

It Works Until it Doesn't

LIFTING THE VEIL ON RETIREMENT PLANNING
AND THE MANY UNINTENDED CONSEQUENCES

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Retirement is not just an economic event

In the stone-age, there were no old people, and there was no retirement. If some did manage to live long enough, they were eaten out of respect. By early medieval times, acquiring some age was much resented, as their middle aged sons had to work much longer before getting their inheritance – this was quite the period of patricide. In 1882, Anthony Trollope wrote a novel *The Fixed Period* in which old men could enjoy one year of contemplation followed by a polite chloroforming. In 1883, Chancellor Otto Von Bismarck *invents retirement* in order to get his countrymen to fight against the onslaught of Marxists, being that penicillin would not be invented for another 50 years, there were not too many takers of retirement still around to collect. And In 1905 the physician William Osler in his address at Johns Hopkins Hospital said that the years between 25 and 40 were the worker’s “golden years of plenty” and workers between 40 and 60 were useless and should be put out to pasture. Roosevelt proposed the Social Security Act of 1935, and with a then average life expectancy of 62, suggested 65 was a proper age to retire. It has not been a glamorous journey to be sure. So, all things considered, the issues we face today, albeit quite different, put into perspective are not nearly as bad as they once were.

Retirement really is a relatively new phenomenon as we know it today. Certainly the aspects of saving and preparing are. Just a generation or so ago there were pensions, a very modest lifestyle and maybe the last few years living with the oldest child and grandchildren. Done. There was very little or no real “planning” – it just happened. Now, it’s 30 plus years of traveling, wine making and yoga. This has not been a gradual evolutionary unfolding, so it’s not surprising really that the first travelers of the “new age” retirement through the maze have found themselves less prepared for the many varied realities.

Just as more hikers die coming down from Mount Everest than ascending it, we seemingly are never afforded a reprieve from paying attention to important details and those things that matter most. It is my desire in this paper to bring to your attention a few highly critical points on positioning your retirement assets and thinking in an enlightened and informed manner. My intention is to help you avoid some costly mistakes that have been made too often by those who have traveled before us.

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Mise en plas (miz ā plas) is a French phrase which means “everything in its place”. Any good chef or line cook worth their weight understands this phrase as it refers to having all of their ingredients exactly where they want them *always*, shallots, parsley, salt, olive oil, and sauces – must be where they are expected to be when the kitchen is getting slammed with orders. *Everything in its place* – that’s how we in the financial services arena would like you to believe it really is. Quantifiable, formulaic, and form fitting. Rarely do I find that to be the case, but that is what we are taught to believe so often through advertising, books, speeches and under-educated advice. *The problem is the truth. As we evolve beyond the baseline thinking we quickly learn that the truth makes for an uncomfortable pairing with what often times gets presented as retirement income planning.*

Remember that dinner party question, if you could be any age – what would that be? Most people immediately hearken back to their early twenties recanting memories of their youthful appearance, physical prowess and good health. The last time I was asked that question was about 15 years ago (as of this writing I’m 56), I was the only one in that group to respond with my current age. It was a time when I had a grasp on how things worked – the grand world was no longer a puzzle. I had healthy relationships, good friends, I understood the opposite sex (almost), I knew how to earn an abundant living, how to buy a house or a fine suit, my son was almost a part of the human race – things made sense.

The problem is the truth. As we evolve beyond the baseline thinking we quickly learn that the truth makes for an uncomfortable pairing with what often times gets presented as retirement income planning.

And then.

And then my profession went through 10 years with stock markets basically returning zero percent. What I thought I knew about providing safe predictable income for my dear clients was wrong. What *seemingly had been* working for a long time failed so many of us terribly.

The constructs, philosophies and especially the math just didn’t work in that environment.

I had read stacks of books, attended what seems like countless seminars, listened dutifully to those in the ivory towers – but to no avail. The existing approaches, with old thinking and frayed books had, for the most part, become ineffectual.

They were simply no longer suited for the current realities of the day. **“It works until it doesn’t”** – and it didn’t work anymore.

Academia, what a strange duck that turned out to be, and even more so as I have spent the last several years studying this topic from all sides. Fortunately, I now know how the train got derailed, but nothing will be gained if we continue to be trapped in our old assumptions. It is imperative to be willing to refine your investment philosophy to separate yourself from the status quo if your intent is to protect your net worth and keep your assets growing or producing income for you with a high degree of success.

Know The Realities So You Don't Get Hurt

I am offering a sobering introduction into the financial dilemma popularly known as retirement income planning.

I have included thought provoking research, some of which may seem unpleasant, but necessary to know if you want to enter retirement with your eyes wide open. *We need the truth so that we can make the most informed choices.*

I believe that money is a tool that empowers those wise enough to become free to live the lives they want. I created this paper to help guide you past “selective” historical data, misguided assumptions and the devastating shortfalls of popular investing models – don't allow yourself to be held hostage by thinking and theories that are no longer effective.

Now, after living through and experiencing delusional arithmetic and real-time tragic outcomes, I have developed a viable and healthy approach for those needing to receive retirement income over the rest of their lifetime.

