ARTICLE BY: WINTER TROXEL | PUBLISHED: APRIL 2015
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Money

A NEW ASSET ALLOCATION FOR RETIREMENT


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Over the years, financial advisors have tried many methods for determining a safe withdrawal strategy for retirement income. The balancing act between portfolio management and income planning is quite daunting when considering the unknowns associated with retirement. Although accumulation planners have successfully developed methods for determining investors' "asset allocation," there has been significantly less emphasis on distribution planning.

Your financial life is made up of an accumulation period and a distribution period. During the accumulation period, or the working years, investors focus on saving for the future and getting a high rate of return. Asset allocation, or the selection of investments for savings and return, is intended to match the investor's risk tolerance and growth objectives. The focus is on finding the most return on savings per amount of risk taken by the participant. The distribution period stands at the opposite end of the spectrum. The focus is on income over savings and growth. During the distribution period, retirees try to convert their saved wealth into financial independence, better known as retirement. A desired quality of life from saved assets is the primary goal of the distribution period. In other words, it's time to spend the money.

New retirees, though, often use the same financial approach in retirement (the distribution period) as they did while they were savers (the accumulation period). Most retirees have been savers for so long it's difficult to figure out how to actually use the money. Some might say savers have become so paralyzed by their assets that the IRS had to create Required Minimum Distributions to "force" withdrawals from retirement accounts.

How many people would go to business school and then work 30 years for free? Very few, yet there are thousands of new retirees who saved their whole lives in order to retire but then do not reward themselves with the quality of life aligned with their net worth. It's all about the unknowns of market volatility and longevity: saving money for a known future is easier than spending money for an unknown future.

One way to unlock your life savings for retirement is to set up a "new asset allocation strategy" in retirement, focused on balancing the use of assets for essential and nonessential uses. The approach involves coordinating your retirement assets with expenses for retirement. On the one hand, the floor of your allocation would be made up of both fixed assets (i.e. Social Security and pensions) as well as conservative income-oriented vehicles (i.e. bond ladders and annuities). The objective would be to maximize income from a specified pool of resources and to minimize the exposure to market loss. On the other hand, the nonessential dollars would be put into market-based investments. With the safety provided by the floor, the overall retirement picture is less vulnerable to market volatility. The discretionary monies can be invested in the market without fear of disrupting quality of life provided by the floor assets.

Eventually, these monies can be used for inflation, emergencies, travel and legacy planning.

A few weeks ago, I was approached by a woman who had plans to retire in a few months. She showed me her advisor's financial plan and asked for my opinion. The advisor pooled all of her assets into an investment portfolio and then withdrew her expected expenses for the duration of her retirement. I asked her the same question that every advisor should ask, "Will your plan survive a market correction within the first seven years of retirement?" She didn't know. Then I continued, "If all of your money is needed to provide retirement income, how will you pay for your next car? Vacation? Furnace?" She didn't know. Finally, she asked what she could do.

It was time for her to have a new retirement allocation strategy.