INVESTOR

The retirement income challenge

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Saving for retirement is challenging. But spending your nest egg in retirement can be even more so.

Many people will probably want their retirement plan to accomplish some or all of the following goals:

- **Fund a desired lifestyle** – which requires maximizing their income stream.
- **Ensure their money lasts as long as they do** – so continued growth is important.
- Provide the **ability to access a lump sum for emergencies** such as an unexpected home repair or health issue.
- **Minimize tax consequences** – which means withdrawing from the right source at the right time.
- **Leave an inheritance** – so it may be important to protect the principal.

Structuring a retirement plan so that all these complementary goals have a better chance of being reached can be quite complex. In the "accumulation" phase before retirement, market fluctuations and investment risks can be offset over time, with techniques such as dollar cost averaging or rebalancing your portfolio. During the "decumulation" phase—when you are withdrawing funds from your portfolio—there is far less room for error.

For people nearing or entering retirement, the need to generate reliable lifetime income is greater than ever before. We're living longer, market returns are generally lower than in the past and will likely remain so, and fewer of us can rely on a defined benefit pension plan. But determining the right way to use your retirement savings can be challenging. And if you don't know how much money you need and when you will need it, it's hard to make optimal decisions. That's why a comprehensive retirement plan is so important.

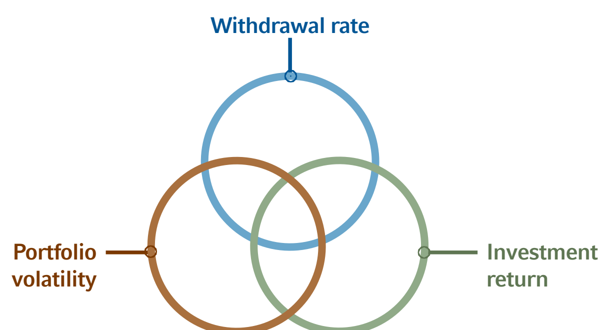
Choosing the right "decumulation strategy" can mean the difference between a comfortable retirement and one that is not.

Many Americans could have several sources of income in retirement. There may be a pension from an employer, income from government programs, taxable and tax-deferred investments, annuities, rental properties or a business, or income from part-time jobs or consulting roles.

To maximize the income from these sources, it's important to fully consider the tax implications of your withdrawals, the rules under which government benefits may be clawed back, and the optimal withdrawal rate.

It can seem somewhat overwhelming, especially when you don't know the key elements that will determine whether your retirement plan will be successful: How long will you live? What will the markets do?

Since you can't answer those questions, you need to understand the three issues that we believe will determine the sustainability of your portfolio.



Withdrawal rate

Ideally, your withdrawal rate is lower than the portfolio's growth rate so that you never have to touch your principal. That would offset any risk of outliving your savings and also allow you to leave a legacy for your family or a favorite charity.

Determining that withdrawal rate, however, is dependent on the size of the portfolio, your income needs, and your ability to manage any unexpected expenses.

Maintaining exposure to growth assets, such as equities, and diversifying risk can potentially help the portfolio grow.

Investment return

20 years ago, an investor could typically obtain a 6.5%[1] yield with a portfolio of U.S. government bonds (10-Year U.S. Treasury). No more. Fixed-income yields are low, equity markets are more volatile than in the past, and a portfolio of those same bonds will return only about 1.7%[1].

1 Source: Russell Investments. 6.5% and 1.7% are the yields on the 10-Year U.S. Treasury from December 1999 and September 2019 respectively.

Diversification across multiple asset classes, strategies and geographies is key:

1. Expand beyond traditional stocks and bonds into assets that can potentially generate income in all market environments
2. Invest in those that have low correlations to other assets
3. Look at investments that target an absolute return rather than try to beat a benchmark

Portfolio volatility

Volatility is a constant, even in positive markets. The issue for investors is managing that volatility: smoothing out returns to limit downside and attempt to preserve upside.

This is especially important for investors just entering retirement, as losses early in the decumulation process can have a significant negative impact to a portfolio. This is known as sequential risk.

