Retirement Income Portfolios and Exposure to Market Fluctuations
by
Robert Stanley
MURA Pension Investment Round Table
April 2019

Pensioners should be wary of having their **core** pension income investments exposed to the vagaries of financial markets. If exposed to the market (stocks and bonds), a market correction (loss) in the early years after retirement may have a negative impact on your pension portfolio and retirement income.

"Average rate of return" over many years is a reasonable measure of the performance of a portfolio over time…. This is acceptable when you are ACCUMULATING your wealth during 30-40 years of working life. A loss suffered early in the accumulation phase will likely be counter-balanced by recovery and winning years later on.

But a pensioner portfolio used to generate retirement income is different.

Pensioners need good returns early in retirement. Poor returns early in retirement may leave you short of cash. The probability is high that your portfolio would not recover from a market set-back.

Therefore, it is wise to consider and include retirement payout annuities as a core pension income instrument, instead of RRIFs and other vehicles with stock market exposure. That way the insurance company assumes the market risk over time, and not you as an individual.

See - Jim C Otar: ***Unveiling the Retirement Myth, Advanced Retirement Planning Based on Market History***, paperback, October 2009
(Out of print but available online here: http://www.retirementoptimizer.com)

Mr. Otar makes several important points for pensioners to consider –

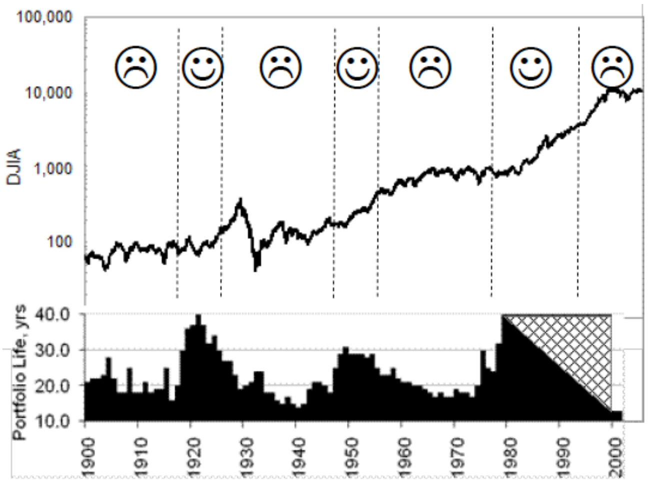
- Using the "average rate of return" of a portfolio of investments over time as a measure of financial success and stability DOES NOT apply to individuals. (It applies to pooled funds of many individuals, but only for the fund as a whole.) What really matters to individuals approaching retirement, or after retirement, is the SEQUENCE of returns.

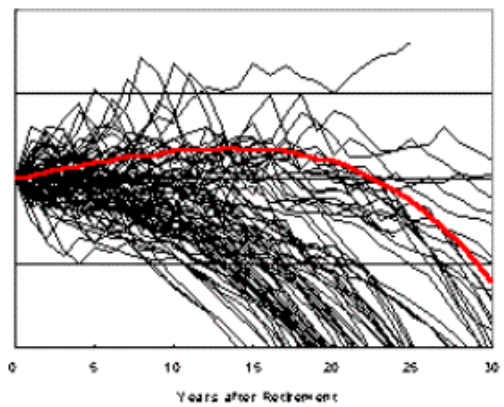
- High returns early in retirement (first 8 – 10 years) may be very good; but bad returns or losses may have disastrous consequences for retirement income.

- A pensioner, or person approaching retirement, who suffers a financial market "correction" (read "loss"), early in retirement (or just before), is likely never to recover from that loss, and will see his or her portfolio and retirement income substantially impoverished as a result.

- This happens because of the legislated requirement to make minimum compulsory annual with-drawls from the pension portfolio (5.0%, 5.28%, 5.4%, 5.53%, etc.). This impedes the ability of the portfolio to recover its losses in the good years.

- Mr. Otar mapped a model post-retirement portfolio based on **60% fixed income** and **40% equities** using 100 years of market data since 1900: a **$1.0 Million portfolio** requiring a **$60,000 annual withdrawal**, **adjusted for inflation**. Otar demonstrated that depending on your year of retirement your funds could last 40 years, or more significantly, might run out in 17 years or less, with a high probability of being exhausted within 20 years.





(The red line shows theoretical portfolio performance with 8% annual average return and 3.5% inflation.)

I submit that we live in turbulent political and economic times (some changes involve paradigm shifts) that create significant market volatility. Examples in the last few years alone –

- Economic meltdown caused by the subprime mortgage debacle in the USA.
- Revolution in petroleum fracking and shale gas production.
- The Arab Spring, the war in Syria and its repercussions.
- Islamic insurgencies in the Middle East and Africa and the destabilizing effects on Europe.
- The Russian invasion of Crimea.
- European Banking Crisis and the danger of default in EU states like Greece, Italy
- Election of Donald Trump and protectionism in the USA.
- BREXIT.
- Development of Artificial Intelligence – self-driving vehicles – and other automated human functions that will change the fundamental nature of work.
- Social Media and the Internet transforming the way we live and work.
- Climate change and sea level rise.
- Sabre rattling between the USA, Russia and China.
- Political instability in the Indian Subcontinent.

There are risks for retirement income portfolios that may be exposed to that volatility, but yet may have to perform for the long term - more than 30 years.