“We can easily represent things as we wish them to be” — Aesop



Next! Now serving customer number 76. We now plug in “average” returns, idyllic allocations, assumed life expectancy, inflation expectations, and then show you a

graph that only goes up in a straight line. We factor in cooking classes in France, travel, second homes, higher education, bequeathing to the kids and grandkids, a charity or two – everybody wins. The next 30 years are planned to perfection. *Mankind* wants so much to fully understand his environment and to control all of its effects, but unfortunately, this quest can also lead to harmful delusion:

- **Lehman Brothers – bankrupt**
- **Cities and countries – bankrupt**
- **Pension funds failing miserably**

And sadly, retirees going back to work because of market shortfalls and faulty assumptions.

I believe the following is singularly the most important concept you MUST understand if you are to have any chance of positioning your retirement income portfolio correctly.

Let's look closer at the facts

I will cover these essential topics:

- **Sequence of Market Returns**
- **Withdrawal Rates (the good, bad and the ugly)**
- **Portfolio Allocations**
- **Distribution Account Set-up**

Retirement Planning is the process of designing a strategy that provides life-long income – it is not a 55 page color proposal with charts and graphs.

I have found that many who advise on this topic are not knowledgeable or comfortable enough to concede that the success of their clients' investment plan has more to do with timing than how much talent the advisor has.

Anyone who has spent their life achieving enough success to feel that they can retire in dignity does not want to feel that they are still subject to factors outside of anyone's control.

I believe the following is singularly the most important concept you MUST understand if you are to have any chance of positioning your retirement income portfolio correctly.

This is the little known or discussed SEQUENCE OF RETURNS. In an income distribution portfolio, the order of market returns dictates greatly the success or failure of portfolio longevity. Simply stated, if you had a 40% Stock, 60% Bond portfolio and retired in the early 1920's, early 1950's, or late 1970's, and took a 6% annual withdrawal – the portfolio would likely have lasted 30 years. At any other time, 1900's, 1910's, 1930's, most of the 1940's late 1950's, 1960's, or early 1970's, the portfolio life expectancy was about 17 years. ^{*1}

Why sequence of returns is so important.

For many people, their retirement account is a fixed pool of assets that they wish to withdraw from over their retirement lifetime. On the surface, it's not uncommon to assume that if our investment account averaged 7% a year during the accumulation phase, that we can now take 5% a year, allow for some inflation (say 2%) and leave basically what we started out with for our heirs. Sadly, this thinking does not play out very well as you will soon read. The rules for an accumulation portfolio do not overlap when you are taking distributions. It's not about assumptions – but confronting reality. Before leaving a legacy you must first feed yourself.

A bit on legacies. Most at this point in their lives have quite definitive opinions on this topic. There are multiple mindsets – and I don't wish to interfere with any of them. But, I must interject some basic truths. These truths vary widely depending primarily upon intent and net worth.

*1 This statistic, as well as all others used herein, unless otherwise specified, uses the actual returns of the Dow Jones Industrial Average from 1900-1999 as well as the commensurate inflation as it corresponded. The bonds are the 6 month U.S. Treasury bill plus .5 percent.

For the sake of this paper, which mainly addresses the stock, bond, and investable liquid asset portion of ones' retirement income stream, please know this: if you are of highly elevated means, with multiple sources of income, the need to invade principle (corpus) may not be necessary and other tactics may be more appropriate or adequate. The following philosophy of this paper is generally suited (applicable) to those whom these assets are a prime and necessary source of their retirement income needs. To those, it is a rarefied set of circumstances that you can live well off of the income generated and leave the entire beginning asset base to your heirs. In the main, it's a delusion of false projections. In many ways, this somehow became the understood thinking of a generation, promoted by a myriad of factors of which even I am unclear. But, that being said, let me return to the eyes wide open portion of this paper.

Exposing the income only mindset

Throughout my career, or certainly the majority of the beginning years, much of the thinking of the newly retired was based around taking just the income of what their nest egg had accumulated. This paired with the thinking that the nest egg would be available to their heirs. To me at least, it is an interesting notion that all one has saved and sacrificed for after 45–50 years of toil would never be spent by those who did the toiling. Much of this same thinking was also tied to the “rule of 100”. This is where you take your age (say 65) and subtract it from 100 (35), and this now becomes your asset allocation (65% bonds, 35% stocks), and as you get older the percentage of stock ownership diminishes.

This incredibly unsophisticated and dubious approach often under delivered, and those who tout it now call it the “rule of 110”. We casually change the name to adjust for the fact that maybe retirees do need to move more of their portfolio to growth assets such as stocks and real estate. These are real live human beings that we are advising – yes?

Taking only the income that the account produces.

Let me state that I have rarely seen this work well for those who need a consistent, predictable, reasonably attractive income stream from these assets. Again, if you have multiple sources of income, and these funds are solely to provide ancillary income, that is a different topic, and of course, not an issue. Let me begin to address the first scenario with two points: 1) In the 1930's, the average stock dividend was 5.7%, and in the 2000's it was 2.0%; 2) The cumulative performance of the S&P 500 during those respective timeframes was negative 41.91% and negative 24.10%.^{*2} The point being, that one can take *only the dividends* in a high or low dividend era, and still walk away with substantially less money than they started with. *And*, this did not even take into consideration the inflation factor. Yes, there are bonds, but history aside, today's bond and CD market is even less attractive from a dividend standpoint. The bottom line: *We don't know what the markets will give us over anyone's retirement.* I think it wise to prepare for the reality that the principle that is started with may be substantially less by the time the heirs receive it.

