Balancing Risk in Retirement

Avoiding Another Stock Market Crash

Peak Financial Freedom Group

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Risk management is a fancy term that describes decisions you make every day. Here are a few examples:

- Because your feet could become wet and cold, you protect them with socks and shoes.
- Because your house could burn in a fire, you buy homeowners insurance.
- Because you could be seriously injured in a car accident, you wear a seatbelt.

Now, let's apply this logic to money... Can you finish this sentence?

"Because you could lose money in the stock market, you..."

If you're unsure of the correct ending to this sentence, the following pages may be enlightening. However, before we explore options for controlling financial risk, let's take a closer look at what financial risk really is.

What is Financial Risk?

Risk is the danger you face from unexpected circumstances or unwanted outcomes regarding your money.

Risk can never be completely eliminated: it is ever-present.

But once risk is identified, it can be effectively managed.

Common financial risks for Retirees and Soon-To-Be-Retirees include:

- Stock market volatility and losses
- Running out of money during your lifetime
- Paying direct and indirect fees that are too high
- Future unplanned large expenses
- Paying too much in income taxes
- Not earning a high enough rate of return to meet your goals

But the biggest risk of all could be "Doing Without Risk" also called "Regret Risk".

"He who fails to plan is planning to fail"

~ Winston Churchill

What does Risk mean to you now that you are retired or soon-to-be-retired?

For most people, we have found that Risk isn't based on fancy words that you don't understand, it simply means the amount of money you could lose in the next big market downturn.

How to Pro-actively Manage Risk

Risk #1: Losing Your Money In The Stock Market

Recommended steps to significantly reduce this risk:

Follow the Golden Rule of 5%-10%

Create a portfolio that can be mathematically tested to have maximum losses of between 5%-10% even when the market drops 50% like it did in 2000-2002 and 2007-2009. You may still remember what these losses felt like, and you probably don't want to feel that way again. Over 98% of Retirees and Soon-To-Be-Retirees we have surveyed do not want more than 10% risk in their portfolios and prefer a risk level closer to 5%, but when their current portfolios are analyzed over 90% of these same people had risk factors between 30%-50%. A 50% loss requires a 100% return just to recover. The strategy to "Ride Out All Market Declines-Hang In There" doesn't work anymore and hasn't worked for years. The Rule of 5%-10% will work for you throughout your retirement.

The Golden Rule Of 5%-10%						
	Percent Loss	Portfolio Value Before Loss	Loss	Portfolio Value After Loss		Recovery Needed To Break-Even
No Loss Limit	-50% Loss	$1,000,000	($500,000)	$500,000		100%
	-40% Loss	$1,000,000	($400,000)	$600,000		66.7%
	-30% Loss	$1,000,000	($300,000)	$700,000		42.9%
	-20% Loss	$1,000,000	($200,000)	$800,000		25.0%
Golden Rule Of 5%-10%	-10% Loss	$1,000,000	($100,000)	$900,000		11.1%
	-9% Loss	$1,000,000	($90,000)	$910,000		9.9%
	-8% Loss	$1,000,000	($80,000)	$920,000		8.7%
	-7% Loss	$1,000,000	($70,000)	$930,000		7.5%
	-6% Loss	$1,000,000	($60,000)	$940,000		6.4%
	-5% Loss	$1,000,000	($50,000)	$950,000		5.3%

It is imperative that you stay in the blue after a big market loss.

Implement a StopLoss on your portfolio

Do not put yourself in a position to suffer a large market loss that may be difficult, maybe even impossible, to make up. A 10% StopLoss will take your assets out of the stock market after a 10% decline. Studies have shown that when the stock market declines 10%, there is a 56% probability it will go down father.

Consider contractual guarantees from insurance companies

Annuities are contractual guarantees from insurance companies that protect your principal against stock market losses, often offer higher potential returns than other “safe” investments, provide the comfort of a guaranteed minimum return, and provide income that is guaranteed for as long as you and your spouse live. You invest your money in an annuity and the insurance commpany sends you a check every month as long as you and your spouse live. The guarantees are backed by the claims paying ability of the insurance company.

Keep enough money in the bank

Bank funds are liquid and carry no risk up to FDIC limits. Bank funds buffer losses and reduce total fees.

Risk #2: Losses Are Worse Than What You Thought

Recommended steps to understand this risk:

It is a mathematical fact that you always have to earn more to make up for the loss than was lost in the first place

It seems logical if you lose 50% like the stock market lost during the 2007-2009 Financial Crisis you need a 50% return to break even. Lose 50% and then make 50% and your back to even. But this is not true. If you lose 50% you have to make 100% to get back to even! If you have $1,000,000 and you lose 50%, your assets decrease to $500,000. If your $500,000 earns 50% you are only back to $750,000, still $250,000 short of your pre-loss asset value. Your $500,000 would have to earn 100%, or $500,000, to break even at $1,000,000.

Income distributions magnify losses

In years you are taking income and your portfolio loses money, your portfolio's value decreases by the amount of the loss plus the amount of income you distributed. Some retirees make the mistake of thinking this risk is reduced by taking less income, but that is incorrect. You reduce this risk by eliminating large losses so you don't have to decrease your income at any time during retirement.

