5 THINGS TO INVEST IN AS YOU APPROACH RETIREMENT

A Guide for Pre-Retirees

IS INVESTING DIFFERENT AS YOU APPROACH RETIREMENT?

Aside from marriage, retirement is arguably the biggest event of one's adult life. It is something you likely have worked and saved decades for. Over time, you've done your part in the accumulation of your assets. You may feel that you have a decent handle on the part of the retirement game. However, you've heard that investing while approaching retirement is different. Perhaps you are unsure about how to go about investing in this new phase of life, or maybe you feel the advisor that helped get you to retirement may not be the best fit for you as you travel through retirement.

These are all typical concerns of someone approaching this new phase of life. In order to make the most of your retirement years, you have to understand how to efficiently use your hard-earned dollars to accomplish your goals and objectives. Inefficiencies can cause you to have to work longer, spend less, and miss out on your retirement dreams.

So, what's the truth?

The truth is that investing as you approach retirement is different than investing to get to retirement. This is illustrated by the figure below:

As you approach retirement, you are likely in the preservation phase. This doesn't necessarily mean you should automatically change your allocation. It simply means you need to begin to think about how you will generate income in retirement, what will your cash withdrawal needs be on a yearly basis, and what is the time horizon to when those withdrawals will need to begin. In many cases, due to Social Security income, pension income, or a semi-retirement wage income, retirees don't need to begin immediately making withdrawals from their portfolios. It's important to have your unique situation evaluated.

Accumulation Phase

- Time horizon is long
- Short-term withdrawals are not expected to occur.
- Typically, the period to accept the highest level of volatility.
- Assets are low building up assets is the number one priority. Small actions done consistently over time will result in long-term success.

Conservation Phase

- Intermediate time horizon
- Withdrawals may be expected within the next 10 years.
- Time to start pre-planning for the distribution phase.
- Time to rethink allocation, discuss retirement goals, and begin implementing steps toward your retirement plan.

Distribution Phase

- Withdrawals are needed now
- Time to implement an income plan for supplemental cash flow
- Important to monitor retirement goals and plan, adjusting year-to-year as needed.
- Consider how assets will be left to the next generation

Inflation

At an estimated 2.5% rate of inflation, a retiree needing $5,000/month today for living expenses would need over $7,800/month in just 20 years to maintain the same lifestyle. And, with the chance for increased medical expenses later in life, those expenses could be even higher.

Longevity Risk

A 70-year woman has a 33.3% chance to reach age 90. Although 1 in 3 women will reach 90, few understand the financial impact of living a long life. This is called longevity risk. Your financial plan must have a contingency plan for living longer than expected.

