Risk Control along the Glide Path

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Timing matters, and it matters be ore and a ter retirement.

T!e gro"t! o a lum# sum in$estment is inde#endent o t!e se%uen&e o returns in an in$estment #ort olio. ' o"e$er, "!en money is being in$ested annually t!e se%uen&e o returns does matter. (or e)am#le, a *2,000 annual in$estment in a 60+ e%uity,-0+ i)ed in&ome #ort olio gre" to about *.00,000 o$er t!e /90year #eriod rom 1920 to 200.. I t!e returns are re$ersed 3meaning "e start "it! 200. and end "it! 19204 t!e inal a&&ount balan&e is about *1.2 million. T!e *-00,000 di eren&e is a result o en&ountering t!e meltdo"n o 200. at t!e start o t!e /90year #eriod 3"!en t!e a&&ount $alue "as $ery small4 $ersus at t!e end o t!e #eriod 3"!en t!e a&&ount $alue "as $ery large4.

5$en more dramati& is t!e im#a&t o t!e return se%uen&e in a retirement distribution #ort olio "!en money is being "it!dra"n annually. Let6s assume a starting balan&e o *700,000 at retirement and a "it!dra"al o 7+ 3or *27,0004, ad8usted annually based on &ost0o 0li$ing in&reases o -+. T!e #ort olio allo&ation is -0+ e%uity,60+ i)ed in&ome. 9sing a&tual returns rom 1920 to 200., t!e ending balan&e o t!e distribution #ort olio "as o$er *- million 3as s!o"n in t!e irst gra#!4. But, "!at i a really bad e$ent !a##ened in t!e irst year o t!e "it!dra"al #eriod: Re$erse t!e returns ; assume 200. !a##ened irst ; and, as seen in t!e se&ond gra#!, t!e #ort olio "as de#leted a ter /2 years, lea$ing t!e !y#ot!eti&al retiree bro<e or t!eir inal se$en years.

Most target date unds are &urrently designed to ser$e #arti&i#ants t!roug! bot! a&&umulation and distribution. =&&ordingly, t!ey really s!ould be renamed target >deat!? unds be&ause t!e im#lied target year is not t!e year o retirement, but t!e in$estor6s deat! date. @e belie$e e)tending t!e >auto0#ilot? glide #at! beyond t!e stated target date is a mista<e. Aoing so o$erloo<s t!e &riti&ally im#ortant transition #!ase rom >a&&umulation? to >distribution? t!at o&&urs rom i$e years be ore retirement to i$e years a ter retirement. T!e year 200. is t!e only #roo "e need.

Bottom lineB &ontrolling ris< in retirement #ort olios is t!e !ig!est #riority. (or guidelines on building target date unds t!at im#lement #rudent ris< &ontrol $isit us at """.TABen&!.&om.

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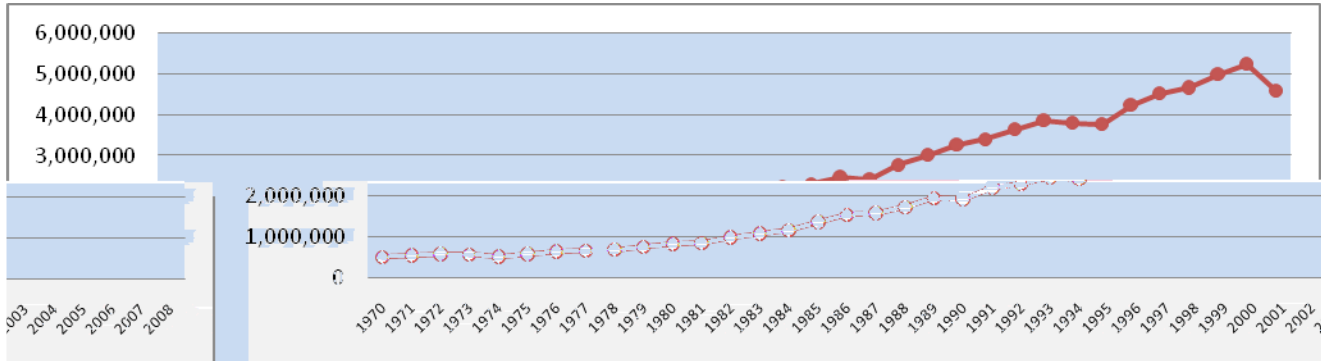
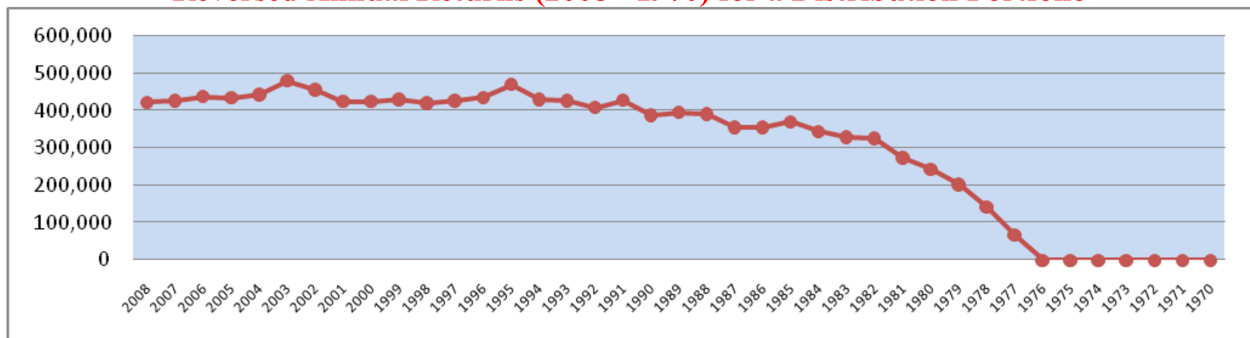


Reversed Annual Returns (2008 - 1970) for a Distribution Portfolio



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