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JOURNAL REPORTS

What You Know About Retirement Investing Is Wrong

Invest less in stocks early in retirement and more later, a study recommends

By ANNE TERGESEN

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You probably know the conventional wisdom: People just entering retirement should have a big portion of their savings—say, 40% to 60%—invested in stocks to help their nest egg grow over time. And as they age, all but the wealthiest should gradually reduce their equity exposure to protect against 2008-style market declines.

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Now, a study in this month's issue of the Journal of Financial Planning is calling that advice into question.

The report finds that those who take the opposite approach—by reducing equity exposure right after retirement and then gradually *raising* it over time—are likely to make their money last longer.

U-Shaped Path

According to the research, those who start retirement with 20% to 30% in stocks and end up with 50% to 70% in stocks can withdraw 4% of their portfolio per year and give themselves annual raises to compensate for inflation over 30 years, even in the worst market scenarios. (The authors examined 10,000 simulations and assumed average annual returns of 6.5% for stocks and 2.4% for bonds.)

Richard Borge

In contrast, those who keep 60% in stocks throughout retirement or who taper to a 30% equity allocation from 60% are likely to run out of money after 28 years in the 5% of worst-case scenarios, says co-author Wade Pfau, a professor of retirement income at the American College of Financial Services in Bryn Mawr, Pa.

The recommendations were much the same when Mr. Pfau and co-author Michael Kitces, director of research at Pinnacle Advisory Group Inc. in Columbia, Md., ran the numbers over 20- and 40-year periods and used lower average annual returns, of 3.1% to 3.37% for stocks and 0.06% to 1.54% for bonds.

The findings indicate that investors may be better off with equity allocations that follow a "U-shaped" path over their lifetimes, says Mr. Pfau—with the low point in the years immediately preceding and following retirement—rather than the gradual downward slope that is typical of many target-date funds.

When You're Most Vulnerable

One advantage of a U-shaped approach, the authors say, is that it provides better downside protection in the years right after retirement, when retirees are most vulnerable to financial losses. If a bear market occurs then, a portfolio can quickly be depleted by market losses and withdrawals.

By contrast, a bear market in the second half of retirement is usually far less damaging because the portfolio—even if it wasn't heavily invested in stocks to start—has already benefited from years of growth when returns were good.

Of course, if stocks fare well in the early part of retirement, those who use the conventional approach will come out ahead. Still, it may be worth trading some upside potential to secure higher odds of a sustainable retirement income.

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