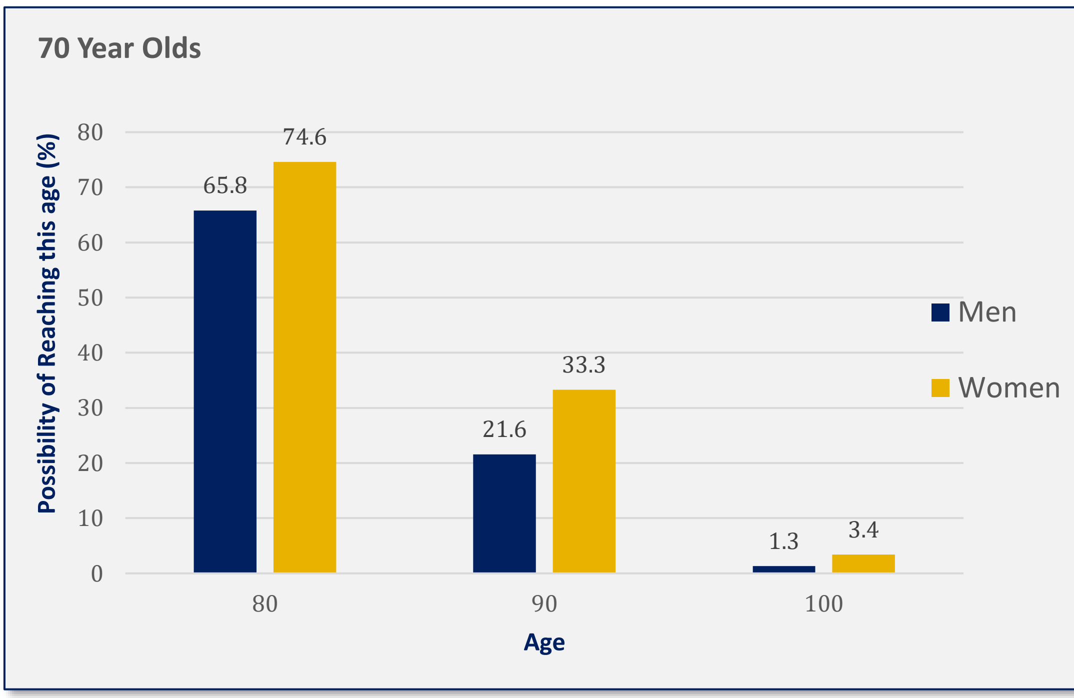
#1. HIGHER-RISK, LONG-TERM INVESTMENTS

A common misconception is that once you retire, you need to have 100% of your money in safe investments and you can't afford to take any risk. The notion is that if a major market correction occurs, there is not enough time for a retiree to recover, especially if that retire is taking withdrawals.

The average 70-year old male has a 21.6% chance of reaching age 90, while a 70-year old female has a 33.3% chance. With that said, if the average person retires at age 65 and lives to age 90, that could be 25 years of retirement. That also means 25 years of inflation and increased living expenses. It's important to allocate a portion of your portfolio to investments that can at least keep pace, and hopefully, exceed the pace of inflation. This might include a diversified allocation toward equities, or investments comprised of stocks.

If a higher allocation toward equities results in a higher average rate of return during your retirement years, then your money will go farther, which could potentially help you retire sooner or spend more in retirement than if your return was lower due to a conservative allocation.

JUST HOW LONG WILL THE "LONG-TERM" BE?



Business Insider/Andy Kiersz, data from Social Security Administration

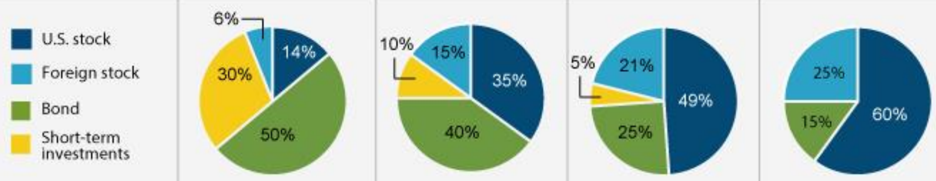
#2. LOWER-RISK, SHORT-TERM INVESTMENTS

Although higher-risk investments, like equities (stocks), can help keep pace or likely even exceed the rate of inflation over a long period of time, it's not common that retirees be allocated 100% toward equities (stocks). Doing so would provide a higher level of volatility, which is not typically something that a retiree or pre-retiree can afford to deal with financially or emotionally.

Lower-risk investments, like bonds or bond funds, can potentially lower volatility in a portfolio. Therefore, it's important to understand your risk tolerance as you enter the conservation phase of life so that you can set your allocation accordingly. If you're the time until you plan to begin making cash withdrawals is short (1-5 years), you may decide that a higher allocation toward bonds is a good fit for you. However, be aware of the relationship between more bonds and lower average returns (see below).

RISK VS. REWARD RELATIONSHIP

	Conservative	Balanced	Growth	Aggressive growth



Annual return %				
Average	5.96	7.91	8.88	9.55
Worst one-year return	–17.67	–40.64	–52.92	–60.78
Best one-year return	31.06	76.57	109.55	136.07
Worst 20-year return	2.92	3.43	3.10	2.66
Best 20-year return	10.98	13.83	15.34	16.49
Historical volatility	4.52	9.61	13.13	15.83

Data source: Morningstar Inc., 2016 (1926-2016). Past performance is no guarantee of future results. Returns include the reinvestment of dividends and other earnings. This chart is for illustrative purposes only and does not represent actual or implied performance of any investment option.

The purpose of the target asset mixes is to show how target asset mixes may be created with different risk and return characteristics to help meet a participant's goal. You should choose your own investments based on your particular objectives and situation. Remember, you may change how your account is invested. Be sure to review your decisions periodically to make sure they are still consistent with your goal.