^{*2} Otar, Jim C., Unveiling the Retirement Myth, Advanced Retirement Planning based on Market History

Why sequence of returns is so important.

Now, let's look at the math. I will use that 5% withdrawal rate and 2% inflation rate that I alluded to earlier – but during the 1900's inflation exceeded 3% and now there are inflation numbers

for “retirees” that better reflects their respective expenses, which is even higher. We start with \$100 and take \$5 (5%) plus \$2 (2%) for inflation and I'll even assume that 7% average annual return. A very optimistic return net after advisory fees, income and capital gains taxes.

Year One	Newly retired, no more income from work, withdraws 5% for the year at the beginning – now has \$95	Account returns +7%.	Ending Value is \$101.65
Year Two	Withdraws \$5 plus \$2 for inflation – now has \$94.65	Account returns 0%	Ending Value is \$94.65
Year Three	Withdraws \$5 plus \$2 for inflation – now has \$87.65	Account returns –6%	Ending Value is \$82.39
Year Four	Withdraws \$5 plus \$2 for inflation – now has \$75.39	Account returns –9%	Ending Value is \$68.61
Year Five	Withdraws \$5 plus \$2 for inflation – now has \$61.61	Account returns +10%	Ending Value is \$67.77
Year Six	Withdraws \$5 plus \$2 for inflation – now has \$60.77	Account returns –12%	Ending Value is \$53.48
Year Seven	Withdraws \$5 plus \$2 for inflation – now has \$46.48	Account returns +15%	Ending Value is \$53.45
Year Eight	Withdraws \$5 plus \$2 for inflation – now has \$46.45	Account returns +15%	Ending Value is \$53.41
Year Nine	Withdraws \$5 plus \$2 for inflation – now has \$46.41	Account returns +15%	Ending Value is \$53.37
Year Ten	Withdraws \$5 plus \$2 for inflation – now has \$46.37	Account returns +20%	Ending Value is \$55.64
Year Eleven	Withdraws \$5 plus \$2 for inflation – now has \$48.64	Account returns +22%	Ending Value is \$59.34

The average return problem.

The inconvenient truth: After just 11 years “averaging” +7% a year and finishing up with the last five years totaling a return of +87%, the account has lost more than 40% of its value, and was halved in years 7–11. This was with only three down years averaging -9%. At this point a \$7 per year withdrawal is almost 12% of the assets, the account is highly likely to fail shortly (run out of money). And, it was far from keeping up with real inflation numbers. It is very important not to buy into the voodoo math of averages or those who tout it. Do not treat a *distribution portfolio* the same as an *accumulation portfolio*. The market losses sustained here were really quite nominal. You must know that every withdrawal creates a permanent loss. The belief that “The markets will always go up in the long run” does not have the same effect on a portfolio where taking distributions systematically is critical. Don’t confuse the average portfolio *growth rate* with a sustainable *withdrawal rate*, as noted above, they are two different things.

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Imagine a T.V. commercial from a financial institution during a major golf tournament stating that “timing” or “luck” is more important to the success of your retirement plan than are its advisors, global financial strength and 140 year history. In retirement it’s how well or poorly the markets returns are *early on* that strongly dictate the portfolio longevity.

Most of the educational curricula for advisors focus on accumulation or growth portfolios. The travesty is that too many advisors and clients treat them the same. As you will see with later examples, the rules are rarely interchangeable, and there is very little that they have in common. If you have any loss during the first four years of your retirement, the chances of depletion increase dramatically

Averages. Do not design a plan around average of returns. *Averages do not apply to individuals in retirement.*

Incorrect assumptions are the unseen icebergs that sink the (assumed to be unsinkable) retirement plan.

Withdrawal rates. “How much can I safely withdraw from my portfolio for the rest of my life?” This question of withdrawal rates runs a close second in importance to the sequence of returns. These are definitely the two big areas of consternation to be sure. The sheer volume of academia studies, reports, debates, and “scientific” methodologies on this topic are at a minimum mind-numbing. I read a report the size of War and Peace that stated in no uncertain terms the proper withdrawal rate is 4.58% *and* that the portfolio was to be rebalanced every 62 months. Wow, I wonder if the author’s room had windows. Let me share a simple truth: “We” don’t know. “We” want very much to know, but “We” can’t even agree on what the earnings of General Motors will be over the next three months so “We” sure can’t extrapolate your life, life events, health, taxes, the markets, and global events for the next 30 years. Aside from the obvious flaws, let me share the biggest variable of what goes into these guesstimates that are so frequently pontificated on with such confidence.

Methodology. This by far was the biggest variable I came across to be sure. There are as many methodologies to taking distributions as there are studies. The variations on a theme combined with the rules to be used if one is engaging in a particular “plan” can really be quite cruel.