High fees magnify losses

In years your portfolio loses money, your portfolio's value decreases by the amount of the loss plus the amount of your fees, plus any income you took out.

Loss recoveries may not be quick

If you lost money in 2000-2002 or 2007-2009, it's hard to forget how those big losses felt. You may have lost -30%, -40%, -50%, or even -60% of your portfolio. It can take years, many years, to recover. Recent studies state if you suffer a 35% loss you only have a 61.1% chance to fully recover over any 5-year time period. In addition, because of huge losses from 2000-2002 and 2007-2009, between July 1999 and December 2012, a period of 13 ½ years, the S&P 500 Index was completely flat, providing a 0% annual gain.

Risk #3: 7 Rules That You Need To Follow To Increase Your Probability Of Having A Successful Retirement

Recommended steps to manage this risk:

Rule #1: Eliminate all large losses to your portfolio

Strictly adhere to the Golden Rule. 5%-10% losses can be made up quickly, 50% losses cannot be.

Rule #2: Minimize Fees

We have found that over 99% of Retirees underestimate the fees they are paying. We have found most Retirees believe they are paying 1% in fees when they are actually paying over 3% per year.

Rule #3: Eliminate Volatility

Between 1/1/15 through 12/31/16, a period of two (2) years, the S&P 500 Index fluctuated 26.15% from high to low. This type of volatility makes it very difficult to design a consistent income plan that can last.

Rule #4: Earn A Reasonable Rate of Return

When you try and earn the highest return possible it means you are also taking the highest risk. And in the past when you have taken big risks, how has it usually turned out? During the last seven (7) 15-year time periods starting in 1996, the S&P 500 Index has just averaged a 3.33% annual compounded increase. Set a realistic expectation of returns that can be achieved without taking too much risk.

Rule #5: Manage Taxation

Deferring IRA distributions until age 70 ½ may save you a little bit of income taxes now, but could significantly increase your taxes later when you are forced to take mandatory distributions off of a bigger asset (that you deferred). Deferring can also increase taxation to your beneficiaries.

Rule #6: Have A Comprehensive Written Retirement Income Plan

Create a retirement income plan, an income tax plan, a beneficiary plan, and complete details of every aspect of your plan in writing. Make sure you understand it and have your planner sign it.

Rule #7: Generate "Certain Income" From Your Assets That Will Last For As Long As You Live, Not "Maybe Income" That Could End At Any Time

The only true way to eliminate your fear of running out of money is to create income that is guaranteed to last for as long as you live.

Think about it…If you did all 7 of these things would you increase your probability of having a successful retirement? Of course you would.

Every Retiree is Guaranteed that they would increase their

Probability of financial success during Retirement by following these 7 Rules.

Risk #4: You Saved Your Money – Now Implement a Plan To Use It

The 2 biggest risks you can take during your retirement are:

1. Running out of money before you die. – Financial Risk
2. Running out of time to do all the things you planned to do – Regret Risk

Recommended steps to manage these risks:

1. Create enough income so you can do all the things you planned to do during retirement

Do all the travelling you can while you are a young Retiree, because as you get older travel becomes harder for everyone. Plan and complete the home renovations so you can enjoy them the rest of your life. Plan and go on the family vacation where you bring everyone. If you don't do these things now, there is a high probability you will regret it later. Most Retirees would love to have more income but they are afraid of losses, afraid of taxes, and afraid their money will run out before they do.

2. Use the funds you saved to create income that lasts your entire lifetime

Create a plan that provides you a large amount of income that is guaranteed to be paid to you, and your spouse, for as long as you both live, regardless of stock market losses. This way you will not worry about your income running out and feel free to spend your money without fear or guilt. Do not base your entire retirement plan on "Maybe Income" that could end at any time, base a large portion of your plan on "Certain Income" that is guaranteed for as long as you live, even to age 120+!

3. Verify that the extra income you take out of your accounts will not create a huge tax bill

Most Retirees can take significantly more income from their accounts than they are currently without putting themselves in a bad tax position.

4. Create guaranteed future income

If you need the extra income in the future make sure you invest your funds to guarantee a certain amount of income will be paid to you at a specific time in the future.

5. Create guaranteed funds for beneficiaries

If you want to pass on money to your beneficiaries, make sure the funds are guaranteed to be there for them.

Conclusion

Risk is unavoidable but it can be managed. To minimize risk during retirement:

- Strictly adhere to the Golden Rule.
- Use a proven scientific system that incorporates a StopLoss.
- Do not suffer large market losses and avoid volatility.
- Use contractual guarantees to create income that won't run out.
- Keep money in the bank.
- Minimize the total fees you are paying.
- Make sure your entire plan is in writing.
- Remember why you saved your money when you were working… to use it during retirement. Don't delay creating an income plan that will allow you to live your retirement dreams.

You can make intelligent decisions that will help to protect yourself from every form of risk except one - that is the risk of taking no action. The sooner you seek professional help in getting your questions answered the sooner you can begin to reduce the risks you face right now. One of the surest ways to avoid unforeseen financial problems is to work with a financial professional. Contact us today to schedule a no-obligation session to discuss your specific situation.

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