Many retired members may have implemented some but not all of these items previously

- They will, however, need to make several adjustments to ensure they are updated for new objectives & demonstrate a tilt to Income Investing

LONG LIST OF 14 ITEMS TO COVER

Will divide into Two parts

TOPICS – PART ONE

- Moving from Accumulation to Decumulation
- Need to Reset Investment Goals
- Formalize your Risk Tolerance
- Redesign Portfolio Allocation & Diversify to lower Risk Profile
- Retirement Horizon & Withdrawal Rates
- Manage Longevity Risk
- Manage Sequence Risk

MOVING FROM ACCUMULATION TO DECUMULATION

- Completely different backdrop requires a reversal in thinking
  - No longer have a salary & benefits to fall back on
- Must live on SocSec, any pensions/annuities/structured settlements, & what you withdraw from PF
- Essential to have a Retirement Plan (RP) developed with your Financial Advisor or trusted CFP, updated every few years

NEED TO RESET INVESTMENT GOALS

- Seek highest returns at lowest risk for Equities & Debt/Annuities
- Diversify to include all asset classes
  - Start with a 60/40 ratio of equity to fixed income
  - Use widely available models from AAII, T. Rowe Price, Schwab, et al
- Use a financial advisor to help you through this process
- Plan for the long term but manage your money tactically

FORMALIZE YOUR RISK TOLERANCE

- Use your Financial Advisor or download forms from the net
- Complete the forms with spouse honestly without bravado
  - Jointly with your spouse recognizing "this is it" for your nest egg
- Most likely find yourself in "Moderate Growth" category
  - Implies a high single-digit return with low volatility & sustainability
- Tolerances can be adjusted over time, as needed