The myriad of allocations, distribution rates, and *assumptions* about all things financial, past, present and future – all stated and presented with such absoluteness are nothing more than *speculative opinion*. The only thing we can depend on with the markets is fluctuation and uncertainty.

Assumptions. That was it. Incorrect assumptions are the unseen icebergs that sink the (assumed to be unsinkable) retirement plan. Remember this; just about everything that is working now **works until it doesn’t**. In the main, the assumptions I studied overwhelmingly used as the basis for investors’ prosperity and future well being are too often horribly flawed. Here is the immutable take-away: almost every retirement planning solution I studied revolved around two major components:

1) Using average returns. This has no bearing on reality in distribution portfolios. As I have shown in previous examples, you can have average returns and end up (or stay) rich and you can have average returns and end up poor. *The only returns that matter are your actual personal returns, and of those returns, the sequence and orders of those returns matters most;*

2) Using Monte Carlo simulations (or similar) to back test the theory. Most studies and retirement plan proposals use a simulation program that runs 1,000—10,000 different probabilities on historical return combinations, usually with random inflation included. There are many studies out now showing the flaws and biases that can be attributed to these computer simulations. Tread lightly.

Back to the question of sustainable withdrawal

rates. There are many inherent issues to be sure. We don't know our life span (portfolio duration), we don't know the future market returns or their order (favorable or unfavorable), and we don't know how adjusting for inflation will change what we withdraw. To be blunt, we don't know any of the other inimical events that await us tomorrow, let alone what is ahead for us over the next thirty years or so in retirement. This can make finding and choosing the optimum strategy complicated and time consuming.

Stay with me. Allow me to present some necessary background information and studies.

Know the realities so you don't get hurt.

Retirement drawdown strategies remain one of the most challenging areas in all of finance. What truths there are lie in the discussion of wants/needs tradeoffs and how the many variables work, and work with each other. The "answer" really is quite personal. It is working through the issues and understanding how the choices of a "Distribution Rate" truly works – and works for you.

There are too many moving parts to publish a magic number, shame on those who do. I assure you, this is not scientific. The newest shiny thing out there is the Guardrail Strategy. It has some merit, but was invented by a computer scientist. Hmm, lacking practical insight.

Comfort level with the unknown, available assets, other sources of passive income, future big ticket items (weddings, second home, legacy) also factor into the equation.

It's not a plan – it's a concept. Human Spending.

Thoughts to Ponder. The inputs and outputs constantly change as does life. Be mindful, most of us don't live as long as we model for. Are you really going to live until 95 and have a 30 year retirement? The average American lives to age 78.8, 76.3 for males.^{*5} What if you planned for 20 years and adjust if needed? (and maybe had a higher quality of life?) Many retirement plan simulations use a 90% probability of success, again denying ourselves. 70-75% may be more practical. Household spending (inflation adjusted) has historically fallen by:

- 19% ages 65-75
- 34% ages 65-85
- 52% ages 65-95^{*6}

Our spending patterns change over time with natural life events. We spend more money at the beginning of retirement as we have our health and youth. We spend less as we become dormant, and a bit more with medical expenses at the later stages. Our income needs are not linear, factor in the real world into the assumptions. Many get to the end of life regretting that they are leaving too much money and didn't spend more.^{*7}

Quality of life.

Retirees chronically under spend. Consider starting with a higher income and – if necessary – reduce it as time goes on and needs lessen. Adjust with the updated life expectancy and spending habits.

Money left over.

Most common withdrawal strategies evaluate end of life balances (again a probability). It's not uncommon to have 50-150% of the initial starting balance remaining.

As an example:

40% Stocks 60% Bonds, inflation adjusted, 30 years, 90% probability. This leaves 150% of the starting balance.^{*8} It's a cruel notion that we spend more money early on and have higher accountability (more years to plan for) and we generally spend less when we have lower accountability.

*5 World Bank Group 2022

*6 Research from the Employee Benefits Research Institute February 2012

*7 *Moneywise* April 2025

*8 *Journal of Financial Planning* April 2011

Define your end game.

Higher quality of life for you or larger homes for your kids. My take away: Computer scientists should not dictate the quality of your retirement. In reality, it's distilling down the next period of your life with informed decisions and discussions and thoughtful input. Life changes. Choices change. Nothing is set in stone. It's really just more of the same – review and adjust, as it was in pre-retirement. Don't deprive yourself, be conscious that your life span is likely less than you think it will be. Don't be 78 regretting that you deprived yourself in retirement. Focus on healthspan over life span.

Practice retirement. Take two weeks off and don't go anywhere. Have replacement activities for work. Put a methodology in place that can insulate oneself from a reasonably poor sequence of returns. Know that academia is flawed – good intentioned – but flawed. Accept that like your life to this point, there will be modifications as events show themselves. Spend more at the beginning of retirement knowing that the Go Go years will eventually be Slow Go years. Re-evaluate on a regular basis and adjust as needed. Seek thoughtful guidance.