Interest Rate Risk

When investing in bonds, it's important to understand the inverse relationship between interest rates and bond prices. As interest rates go up, bond prices come down. If too much of your portfolio is invested in bonds during a period of time when rates are going up, you are likely to see a decrease in total return.

Future of Interest Rates

With interest rates being at historical lows, one should consider the future performance of bonds. If rates stay consistently low, that points to a subdued total return for bonds. If rates increase, total return on bonds could even go negative temporarily. For these reasons, it's important to understand how to invest in bonds, bond funds, and how to limit your interest rate risk.

#3. INVESTMENTS WITH INCOME-PRODUCING POTENTIAL

The scary part about retirement is that once you retire, you stop getting paychecks. That obvious, but profound, fact is what causes so much stress and anxiety for investors during retirement. And, if no paychecks are coming in, or if Social Security and your possible pension are not enough, then where should the rest of your income come from?

Investors should not only think of the growth opportunities of their portfolio, but they should also consider the income that their portfolio can produce. And, a steady, consistent, stream of income is certainly preferable. Dividend-paying stocks are one example of this. Stocks that pay dividends may be in a later phase in the business cycle, recognizing that rapid growth may be behind them (think Coca-Cola). But, by paying a decent dividend, they can entice investors to stick around. Plus, the dividends can add a solid boost to total returns over time (see below).

Another popular method of producing income in retirement is through the purchase of an annuity. An annuity is a contract between an investor and an insurance company. They can provide unique income benefits that may differ from other types of investments. However, annuities can be very complex and they vary widely in type, features, and costs. It's extremely important to seek advice about annuities from a knowledgeable advisor before purchasing.

The Difference of Dividends

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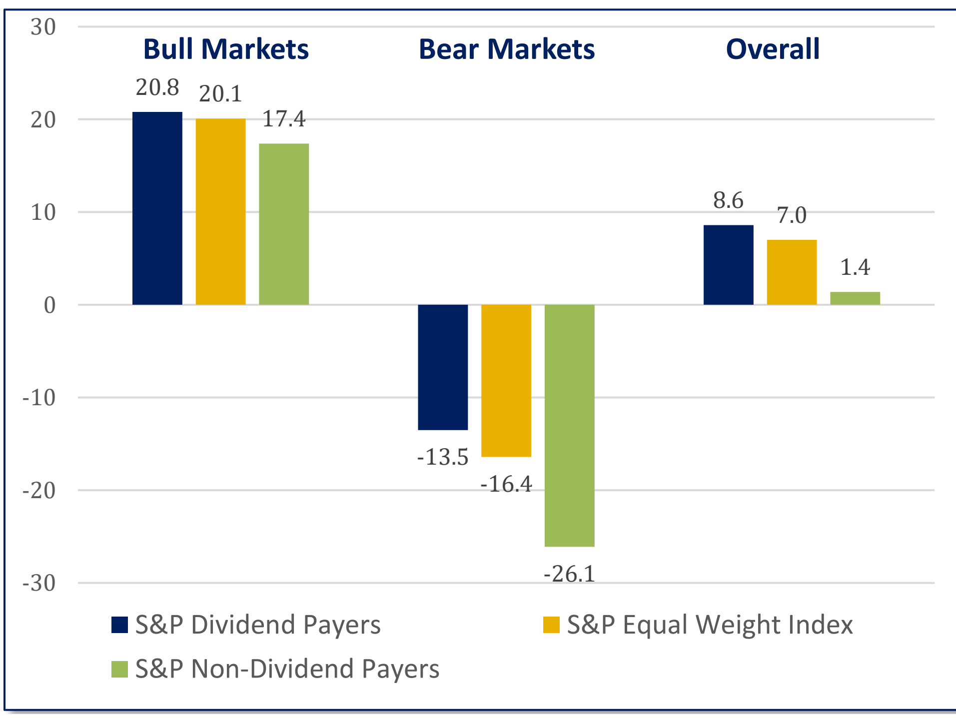
DIVIDENDS IN DIVERSE MARKETS



Source: Ned Davis Research. Data as of 12/31/11. A cyclical bull market requires a 30% in the Dow Jones Industrial Average (DJIA) after 50 calendar days or a 13% rise after 155 calendar days. A bear cyclical market requires a 30% drop in the DJIA after 50 calendar days or a 13% decline after 145 calendar days.

Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index.

#4. DIFFERENT SECTORS OF THE MARKET

We've all heard it. "Don't put all of your eggs in one basket." It's one of the first lessons we learn about investing. And, while that phrase it very basic in nature, it is also quite profound. It can be applied not only to investing, but to many things in life. But, regarding investing, not "putting all of your eggs in one basket" means to diversify your portfolio.

The proof that the phase works can be seen by looking at historical returns across all asset classes. Below is a chart that shows the variation or returns across different asset classes from 2002 – 2016. You'll notice that the best performer has varied greatly over that timeframe. The same is true for the worst performer.

The problem is that too many pre-retirees and retirees are misled and think that there is one investment, one silver bullet, that will solve all their problems. You may think or be told that all you need is an annuity or an S&P 500 index fund, and your money will do just fine. The truth is, every investment vehicle has its pros and cons, and every sector has periods of good performance and periods of underperformance.

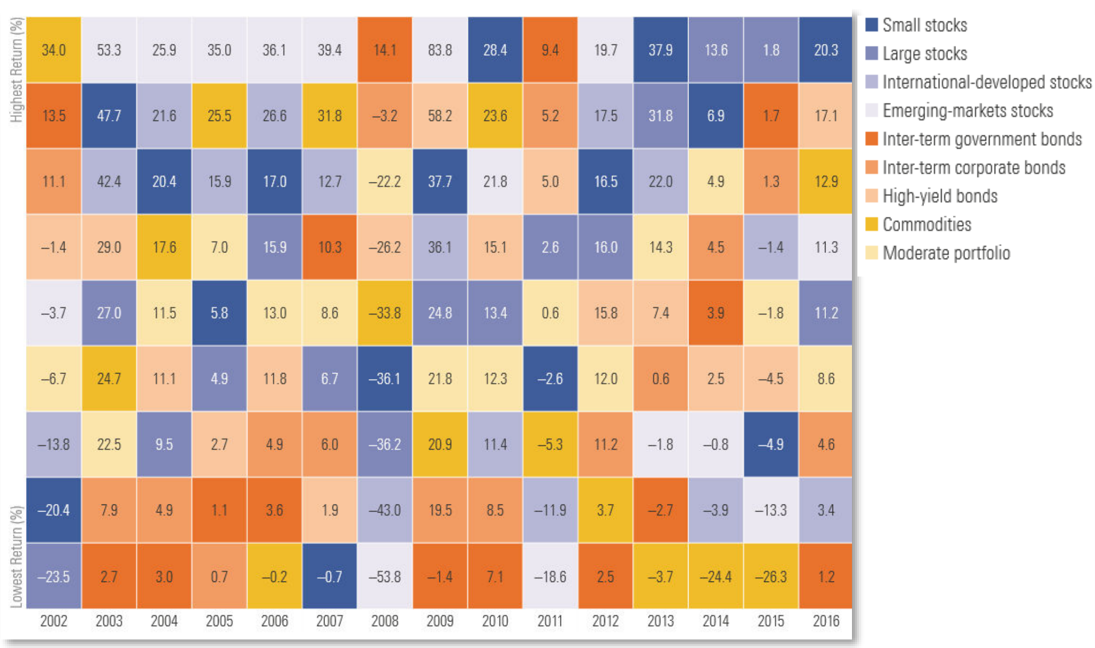
There is not silver bullet. The solution is spreading out your risk. That is not only the case during your accumulation phase, but it is also a prudent strategy as you prepare and enter retirement.

[1]https://www.forbes.com/sites/advisor/2010/09/13/its-not-really-a-lost-decade/#318f9ae17cf8

The Lost Decade

The S&P 500 (representing large-cap U.S. companies) has recorded many years of positive returns since its inception. However, it experienced a decade of no growth from 2000-2009 (known as the lost decade). Had you only been invested in the S&P 500 during that timeframe, your portfolio would have earned -0.95%.

