



# Do Retirees Own Too Much Stock?

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# What Is The Right Stock Allocation?

Traditional rule: reduce stocks as age

- Traditional formula #1:
  - $100 \text{ (or } 110) - \text{age} = \text{stock } \%$
- Traditional formula #2:
  - 60% stocks/40% bonds or inverse
- Latest financial research

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## Why It Matters

- Sequence of returns risk
- Five years before and after retire:
  - The Retirement Danger Zone
  - Window of Vulnerability
- Wide use of Target Date Funds

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## Sequence of Returns Risk

- Largest balance often is at retirement
- Begin drawing down principal
- Less ability to recover losses
- About 80% of distribution variation
- Determines success or failure and adjustments that must be made

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## Example #1

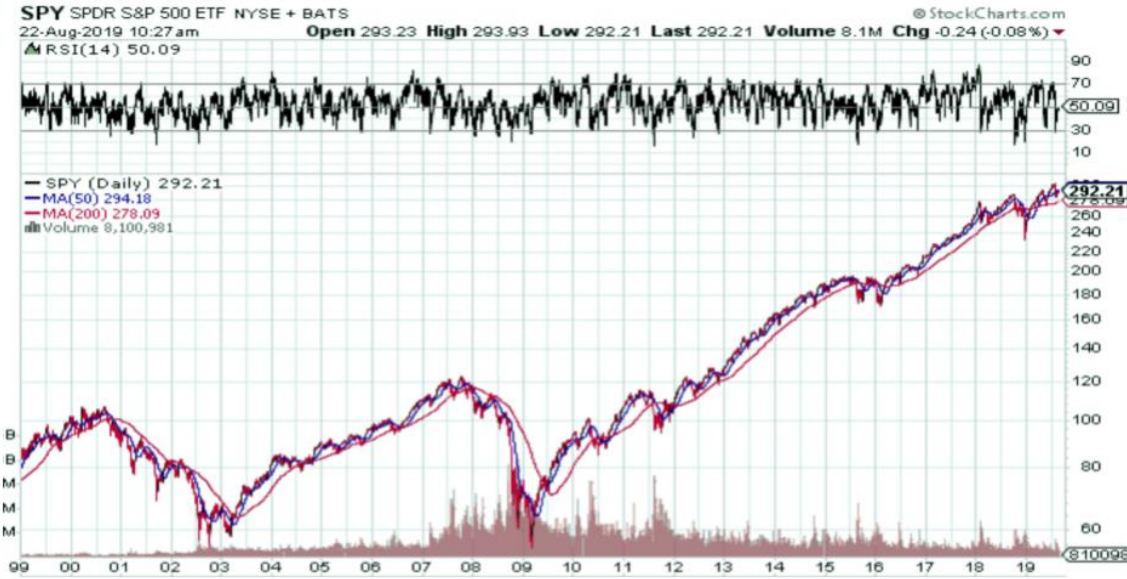
### S&P 500

- ~ 1400 in early 2000
- 815 September 2002
- 1,550 October 2007
- Decline again in financial crisis
- Recovers by March 2013
- Worse for Nasdaq 100

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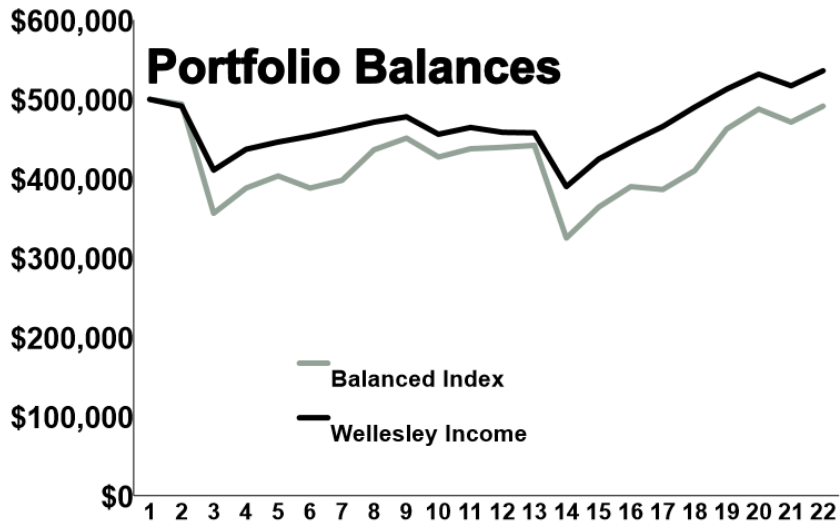
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# Example #1



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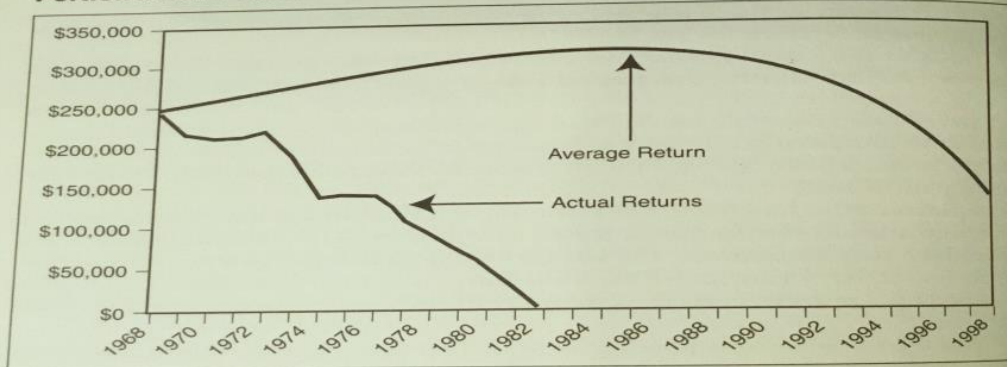
## Example #2



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# Example #3

**CHART 6.1 How Much Can You Withdraw from Your Retirement Portfolio: 1968–1998?—The Pitfalls of Projecting Average Returns**



Assumptions: Initial withdrawal amount increases by 3 percent each year for inflation. Withdrawals are made at the start of each year. Taxes and minimum required distributions from tax-deferred accounts are not considered in this illustration. Performance is based on historical returns for these periods of the S&P 500 Stock Index (60 percent of the portfolio), U.S. Intermediate Government Bond Index (30 percent), and 30-day Treasury bills (10 percent).  
Source: T. Rowe Price Associates. Performance data supplied by Ibbotson Associates.

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## Some Conclusions

- Returns when balance is higher are more important than when balance is lower
- Long period of mediocre returns worse than crash and recovery
- Best time to retire is bottom of bear market

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## Advice From Researchers

- Use rising equity glide path
- “U”-shaped lifetime asset allocation
- 20% to 30% at retirement
- Gradually increase to 50% to 70%
- 30% rising to 70% did best
- Or use buckets strategy

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## Criticism of Rising Equity Plan

- **Success rate not significantly higher**
- **Historic vs. random returns**
- **Is a bear market strategy**
- **Doesn't work if need to spend more**

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## What This Matters Today

**Especially vulnerable now because:**

- **Long period of high returns**
- **High valuations by most measures**
- **Projected returns likely below average**
- **Central banks have few tools left**

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## What You Should Do

- **Historic, average scenarios not useful**
- **Environment when retire matters**
- **Stress test**
- **Don't set-it-and-forget-it**
- **True Diversification is better**
- **Tactical investment strategy is better**

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## Other Helpful Strategies

- **Integrate with spending strategy**
- **Need flexible spending policy**
- **Increase guaranteed income**
- **Reverse mortgage LOC as a hedge**

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