The known unknowns

- Inflation
- Tax rates
- Our longevity and health
- The stock market returns and the sequence of those returns
- Politics and policies
- Long Term Care needs
- Tragic events

What we can control

- Ourselves
- The money we give our kids (or don't)
- Thoughtful investment decisions
- Over spending (or quite often) under spending
- Living too much for the future
- Willingness to make adjustments
- Taking care of our health
- Getting the best guidance

*When the world retreats it takes no prisoners
and it has no respect for confident opinions
or computer simulations to the contrary.*

The myth of safety and security

Asset Allocations. I'm sorry, but this too is often presented as the great cure for many retirement planning issues, but it simply isn't. I see so much time and emphasis spent on this topic, maybe because many still mistakenly believe this to be the "solution" to the vast array of portfolio concerns such as risk (safety), returns and longevity. In a *distribution portfolio* as you will see, asset allocations (at least the common allocations most are familiar with) quite often do not provide the benefit many assume it does.

You Either Succeed or Fail. The allocations in the studies generally use some form of Modern Portfolio Theory (that pretty pie chart that so many want to convince you is the optimum choice) – I won't take the time here to expound on its frailties, but one can do much to improve on this.*⁹

Allocation matters but it is sometimes less important than you might think in a distribution portfolio. A higher withdrawal rate does not necessarily dictate a higher percentage in stocks – most times it turns out to be just the opposite. Stocks can have a diminishing benefit. At a certain point, stocks can actually shorten a portfolio's life in poor markets. Many investors believe that a diversified allocation can prevent large losses in bad times – that is often false. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns.

When the world retreats it takes no prisoners *and* it has no respect for confident opinions or computer simulations to the contrary. Stocks *can* help provide greater purchasing power but *can* sometimes cause lower longevity success rates. Many pension managers also believed in the miracle of asset allocation at the expense of sequence of returns – that is a big reason why many of them are in the news and grossly underfunded today. By far, the biggest factor in long term income portfolio performance is sequence of returns. Simple asset allocation does not sufficiently protect investors from prolonged market maladies.

*⁹ August 2013, Robeco's Introduction to Factor Investing. 1996, James O'Shaughnessy, What Works on Wall Street

Failure at this point in life is penalized

much more than success.

Allocate using a better set of questions

The proper distribution account set-up. Retirement planning is the process of designing a strategy that provides *life-long income*. Ultimately, the most critical factor is having enough beginning capital to finance market volatility, sequence of returns and inflation. *Failure at this point in life is penalized much more than success.* Large declines or withdrawals in the early phase wreak havoc for the remaining years. Let me acknowledge that the management of the retirement phase needs to be far more personalized and sensitive than the savings and growth phase. That being said, the following are just general outlines to provide some insight into my thinking – feel free to reach out to me if you would like to discuss the specifics of your situation. Again, one must remain flexible and maturely embrace uncertainty by becoming fully aware of the external events out of the average investor's or advisor's purview while monitoring and benefiting from what is within one's control.

Risk. Risk profile is not really applicable here, I know that doesn't quite seem right, but there just isn't a "conservative" or "aggressive" approach to this. Typically a new retirement account gets opened and immediately the risk assessment begins. I submit that many start out by addressing the *wrong risks*. You run out of money or you don't. That qualifies as the ultimate risk litmus test, again – **"It works (or) it doesn't"**.

Begin with the end in mind. The best allocation with the highest degree of success was shown to be 40% Stocks and 60% Bonds. That is the straightest line from A to B. Having said that, we could be looking at this from the worst case scenario perspective, and blindly investing based on that, with no thought given to what structural market cycle we are in. The point here being, that not all roads lead us to where we want to be. To succeed we must align our thinking and our portfolio to what it takes to get to the destination. We must always be diligent, flexible, un-emotional and be in alignment with what is most likely to work next. There is a meaningful chance that if one deals with the first part of this retirement phase correctly, a portfolio *can* experience returns above the minimum expectation. When that happens, an investor may want to judiciously increase their rate of distribution.

More on allocations. I'm sure my earlier comments that allocations were not the magic elixir will upset those who are heavily invested (no pun intended) in that part of the process. If you were to search the web for asset allocations you would have more than 3 million choices. I am keenly aware of all of the investments and hybrids that this industry has to offer. I understand hedge funds and all of the alternative investments, the bevy of "market neutral" funds, indexed products with so-called "zero downside", commodities, managed futures and structured products. I also value the role of real estate as part of an investor's mix of assets.

I am not dismissing the intelligent use of these assets as partial solutions, but, not owned correctly, they often just dull a symptom, they don't provide a cure. There is a very important point here: if you are of the mindset that there are investments that, if incorporated, somehow mitigate the risks of investing in stocks and/or bonds, then you need to be mindful that if something does mitigate downside, it can also mitigate upside. Downside protection in any format is not a free lunch – losses are limited at the expense of gains. Sometimes the outcome ends up being “return-free risk”. The best way to mitigate market risk is by not being in the market. Please appreciate this comment. Understand and respect the stock market for what it is, then, use it to your advantage not unlike one would real estate. This is key going forward as I lay out my thinking. Successful investing involves time. Respect this and incorporate this into your planning.

I do take great issue with the propensity of long-term “growth” accounts that have been muted with short term thinking and fearful investing. You must transcend attachment to short term thinking – this is a critical point of discernment and necessary for those who wish to achieve and sustain a truly abundant retirement. *Do all that you can to maximize the growth portion of your growth allocation*; one of the single biggest positive attributes to the well-being of the plan is excessive return above the norm. If you invest mostly to feel safe, you are likely to put your future in greater risk.