ASSET CLASS WINNERS AND LOSERS (2002-2016)



Source: Small stocks – Morningstar Small Cap Index. Large stocks – Morningstar Large Cap Index. Int'l stocks – Morningstar Developed Mkts ex-U.S. Index. Emerging stocks – Morningstar Emerging Mkts Index. Interm. Govt bonds – Morningstar Interm. U.S. Govt Bond Index. Interm. corp. bonds – Morningstar Interm. Corp Bond index. High-yield bonds – Barclays U.S. High Yield Corp. Bond Index. Commodities – Morningstar Long-Only Commodity Index. Moderate portfolio – Morningstar Moderate Target Risk Index. ©2017 Morningstar

#5. CASH OR MONEY MARKET

"But…those things don't pay any interest", you say. True, which is why you cannot afford to allocate too much of your portfolio to cash or money markets, but that doesn't mean they don't have their place. Where investors error, and even where some professional money managers error, is that they try to time market corrections. So, they will allocate 20, 30, or even 40% or more to cash at certain times if they feel sure the market is due to correct itself.

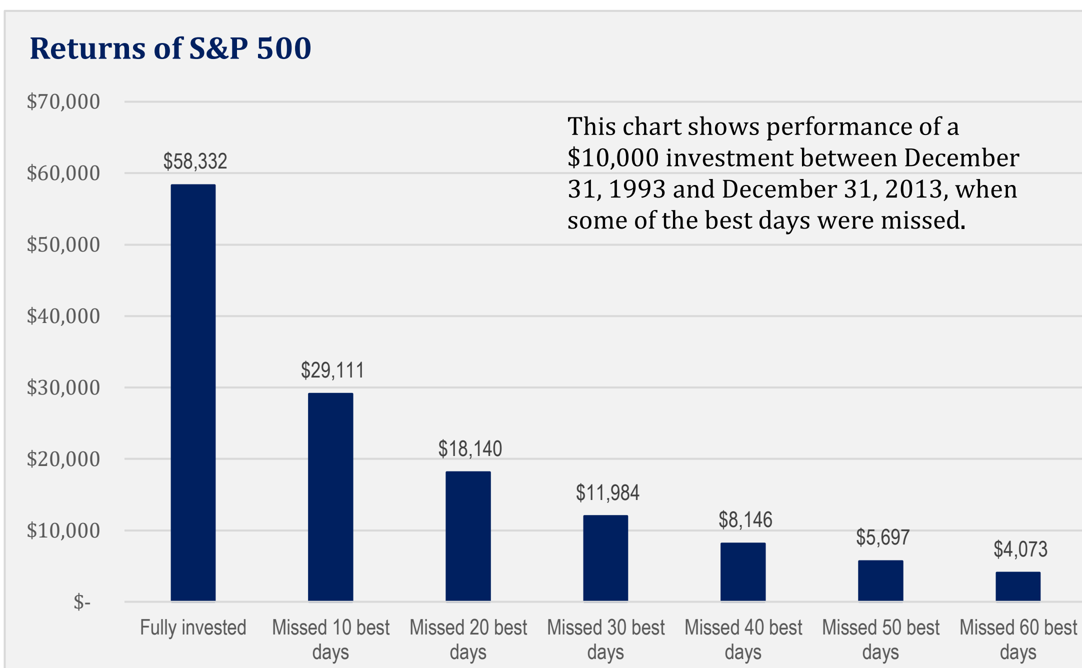
The downside to such a strategy is that they often end up missing out on several positive days in the market as they wait for their predicted correction. Sometimes, they may be waiting weeks to months. Other times, the correction never comes, and they surrender that notion, and subsequently investing back into the market. The chart below shows the effects of missing anywhere from 10-60 of the best days in the market over a 20-year period. The results are staggering.

The solution is to allocate to cash only what you feel you'll need to withdraw in the next 12-24 months and keep the rest fully invested. The reason is that during a correction, the last thing you want to do is sell. Since many corrections or recessions will last only 18-24 months, keeping enough cash on hand to handle distributions for that amount of time should prevent you from having to sell in a down market.

The Average Bear Market

Why is 12-24 months a good target in determining how much of your portfolio should be in cash? Well, according to Morningstar, there have been eight market downturns since 1926. And, the average duration of each downturn comes out to just over 16 months. So, if you have enough cash reserves to allow you to avoid selling discounted stocks, it will hopefully allow those stocks to rebound. But, too much cash will hinder performance over the long-term, so it's important to understand the proper percentage to allocate to cash for you.