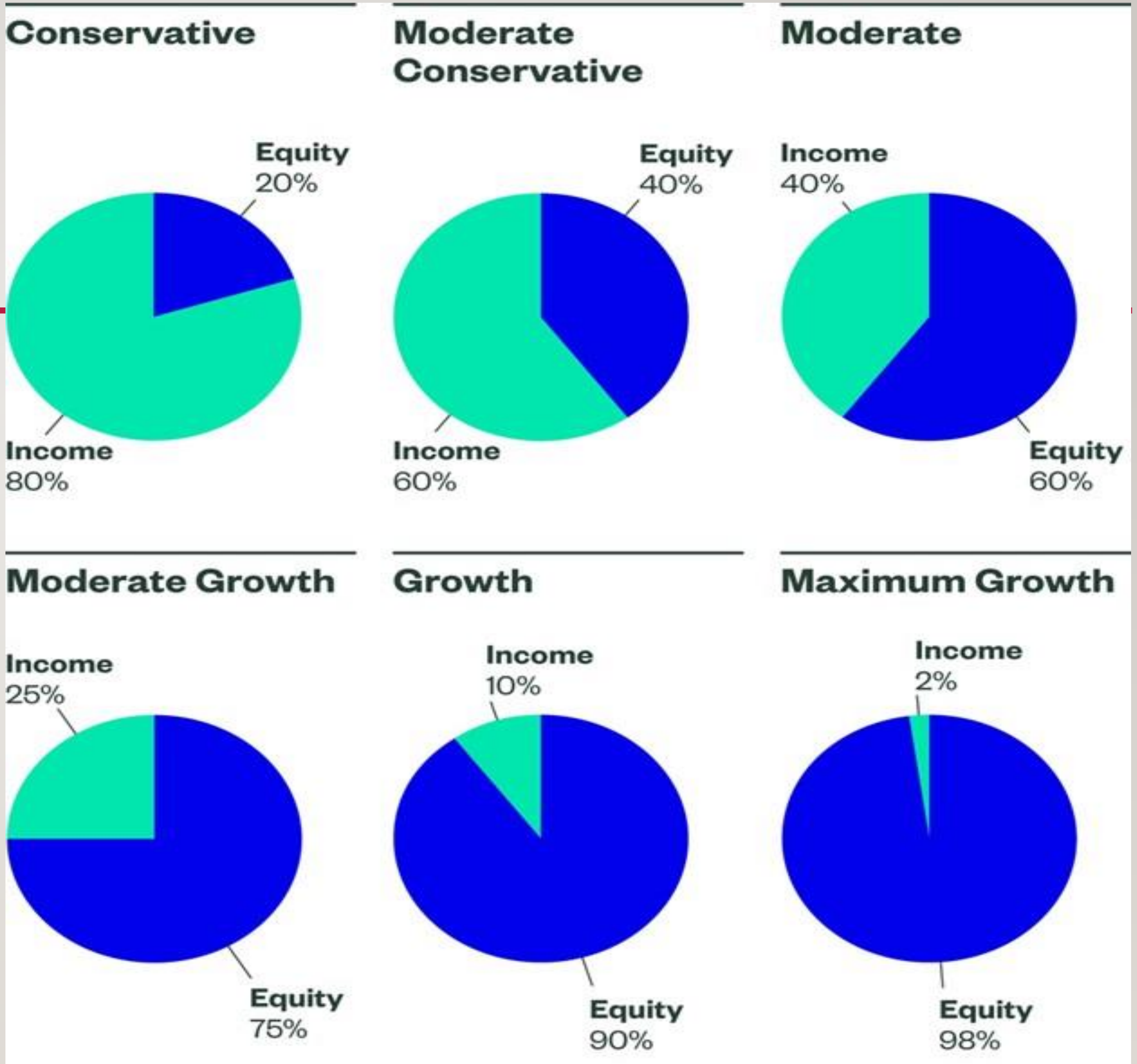
REDESIGN PORTFOLIO ALLOCATION – TO LIMIT INFLATION RISK

- Redesign for longevity, risk tolerance, & capital preservation
- Start with US Equities, Bonds & Cash
  - Break Equities into LC & SC ETFs
  - Bonds into Govt, Corporates & International
- When you feel ready, bring in some Real Estate & Gold allocations
- As you become more sophisticated, consider MidCaps, HiYield bonds, & a quality Global fund
- Lastly, consider private investing in real estate, & private bonds

PORTFOLIO RISK MODELS – BY STATE STREET (SSGA)

➢ Conservative	80/20%	Equity to Fixed Income
➢ Moderate Conservative	60/40%	..
➢ Moderate	40/60%	..
➢ Moderate Growth	75/25%	..
➢ Growth	90/10%	..
➢ Max Growth	98/2%	..

SSGA MODEL PORTFOLIOS



Source: State Street Global Advisors.
All asset allocation scenarios are for hypothetical purposes only and are not intended to represent a specific asset allocation strategy or recommend a particular allocation. Each investor's situation is unique and asset allocation decisions should be based on an investor's risk tolerance, time horizon and financial situation.

