INVESTING

Asset Allocation During Retirement

So many investors get their portfolio arranged to reach their magic number, it is easy to forget that investing continues after retirement. Asset allocation within retirement is essential to preventing value loss from inflation and can ensure your finances will accommodate unexpected costs.

Investor Timeline and Diminishing Risk

Half of portfolio management focuses on managing risk, the Because an increase in risk can increase both potential return and potential loss, each investor must determine an appropriate level of risk for his or her portfolio. Investors must be comfortable with their risk level, while still being able to get the returns necessary to meet their goals. Using several different factors, financial advisors calculate this level of this "risk tolerance" and help investors create a plan accordingly.

Young investors tend to have a high risk tolerance. They do not typically have retirement plans and their long timeline allows them to recover from major losses in their portfolio. As they grow older, investors tend to lower their risk tolerance, giving up higher returns in favor of securing the money they already have. As retirement nears, investors continue to decrease their risk to the point where they can confidently plan around their portfolio's value.

Risk in Retirement

But if risk decreases slowly while heading toward retirement, what does that mean for choosing assets during retirement? Should retirees look to eliminate all risk? Should they increase their risk in an attempt to grow their estate value? Will they need their assets long enough for it to even matter?

> The classic model considers a single portfolio of mixed assets… The other method involves creating a hierarchy of three to five different sub-portfolios (sometimes referred to a "levels" or "buckets.")

A retiree's primary goal is to work towards ensuring his or her financial plan is "successful", that they have enough assets to last the remainder of his or her life. Three major factors affect the success of a retirement account are: rise in investor spending, investor longevity and decline in asset value.

- **Investor spending** – This simply refers to a retiree going over budget with their spending. This could be affected by necessary expenses (home repair, health costs) or through frivolous buying. It is not only important for retirees to have spending discipline but also for them to plan sufficient income for themselves.
- **Investor longevity** – It is hard to think of a long life as a source of stress, but for some investors, living beyond their expected years can cause significant problems. Investors should

Heim·Young & Associates

Heim, Young & Associates, Inc.
(417) 882-7283

1256 E Kingsley St
Springfield, MO 65804

This article was written by Advicent Solutions, an entity unrelated to Heim, Young & Associates, Inc.. The information contained in this article is not intended to be tax, investment, or legal advice, and it may not be relied on for the purpose of avoiding any tax penalties. Heim, Young & Associates, Inc. does not provide tax or legal advice. You are encouraged to consult with your tax advisor or attorney regarding specific tax issues. © 2012,2014 Advicent Solutions. All rights reserved.

always assume the best and plan for a long, happy retirement.

- **Rise or fall in asset values –** Tied to asset allocation, this refers to the loss of a portfolio's value through market fluctuations or inflation. Investors with too many risky assets could have their retirement ruined by a single downturn; however, investors with completely safe assets might not be able to outpace inflation.

While problems with investor longevity can be countered, for example, by purchasing an annuity that guarantees lifelong income, investor spending and drops in asset value are difficult to predict. To prevent or reduce the effects of possible losses, new retirees are encouraged to reformat some of their investments. The challenge of asset allocation during retirement is creating an investment plan that has both stable growth and the ability to make regular distributions to owners. As with all investment plans, asset allocation is determined through a highly personalized strategy that should only be constructed under the guidance of a financial advisor.

Use of Assets during Retirement

In general, money and property held during retirement is either invested or used to meet current needs. Though many people would like to think of reaching retirement as the end of income and investment planning, the reality is retirement can go for far longer than they expect. It is essential for retirees to plan for all scenarios and effectively invest their property.

Advisors have developed two popular types of approaches to asset allocation during retirement. The classic model considers a single portfolio of mixed assets that a retiree occasionally accesses to replenish his or her savings account. This method is simple, but requires readjustment of assets with every major withdrawal.

The other method involves creating a hierarchy of three to five different sub-portfolios (sometimes referred to a "levels" or "buckets.") While some assets (like pensions or annuities) are constant, most are categorized by risk and placed into an appropriate bucket. Investors establish the buckets at the start of their retirement and each one works to supply the level.

- **Short-term cash–** This simple bucket is designed to cover the first 3-8 years of retirement. An investor puts money into bank accounts and simple securities for easy access.
- **Mid-term investments –** Usually heavily invested in bonds and other low risk assets that produce small growth but have little chance of losing value. This bucket usually covers the next 4 to 10 years of retirement. As the short-term cash bucket runs out, it is refilled by selling these mid-term investments.
- **Long-term investments –** Because this bucket often is left alone for 10-15 years, it has substantial time to grow. Some choose to continue investing this money as they did before retirement, with a moderate amount of risk. Growth from long-term investments can add significant value to a retirement fund. As a retiree gets closer to needing these assets, they are redistributed to the mid-term bucket to prevent any sudden loss in value.
- **Estate assets –** For estate planning purposes, retirees can delay the use their most appreciated assets (e.g. high-growth stocks or real estate) until all other assets have been depleted. Appreciated assets receive a step-up in their basis value at the death of their owner. Though this increases the owner's taxable estate, it removes the capital gains tax up to that point. Passing appreciated assets to an inheritor essentially allows a person to use their estate tax exemption as a capital gains exemption.

While either method of planning for asset growth and use in retirement can be successful, no one system or portfolio will fit every retiree. Hybrid methods of asset allocation are common; each person must work with an advisor to tailor a plan that best suits his or her needs.

Retirement can be a wonderful time to relax and enjoy life, but it requires serious attention to avoid its financial pitfalls. Asset allocation is a key part of planning for every stage of life. If you have concerns about your financial strategy or desire to adjust your asset allocation, contact the experienced advisors at Heim, Young & Associates, Inc..

■