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I have often observed that emotions tend to be driving the construction of portfolios more than the end need of the assets. All of the data illustrated herein are historical market returns. When a portfolio earns above average returns by as little as 1–3%, it will go a long way to help elevate an investor's probability of achieving longevity of income.

I encourage you to read and contemplate my article mentioned earlier for an in depth look on growth portfolio management and asset selection. Acquiring and holding the right assets during the best time can make a very positive impact in growth or income portfolios. Think in terms of *asset selection* rather than *asset allocation*. This can have a much higher contributing factor to returns. Owning out of favor assets waiting for them to come back around is often a waste of precious time and opportunity. I employ a process that owns “what's working now” and not a static allocation that never changes. Distribution accounts do not have time on their side to wait 3 years for an underperforming piece of a static allocation to come around. Why own 15% of international stocks if they clearly are underperforming? One must amend their thinking on this topic.

A portfolio doesn't care how long its owner lives.

A portfolio doesn't care how long its owner lives. Here is a basic "concept" outline, of how one might *initially* set up their retirement accounts for distribution. Let me state that the overwhelming design of this is to allow for some insulation if the beginning of retirement coincides with negative or sideways markets. There isn't too much one can do but to buy time and avoid spending down assets that have depreciated. This of course assumes that one needs to be withdrawing income from these assets, if there are other income sources to draw upon then the accounts might be positioned differently. Again, there are many strategic and tactical variations depending on an individual's specific situation, so please take this example only as a template to be modified accordingly.

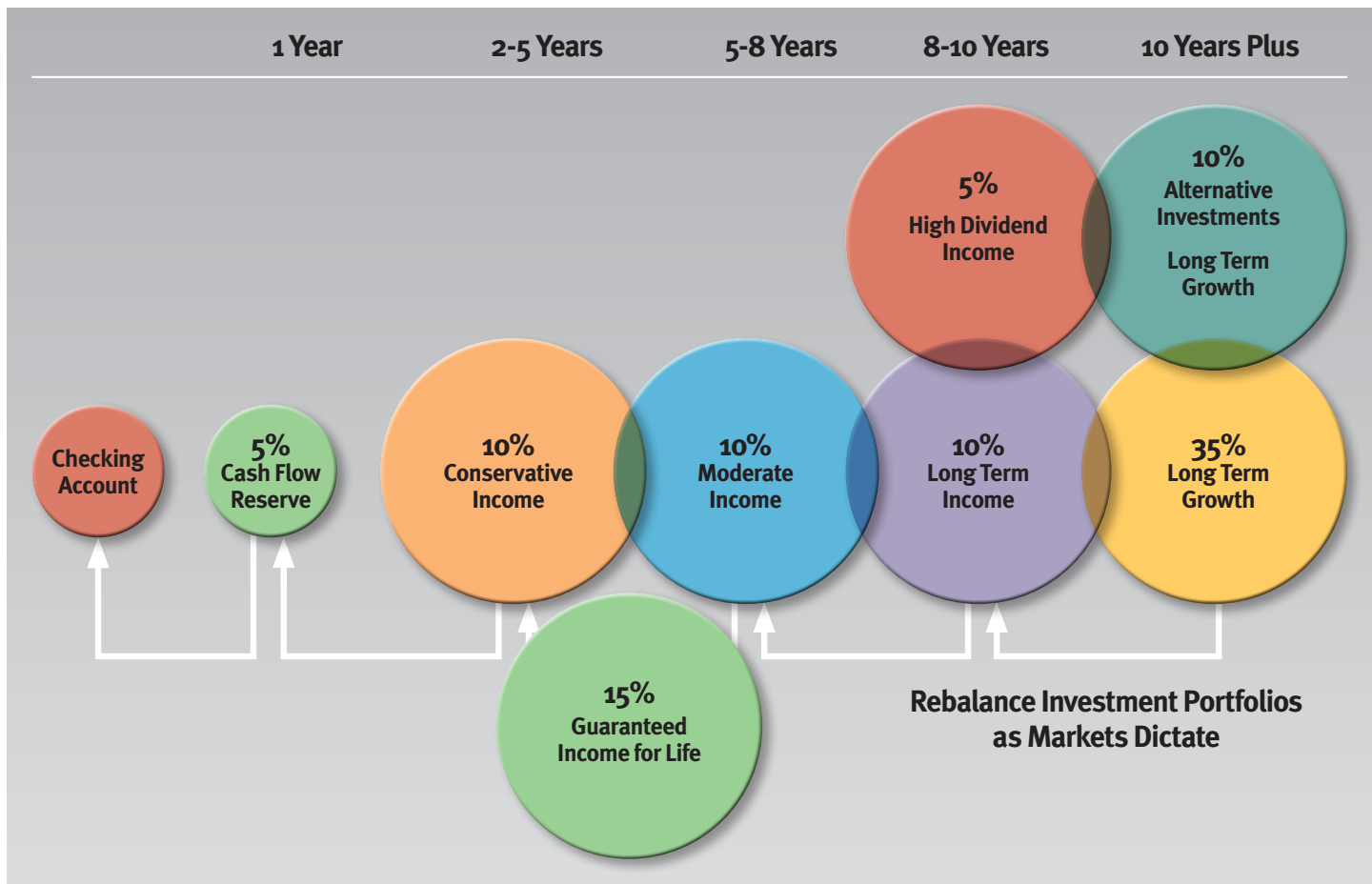
If income is withdrawn from fluctuating assets such as stocks, a significant portion of the portfolio life might be lost during a typical retirement. Knowing that growth is necessary – and that we don't want to withdraw money from a volatile or possibly depreciating asset – we begin by segregating our broad assets classes into distinct accounts, or "buckets". The purpose of this is to match the type of investment to a "need" date that fully allows for the investment to have the greatest chance of being successful. This helps to maximize the chances of success by giving each asset class the time it needs to generally show its gains.