DIVERSIFY TO LOWER RISK PROFILE

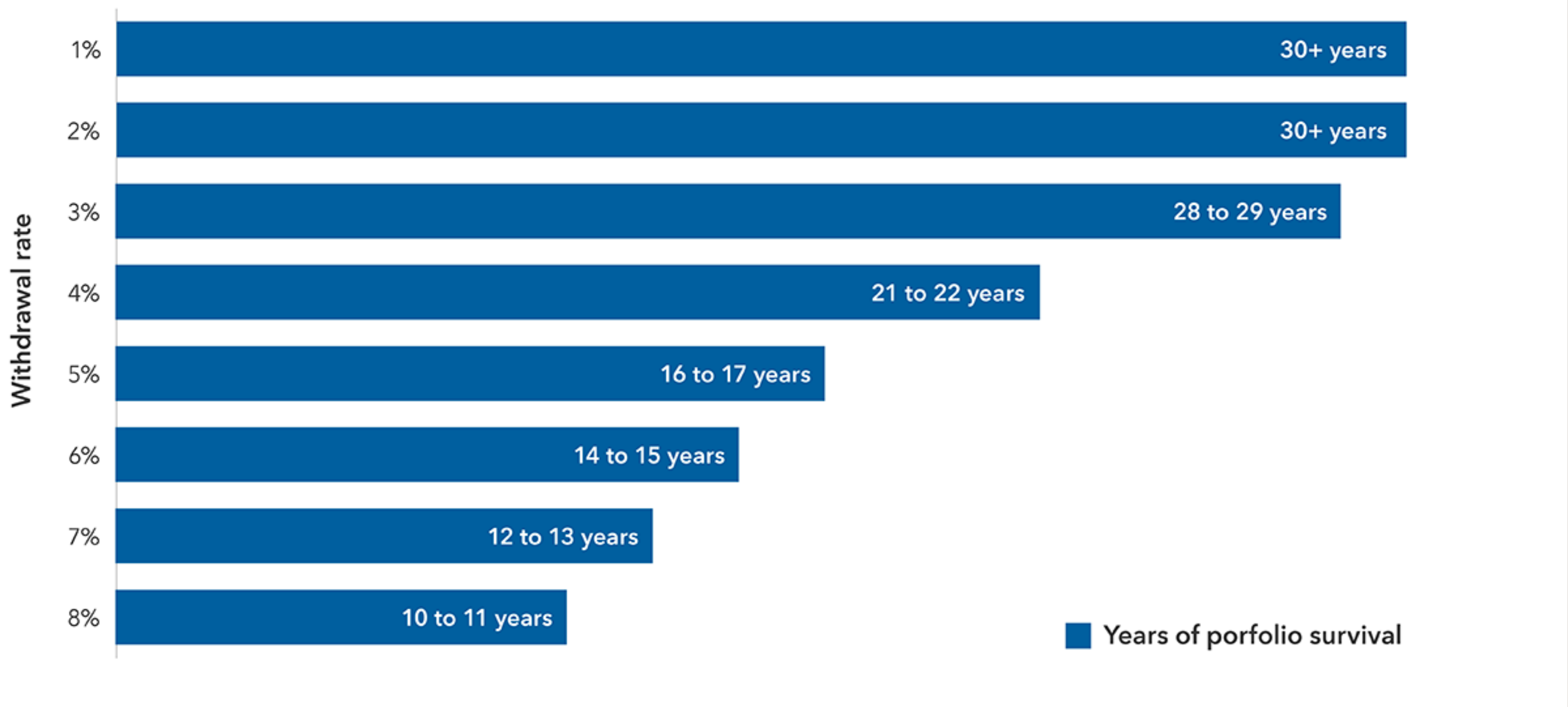
- Expand number of asset classes to diversify & improve the risk profile of portfolio…as many as you can manage
- Examples:
  - With Lo-Rtn/Hi-Risk assets, add the opposite - Midcaps/HiYld bonds
  - With Hi-Vol assets, add the opposite - Bonds or Privates
  - If highly correlated to the S&P500, add hedges - Gold & Real Estate
  - Own real assets to protect you from inflation – Oil & Metals

DECIDE ON WITHDRAWAL RATES

- Pick a method you are comfortable with e.g. Bengen 4% with guard rails
  - WD rate as function of a % of your Portfolio (PF) or a fixed annual budget $
  - A useful alternative is new IRS Mortality Table to spend less upfront/more later
  - Reduction in W/D rates on the downside is paramount
  - Allow for payment of income taxes in your WD rates
  - Be more conservative based on legacy plans e.g. to surviving spouse, then children
- This should place you in the mainstream & allows for upside adjustment in good years
- Many books & articles on the pros & cons of different methods

RETIREMENT HORIZON & WITHDRAWAL RATES

WSJ quoted a recent paper that followed experience over many decades: “retirees who wants < 5% odds of “financial ruin” should withdraw just 2.26%”



Source: Capital Group

MANAGE LONGEVITY RISK

- Use min age 90, generally for your spouse in planning
  - "90 is the new 85" especially for couples & financially secure
- Plan for a long life that balances your income & spending
  - Update Retirement Plan (RP) every other year to stay on track
- Longevity implies higher medical costs & maybe nursing homes
  - Fund either through LTC plans or thru a sizeable PF
- Statistics: "longer you live, the better your odds of living longer"

FOR NEW RETIREES - MANAGE SEQUENCE RISK

- Start with a diversified portfolio with lots of downside protection - 60/40 model
- Make withdrawals conservatively first five years of retirement
- See if you have room to spend more liberally after 2yrs using an updated RP
- Continue with 60/40 ratio or adjust, based on your risk tolerance
  - Have your advisor bring your RP to life using "What If" scenarios
- Rebalance the PF when you add the future value of SocSec, Annuities, & Home Equity since they change the focus from PF to Net Worth
  - Boosts the value of Fixed Income-like instruments as % & allows more equity

TOPICS – PART TWO

- Formalize Portfolio Risk Management
- Modify Portfolio Optimization & Rebalancing
- Manage RMDs & SocSec Deferral
- Bucket Portfolios helpful for Allocation & Location
- 6 Numbers you should Know about Your Portfolio
- "Timing the Market" or "Time in the Market"
- Spending Outlook in Retirement

FORMALIZE PORTFOLIO RISK MANAGEMENT

- A good PF is one that approaches the “Efficient Frontier” ideal of a Hi-Rtn/LoRisk profile
  - Models now widely available to assess PFs e.g. Research Affiliates, SSGA, MS
- Use more Non-correlated assets to complement your PF
  - Morningstar thinks HiQ bonds are the best diversifier
  - Gold, Commodities & Real Estate may be even better
- In a Crisis, do all correlations migrate to 100%?
  - Remember 2022 when bonds & stocks both went down!

