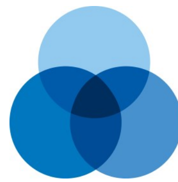
A Compendium on Achieving Financial Independence



EnRich Financial Partners
ALIGNING YOUR MONEY WITH YOUR LIFE

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Is Safe Really Safe?

People like safety. We see this practiced in all sorts of ways in everyday life from wearing seatbelts and locking our doors, to avoiding conflict and wearing a helmet when biking or playing sports. As you can imagine, this desire for safety can extend to one's retirement portfolio. The thinking goes that stocks may be okay while I'm accumulating, since I still have an outside income, and I've been taught the benefits of dollar-cost-averaging through rising and falling markets. However, when faced with these same bear markets in retirement, the fear instinct kicks in and we want safety. We tell ourselves that we don't have the luxury of time to recover from a bad bear market, so we need investments that minimize fluctuation and uncertainty-like bonds and cash do.

Unfortunately, what our natural instinct for safety fails to remind us of, is that there is a high long-term price to pay for owning bonds/cash rather than stocks. In a world of inflation, where everything costs more every year, we may need that income stream to provide for upwards of a 30+ year retirement. Unless you're blessed with a very large portfolio and rather modest income needs, most of us will need to have a certain amount of growth above and beyond our income needs to account for the effects of inflation. Bonds historically haven't been able to meet this need very well. Bonds do provide the illusion of safety by having low levels of fluctuation, but they're also generally cursed with low returns.

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Most retirees will be better off with a globally balanced account holding both stocks and bonds that is significantly tilted to stocks. Of course we know that this type of portfolio will experience more drawdown in bear markets, which can be very uncomfortable and trigger our fear instinct. The strategy will also entail systematic spending from the entire portfolio during bull markets, but turning to only spending from the bond shares during bear markets.

Stocks have produced the highest long-term results, so we know that this balanced approach has worked out most of the time. What most retirees cannot envision is how this strategy behaves through a full cycle bear market and subsequent recovery. Thus, the uncertainty of not knowing turns into fear and a desire for safety. This is one of the reasons people bail on stocks at just the wrong time during steep market downturns, when all they can envision is further decline, only to see the stocks recover over the

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subsequent years.

Let's test this strategy over a period that included two very significant stock market declines of more than -45% each: the 20 year period between 9/1/1996 and 8/31/2016. To be specific, we'll model a retiree with $1 million needing $40,000 per year, adjusted for inflation. In the first scenario, we'll put all $1 million into the Barclay's US Aggregate Bond Index-a proxy for a bond portfolio-and call this the Bond Portfolio. In the second scenario, we'll put all $1 million into a diversified global index portfolio of 70% stock / 30% bond with a value tilt similar to a real life portfolio many people might actually own, and we'll call this the Global Balanced Growth Portfolio.

Retirement Approach (starting 9/1/1996)	Value of $1 Million (through 8/31/16) Net of 4% Annual Withdrawals
Bond Portfolio	$1,390,635
Global Balanced Growth Portfolio	$2,352,268

The Bond investor did fine, mostly due to the fact that bonds had a yield over 6.9% in 1996. After taking a rising income stream for 20 years ($40,000 grew to almost $60,000), they had grown their portfolio to $1,390,635, a gain of $390,635 on top of the original investment. Seems okay until you consider that the same $1 million invested in the Global Balanced Growth portfolio grew to $2,352,268, which was a growth of $1,352,268. The price paid for the higher return: higher short-term volatility, but you achieved over 3 times the portfolio growth when compared to the "safe" Bond portfolio. Clearly, some investors will accept a lower portfolio value for stability of principal. However, we should all ask ourselves whether $960,000 more in ending wealth on an investment of just $1 million is a reasonable sacrifice to the more consistent month-to-month portfolio values. The opportunity cost is large.

Now, let's consider what happens if you end up taking out more than $40,000 per year (4%) due to unforeseen circumstances (health issues, premature retirement, family needs, etc.), and end up taking out 6% annually.

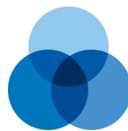
Retirement Approach (starting 9/1/1996)	Value of $1 Million (through 8/31/16) Net of 6% Annual Withdrawals
Bond Portfolio	$571,941
Global Balanced Growth Portfolio	$1,322,308

The revised simulation incorporating a 6% withdrawal rate instead of 4% produces a different picture. The Bond investor saw their portfolio lose -$428,059 and is now worth only $571,941. In addition, the current bond yield of 1.9% is not enough to support the nearly $90,000 withdrawal rate in 2016; the principal will only continue to decline. This is exactly the type of principal loss the retiree was seeking to avoid. The same risks did not show up in the Global Balanced Growth Portfolio. Even after accounting for the 6% annual real withdrawals, the ending portfolio had grown to over $1.3 million. The effective withdrawal rate for the "balanced" investor after 20 years was only moderately higher at 6.8%.

Is Safe Really Safe?

Today, bond yields are low at less than 2% for most high quality intermediate bonds. The case for keeping one's retirement portfolio "safe" in Bonds is anything but. Your portfolio will need a much higher principal value to avoid prematurely running out of money, and you still have the risk that your actual retirement spending rate might be higher than your original plan.

Thus, we still come to the conclusion based on all of the historical and current evidence that a diversified portfolio with a significant allocation to stocks represents the best chance a retiree has to earn sufficient long-term returns to fund their ongoing income needs, including the necessary income growth that must be accounted for over time. Yes, stocks come with a significant amount of short-term volatility, so having a reasonable amount in bonds to carry through a few years of turbulence and recovery is prudent, but as the examples above show, allocating a prudent exposure to stocks will probably come out ahead.



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Bond Portfolio: 100% Barclays US Aggregate Bond Index

Global Balanced Growth Portfolio: 30% Barclays US Aggregate Bond Index, 17.5% S&P 500, 17.5% Russell 1000 Value, 8.75% Russell 2000, 8.75% Russell 2000 Value, 5.25% MSCI EAFE, 5.25% MSCI EAFE Value, 7% MSCI EM.