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About to Retire? Check Your Stock Exposure —Quickly

We ran a simulation showing how various portfolio allocations performed for someone who had retired in 2000—and it was revealing

Studies show that people who retire at bull-market peaks have a higher chance of running out of money. PHOTO: CARLO ALLEGRI ☐REUTERS

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There are a lot of people thinking of retiring now because the bull market has boosted their 401(k)s.

But they may need to re-evaluate their allocations. And quickly.

Over the past decade, the S&P 500 has returned more than 13% on an annualized basis. And studies show that this is exactly when a lot of people choose to retire—the height of a bull market, when their portfolio is plump.

But those same studies show that people who retire at bull-market peaks have a higher chance of running out of money. That is because they wrongly assume big returns will continue to pile up—and then they lose a big chunk of cash when bear markets arrive.

So, investors about to retire may want to re-evaluate how their money is allocated. To assist in that effort, we ran a simulation showing how various portfolio allocations performed for someone who had retired in 2000, the beginning of a bear market, followed by another later in the decade.

We cherry-picked a retirement date with bad years at the beginning of the period, to counter the tendency for investors to focus on recent bull-market returns. For withdrawals, we applied one version of the “4% rule” that advisers often use, assuming retirees take out 4% of their account the first year, and then increase the dollar value of the initial amount by 3% in each subsequent year to account for inflation. Our simulation didn’t account for taxes, however.

Don’t scoff at bonds

First, let’s look at how a pure stock scenario played out.

We had our theoretical investor retire in 2000 with $500,000 fully invested in the S&P 500. Using the 4% rule, that nest egg eroded to less than $200,000 at the end of 2018.

Why? Although the S&P 500 produced a 4.86% annualized return over the 18 years of our study—and, of course, 13% returns from 2009 through 2018—it experienced two declines of roughly 50% (2000-02 and 2008-early 2009) within the first decade. Bad early years in a withdrawal phase can crush a portfolio; the double whammy of withdrawals and losses means there isn't enough money or time left for a roaring market later on to restore a portfolio to its original balance later.

But increasing bond exposure, represented by the Bloomberg Barclays U.S. Aggregate index, helped the portfolio to hold up.

A $500,000 investment in a balanced allocation (60% stocks, 40% bonds) would have been worth around $424,000 in 2018 using the 4% withdrawal rule. And a conservative portfolio (30% stocks/70% bonds) would have had around $508,000 at the end of 2018.

That is mainly because bond-heavy portfolios protected against big losses in the early years. Bonds' annualized returns for the whole period of the study were on par with those of stocks—4.84% for bonds vs. 4.86% for stocks—but bond returns held steady in the market downturns. In 2000-02, bonds gained a cumulative 33.5%, and they returned 5.2% in 2008-09.

Stick to 60% or less stock exposure

All of this means investors on the verge of retirement should contemplate having no more than 60% stock exposure and might prefer less. And that is what we found when we examined the funds in Morningstar's Target Date 2020 fund category. No fund had more than 63% stock exposure, and the average stock exposure for funds in the category was 43%. Beyond stocks and bonds, the average fund's cash position was nearly 14%.

Full article may be viewed at https://www.wsj.com/articles/about-to-retire-check-your-stock-exposurequickly-11564970680

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