PORTFOLIO OPTIMIZATION & REBALANCING

- Vanguard: rebalance annually to keep your Risk-Reward profile in sync
  - Trading off risk control w/trading costs – “higher return level at a medium risk”
  - Rebal is timely following an equity surge or after a downturn
  - “Avoid losers & hang on to winners” *Chris Litchfield PM*
- Important not to seek higher returns at risk of losing shock absorption from Fixed income assets
- Don’t expect mid-range correlations to hold up in a correction
- Rebalancing avoids volatility spikes, which can damage performance

MANAGE RMD'S & SOCSEC DEFERRAL

- Required Minimum Distributions start at age 73 under SECURE Act
  - "Tax free" misnomer becomes "Tax deferred"
- Direct reductions from your Traditional IRA based on IRS mortality tables
  - Roth IRAs are excluded (fully Tax-free)
- RMDs are fully taxable but the A.T. balance is yours to use for WDs
  - Sweet spot for Roth Conversions is after taking SocSec & before RMDs
- SocSec can be deferred by 25% from ages 62-66 & 32% from ages 66-70
  - Great incentive to find ways to fund deferral from ages 62-70
  - Personal decision based partly on family genetics

BUCKET PORTFOLIOS HELP ALLOCATION & LOCATION

- Allocate for Risk Management but locate for Tax Optimization (IRAs)
- Bucket One – Liquidity & preservation of principal
  - Near term – Cash, Money markets, CDs, &ST bond funds
- Bucket Two – Income, purchasing power & some growth
  - Medium term – HiQ bonds/funds, Balanced or Equity Income funds
- Bucket Three – Growth & Income
  - Long term – Equities, Eq funds, Hi-Yld bonds, Commodities, Real estate

Source: Christine Benz Morningstar

SOME FUNDS TO CONSIDER

- Bucket One – Keep 1-2 years of living expense in money markets, best rate CDs & ST bond funds at Fidelity or Schwab
- Bucket Two – Balanced funds Mairs & Power Balanced (MAPOX), Greenspring (GRSPX), ST Inflation-Protected Index (VTIPX)
- Bucket Three - Core equity funds from Fidelity, Schwab, & Vanguard, as well as actively managed funds from Artisan, Primecap, & Oakmark, Gold & Real Estate ETFs
  - Real Estate can be REITs for Income or Private Investments for Growth