Please understand, appreciate, and address that we are hard wired to minimize the emotional experience of investing as much as possible, but this is not always the best approach to maximize returns of long-term assets. There was a *Dalbar* study (this company just reports on investor behavior) that reported the *number one reason* for losing money *was trying not to lose money.*

I simply cannot tell you how profound this is.

The benefits of having the accounts designated for different purposes and timeframes can also help to alleviate rash and harmful deviation from the plan when those unpleasant market declines inevitably occur. The psychological benefit of knowing that the "growth" portion of the account may not need to be accessed for 10 years or so helps to minimize the scope of these events. Being obsessed with market fluctuations can do real damage by over-reacting, which so often results in losses or less than optimum returns. Manage your portfolio with sound strategies and tactics applied in a timely manner, not emotions. Such a mature and disciplined mindset will go a long way to truly providing you the best chance for an abundant retirement. Having the right kind of investment strategy will empower you to get on with the joys of retirement.

Time Segmentation Allocation (example)



At the end of each year, the cash account gets funded from the short term bonds account. Now, at the beginning of year five, this all gets reviewed and adjusted accordingly. What we have accomplished is getting to year five without taking distributions from volatile investments. If the stocks are down, we can hold them to “marinate” longer and continue to fund the retirement income stream with the relative safety of bonds.

If the stocks are up, perhaps the gains are taken and added back to the bonds. Also, inflation and lifestyle needs get reviewed and help determine the ongoing income distribution rate. This is the first major yardstick as to how “the plan” will unfold. On the surface, this may appear almost too simple, but in practice there are always more moving parts and many choices to consider. I do factor in the current market cycle and the bond environment as well. In a complex global economy and constantly fickle markets, almost *nothing* is simple. Many sovereign wealth funds and endowments are now using a variation of what I am describing in this article. Some of them refer to this as a “Dynamic Asset Liability Management Framework” (of course they do). It consists of three different portfolio approaches:

- 1) *A liability portfolio* (short term needs)
- 2) *A liability hedging portfolio*
(buying time if they need it)
- 3) *A performance seeking portfolio*
(long term growth).

What’s the dynamic part? The ability to move money between the three portfolios as needed and warranted. This is really the key; short, intermediate, and long term accounts. Depending on how an asset or market is trending and life events unfold, we have allowed for a protracted bad stretch without having to take withdrawals from the (diminishing) “growth” account. This can dramatically help the recovery process and allow the time needed for this cycle to pass and the asset base to grow. And, we did so with minimum damage (financially and emotionally). But, we also have the flexibility to harvest the gains and reallocate should the markets be favorable. Allow for bad times, and take advantage of the good times.

A big part of the success of this equation is managing the asset selection, holding and selling process effectively from the beginning. I don’t believe that more assumptions and more sophisticated analysis necessarily helps the process. Making five more unprovable points and adding two more decimal places is just pretending to a degree of accuracy that is at best pure speculation anyway.

Other considerations

One might also consider having 10% in a “growth” account that owns high dividend paying investments like MLPs (master limited partnerships) REITs (real estate Investment trusts) and high dividend paying stocks and have those dividends help fund income needs in addition to potentially providing some growth. These examples can be morphed in many ways depending on individual circumstances. The take away is this: give time to those investments that need it, take your income from non or low volatile sources, review and adjust. And remember, retirement allocations don’t magically manifest themselves on the day you receive your gold watch. Whenever possible, set-up your retirement strategy 4–5 years before retirement begins, each of the 5 year segments before and after retirement distributions start are nothing short of critical.

Taxes. Again, a topic unto itself, but here are a few ideas to begin. I am not licensed to offer tax advice, so review these concepts with your tax advisor first.

Location, location, location. Consider having bonds (and high income investments) in your IRA account and stocks in your taxable account. Tax rates vary from year to year, but if income is taxed higher than capital gains (for most of us it is) then this is advantageous because having the income generating securities in the IRA allows for deferral of higher taxes, and keeps your IRA from growing as much as if it were invested in stocks (historically). It sounds counter intuitive, but the benefit here is that IRA distributions are taxed at your higher income rate when distributions are taken, the smaller the IRA, the less income tax paid. This doesn’t change an allocation, just where the assets are allocated. Having your stocks in the taxable account allows you to share your losses with the government (write off losses versus gains) *and* long-term capital gains taxes are less than income taxes.