As you can see in the Exhibit below, Johanna and Josh both started their retirement with a $250,000 portfolio and withdrew $15,000 a year for a 10-year period. They both had the same average annual return—9%.

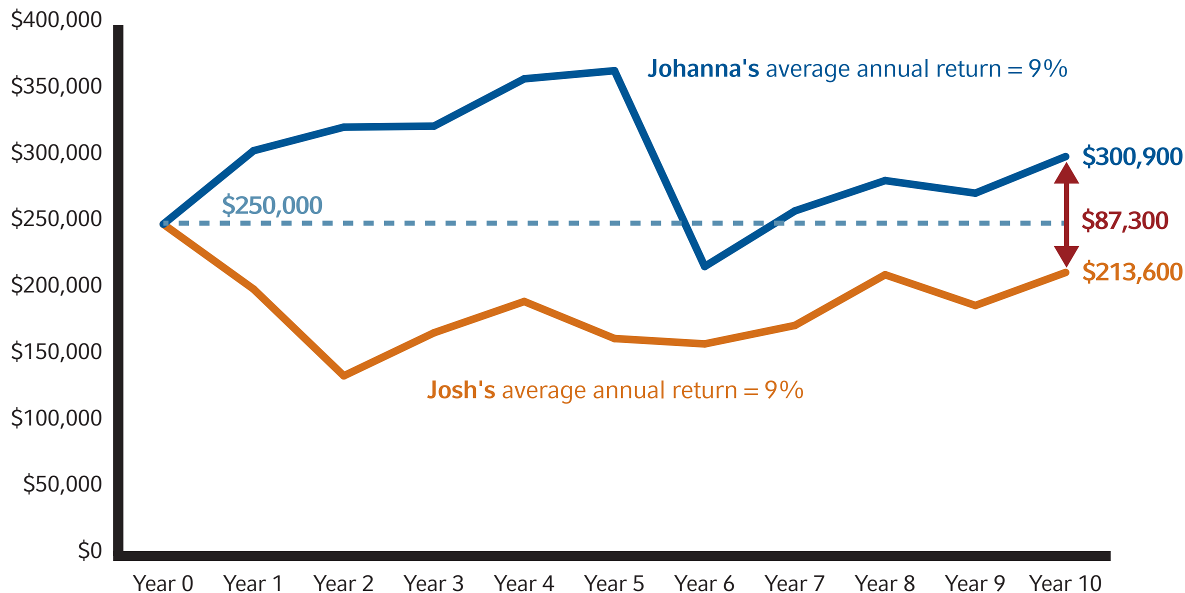
Both portfolios experienced losses and gains throughout the 10 years. But the sequence of those returns matters to the ending wealth of their portfolios. Negative returns early in the period, like Josh experienced, have a bigger impact on ending wealth than negative returns later in the period. After 10 years, Josh's principal has eroded, while Johanna's portfolio has grown.

As an investor, what can you do?

- Invest in diversified fixed-income strategies that can potentially provide higher fixed-income returns while limiting volatility.
- Make sure your portfolios contain growth as well as income assets, and asset classes like real assets (real estate, infrastructure) to provide diversification and to limit downside risk.
- Manage risk and return through a dynamic asset allocation. This can often be achieved through a professionally-managed multi-asset portfolio.

If you have a financial advisor, they can be a good resource to help you develop a comprehensive retirement plan and determine a decumulation strategy that is right for you.

Exhibit: Sequential risk / The order of investment returns matters



ANNUAL RETURN	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	AVERAGE
Johanna[1]	29%	11%	5%	16%	6%	-37%	27%	15%	2%	16%	9%
Josh[2]	-14%	-26%	37%	24%	-7%	7%	19%	32%	-4%	22%	9%

Assumption: Johanna and Josh have an annual withdrawal of $15,000 per year. [1]Johanna's returns reflect the S&P 500® index annual return between 1993 and 2002 [2]Josh's returns reflect the S&P 500® index annual return between 2001 and 2010. Indexes are unmanaged and cannot be invested in directly.

Russell Investments

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