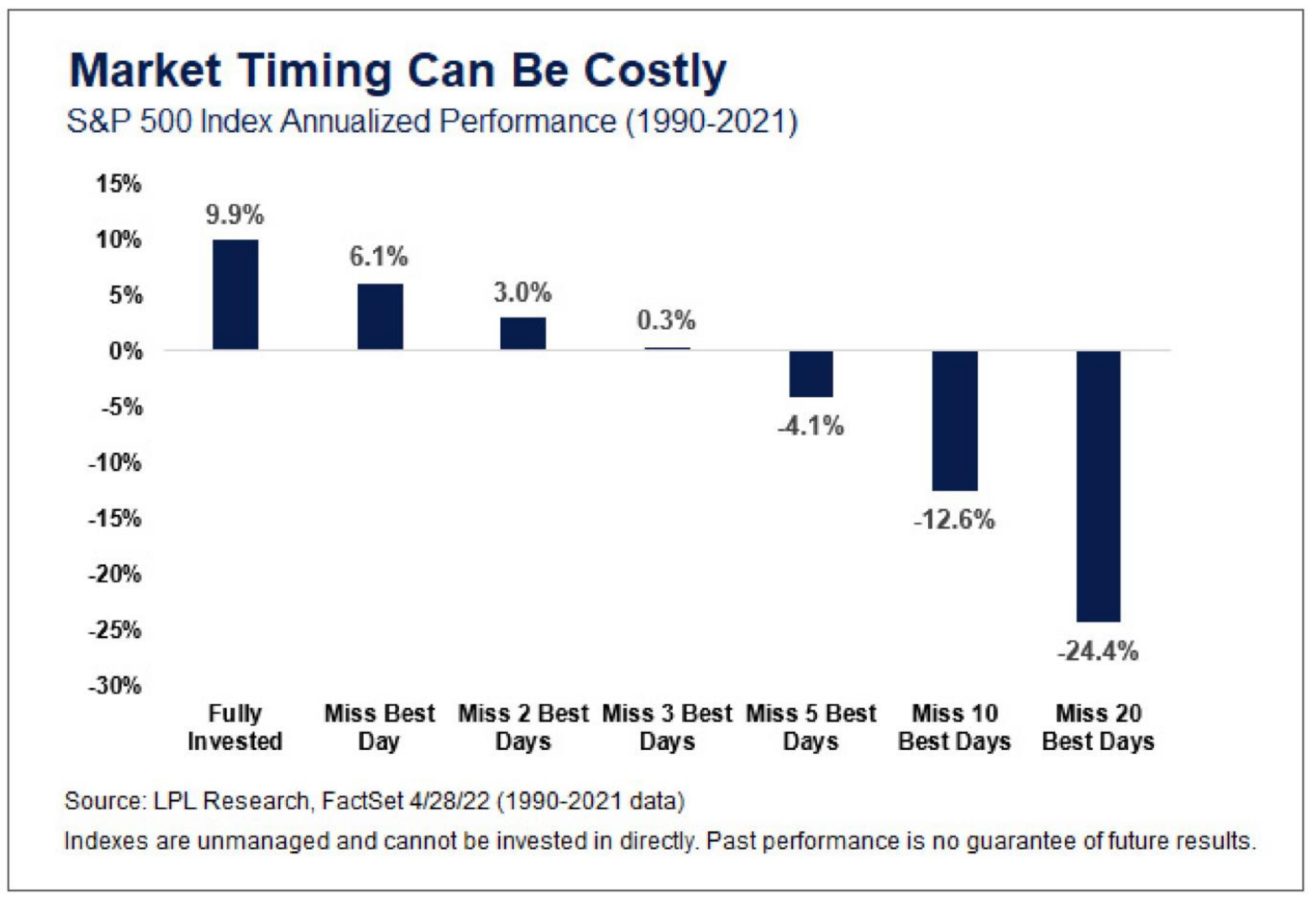
Source: Christine Benz Morningstar

6 NUMBERS YOU SHOULD KNOW ABOUT YOUR PORTFOLIO

- Asset Allocation – designed by you & spouse with your advisor
- Expense Ratios – from disclosures
- PF Overall Rate of Return – from disclosures, advisor or broker
- Benchmark Return for your Equity/Debt mix - from advisor
- Benchmark Return for every fund you own – from advisor
- Tax Efficiency of your non-IRA Taxable Assets (Goal < 30%)

Source: Jonathan Guyton

TIME IN THE MARKET vs TIMING THE MARKET?



SPENDING OUTLOOK IN RETIREMENT

- Three major determinants:
  - **Go-go years**: Keep Spending till ~75 in travel & meals out = WD rate
  - **Slow-go years**: Activity drops off & spend a lot less ~75-85 < WD rate
  - **No-go years**: Spending goes up in 80s with Medical needs > WD rate
- Better to overestimate costs in Retirement Planning
  - *BIGGEST FEAR: RUNNING OUT OF CASH!*
- Recognize now that medical costs will increase – for some people greatly!
  - Consider Homecare Ins, LT Care Ins/Hybrid Annuities or self fund?

Source: Christine Benz - Morningstar

FOR ANOTHER DAY……….

- What steps to take in a Financial Crisis
- How to manage the Business Cycle to Position Assets in PF
- Creating a Succession Plan for when you are ready to handover
- What steps to take when Falling Behind in Your Plan
- Detailed Tax & Estate Planning concepts, documents & strategies
- Other topics upon request ……………

QUESTIONS & CONCERNS

KEY LESSONS FROM FORMAL FINANCIAL PLANNING

- Have done multiple RPs w/Schwab & JP Morgan
  - Having an advisor more than pays for itself in returns & risk avoidance!
  - Better for you & spouse to have before making retirement decisions
- Forced Lessons:
  - Focus on longevity for you & partner mortality dates (when to plan dates)
  - Focus on planned legacy traded off against lifestyle
  - Minimize Income taxes & RMDs
  - "What if" benefits from multiple Monte Carlo simulations
  - Validated & polished our own plans, strategies & decision making
  - Provided a 90% plus confidence level on the financial results of the RP