Just when you thought it was safe. Taxable versus tax- deferred skews the distribution rates. The numbers used overwhelmingly in studies assume after tax monies. Whatever portion of your assets that are tax-deferred (IRAs), have to have the tax liability paid first. For example, if there is \$100 in an IRA, and you take out 4% (\$4), assuming a 25% tax bracket, you now only have 3% (\$3). This needs to be accounted for when planning.

– *understand what goes into the packaging.*

Food and investments.

Hippocratic Oath – First do no harm.

After assiduous contemplation, I realized my greatest contributions to the retirement planning process revolved as much around what *not to do* as much as *what to do*. First do no harm – Hippocrates was an ancient physician and obviously not a financial advisor. I am very much aware that there are many other important topics that pertain to retirement planning that I did not address here.

I purposely chose to focus on the few that I felt would offer the greatest and broadest reaching benefits if acted upon or avoided.

The point being – understand what goes into the packaging. Food and investments. Understand that a prepackaged retirement plan may not be as healthy as it appears. It's too important a topic not to know everything that goes into the retirement sausage. As I mentioned at the beginning, I too made these typical mistakes at the expense of my clients – I too saw and suffered the outcome – I too was unknowingly undereducated and naive on what I was presenting. I assumed the Industry was feeding me the best information. I was wrong, a fact of which I'm not proud. But, I rectified it, and that is what I wish for you. Get the facts and not the fluff and make wized decisions with wized advisors. Don't abdicate your power. Do your part to ensure a dignified retirement knowing that you are acting and adjusting on the best information available.

“Suffering is optional” Buddha

Do not allow yourself to be trapped in your own false assumptions or anyone else's false assumptions. Properly channel, manage and structure all of your wealth in a holistic and synergistic way. Remove as many of the ignorance or apathy based obstacles from your retirement as possible. Proactive planning is an ongoing process that enables you to make better, more informed decisions as you go. Please avoid the current popular tools to plan your retirement that are simply computer driven – they are cerebral succotash and not as “scientifically” valid as they appear to be. Ultimately my process takes into account a wide array of variables and a series of trade-offs. These trade-offs often show up as your life situation changes. Areas of importance move in and out (as do our kids and in-laws) as our lives progress. One of the biggest issues with a “stagnant” plan and a “stagnant” portfolio is that often, by the time you realize that there are problems, it is too late to correct the course. When bad things happen, apathetically managed portfolios tend to run out of money. Conversely, portfolios that are consciously and assertively managed are more likely to adapt and overcome adversities.

It appears as though long term retirement account performance consequences are seldom instant, instead, they accumulate until the inevitable day of reckoning finally arrives and the price must be paid for poor choices – sometimes that is the case with choices that didn't seem to matter. Often failure's most dangerous attribute is its subtlety. A long term perspective combined with a disciplined, proactive and tenacious management system is essential to ongoing effectiveness. People who fail to think through a long term vision and action plan are self-destined to suffer less effectiveness and fulfillment. Without the disciplined application of correct principles, you aren't likely to achieve or to sustain your vision.

I am in the business of bringing relevant wisdom that people need but are not getting elsewhere.

I am in the business of bringing relevant wisdom that people need but are not getting elsewhere. I sincerely hope that you found this thought provoking, and that it helps you to transcend the common thinking that leads to ordinary or average results. I believe that retirement ought to be about spending your time, talent and resources on what matters most to you. I encourage you to contact me if the above has sparked your imagination about your retirement investment philosophy and management approach. I would love to share some additional facts and insight with you in ways that are personally relevant to you.

And remember, **it works until it doesn't.**

A note to high net worth families.

In the main, the thoughts and tactics herein can apply and may be very important to just about anyone, regardless of their personal net worth or amount of investment capital. Although the asset base may be broader and often times more ill-liquid (real estate, art, cars), most people whom I have worked with still wish to maximize income streams in a healthy fashion even when there are no issues with depletion. To that end, knowing the pitfalls and more importantly this effective approach to distribution rates and management also pertains to qualified retirement plans, foundations, endowments, and especially special needs trusts.



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Disclaimers

- *1 This statistic, as well as all others used herein, unless otherwise specified, uses the actual returns of the Dow Jones Industrial Average from 1900-1999 as well as the commensurate inflation as it corresponded. The bonds are the 6 month U.S. Treasury Bill plus .5 percent.
- *2 Otar, Jim C., Unveiling the Retirement Myth, Advanced Retirement Planning based on Market History
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About The Author

Gregg Haglund has been a Financial Advisor since 1991 and a Portfolio Manager since 1996. Gregg provides quality investment advice and his portfolio management skills to other financial advisors for use with their clients, as well as personally for a select group of his own clients. He is a student of the markets and from time to time authors timely industry related articles when warranted. Gregg finds that being a Fiduciary Standards of Care Portfolio Manager in addition to a Financial Advisor allows for greater transparency with his clients as the management of their assets is not “delegated” to third parties or products elsewhere. This empowers Gregg with a greater depth of knowledge of his clients’ assets and the ability to provide timely insight on alignment with the realities of the markets.

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