THE COST OF BEING IN CASH



This chart is for illustrative purposes only and does not represent the performance of any investment or group of investments.

Source: Prepared by J.P. Morgan Asset Management using data from Lipper. 20-year annualized returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data as of December 31, 2013.

HAVING A PLAN MAKES FOR BETTER DECISIONS. WE WILL BUILD IT WITH YOU.

When faced with the decision of how to invest, at any phase of life, it can be overwhelming. Uncertainty is part of investing in the stock market. With uncertainty comes fear, stress, and anxiety. But, it doesn't have to be that way.

If you've ever tried to navigate your route in an unfamiliar territory, it can be stressful. You don't know where you are, and you don't know where you're going. You have a destination in mind, but you have no idea how to get there.

But, do you feel that same stress when you're sitting in the back of a taxi and someone else is driving for you? When you can see a GPS on the dashboard, showing the route, you are confident in the driver's plan.

It is also easy to tell if the driver is experienced and familiar with the territory. You want to be sure they've navigated this area before. And if so, your experience becomes much less stressful, and you can enjoy the scenery along the way.

The same holds true for your retirement journey. We encourage you to enjoy your retirement. We exist so that our clients can focus on what they do well in preparation for retirement so that they can enjoy their retirement once they get there. First, we will evaluate where you stand today. Then, we will create a plan for you that will help us outline the future together. We will act as your guide, your navigator, and we can help you get to your desired destination.

HOW TO EVALUATE YOUR FINANCIAL PLAN

	Yes	No
1. I currently have a written retirement financial plan.		
2. I would prefer to spend my free time on hobbies, family, and friends, rather than working on developing and monitoring my retirement plan, investments, etc.		
3. I have a detailed contingency plan that my spouse will understand in the event that I become deceased.		
4. I have calculated the exact rate at which I can withdraw assets from my investment portfolio for living expenses and ensure that I don't run out of money.		
5. I am confident in the asset allocation strategy I am implementing for my portfolio and have an asset allocation plan for the future.		
6. I feel I have sufficient tools and resources to ensure I can accurately track my retirement progress.		
7. I have a process that ensures I am limiting my tax liability every year.		
8. I am well-versed in advanced estate planning and insurance strategies that can protect my portfolio from Uncle Sam and help me pass more to my heirs.		

HOW YOU CAN GET STARTED

It seems that the best decisions, the right decisions, are often simple, but never easy. The many facets of retirement planning can be overwhelming for some. The simple solution is to build a plan for your financial future. But, where do you start.

Our step-by-step process has been proven to help our clients get organized, focus on their objectives, and follow a customized plan that helps improve long-term proficiency and accountability.

And, where building a plan may seem to be overwhelming to some, it is what our team of experienced and credentialed advisors does every day. We can help remove uncertainty and add clarity to your situation. We will help you focus on what you should be focusing on, and forget about the things you cannot control.

However, as with any new journey, the most important part is – the first step.

1

Schedule an appointment

- You may contact our office by phone or email to request a 45-minute introductory meeting

2

Have a values discussion

- In our first meeting, we will take the opportunity to ask questions about what your goals and objectives are regarding your financial plan. As you evaluate our team and philosophies, we will also evaluate if our philosophies align with yours.

3

Get your customized plan

- In our Planning session, we will provide you with a detailed plan that we will also help you implement. Our evaluation process should uncover any gaps that exist in your financial life, and our plan's recommendations will fill those gaps.

About CarsonAllaria Wealth Management

CarsonAllaria Wealth Management is an independent, Registered Investment Advisor (RIA). We believe in a team-based approach to wealth management and and financial planning. Our team of advisors act as fiduciaries, operating with full transparency as we guide you in making the best decisions for you and your family. Together, we will listen to what is most important to you and we will develop a strategy to accomplish your goals and objectives.

At CarsonAllaria Wealth Management, we help you build and manage your wealth, so you can enjoy it.

For advice on how you should invest as you prepare to enter retirement, email us at info@carsonallaria.com for a complimentary review.

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