

## RIA and IRA Advancements

- IRAs are the biggest pool of retirement assets with \$8.4 trillion. They are destined to disappoint even more than 2008.
- RIAs can and should step up their IRA advice and guidance. “Save and protect” would help a lot.

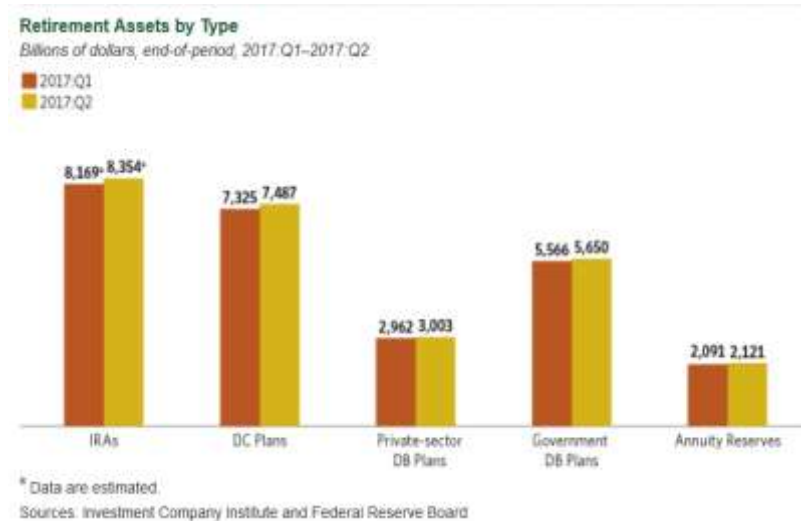
In a June 7, 2017 Investopedia article, author Barbara Friedberg asks [Are We in a Baby Boomer Retirement Crisis?](#) in which she reports on the inadequacy of retirement savings in the following table:

Age	Median Income	Retirement Savings Benchmark	Percentage on Track	Percentage Behind
24	\$34,605	Started a retirement fund	48%	52%
30	\$54,243	\$16,272.90	33%	67%
40	\$66,693	\$100,039.50	20%	80%
50	\$70,832	\$212,496.00	22%	78%
60	\$60,580	\$260,494.00	26%	74%

Three-fourths of those nearing retirement have not saved enough. This is a serious problem that Registered Investment Advisors (RIAs) can address in two ways:

1. Encourage clients to save enough.
2. Help clients keep their savings by.
  - a. Investing wisely
  - b. Spending wisely

RIAs are in the best position to address the retirement crisis because they are the primary advisors to Individual Retirement Accounts (IRAs) and [according to the Investment Company Institute](#) IRAs are the largest pool of retirement assets, representing \$8.4 trillion of the total \$26 trillion in retirement assets.



## Save Enough

Saving enough is a behavioral challenge. RIAs can educate their clients on the importance of savings and work with them to develop a behavior of regular and substantial contributions to their IRA and other savings plans like 401(k)s.

As the Investopedia table above shows, this is the number one way that RIAs can help their clients. Workers are simply not saving enough, and investment returns will not bail them out. In this [Working Paper](#) the authors show that savings are far more important than asset allocation. To summarize, all cash is a fine investment strategy if you save enough.

But an advisor's job doesn't end with education. It's the RIA's job to see that their clients earn a decent return and most importantly that they don't lose their lifetime savings, as discussed in the next section.

## Keep it: Invest wisely

The \$ 8.4 trillion invested in IRAs is destined to be devastated by a risk that is well documented but generally unrecognized. [Sequence of Return Risk](#) will destroy lifestyles and this time it will be much worse than 2008. Fortunately, each of us can control this risk because it's personal, but not if we wait until it's too late. We only get one chance in a lifetime to dodge this risk. Unlike other risks, this risk is individualized and we know when it is greatest so we can protect or take the [gamble](#) that losses won't occur in our own personal [Risk Zone](#). It's like sky-diving risk where there is little chance of recovering from being unlucky; the odds of bad luck may be low but the consequences are huge.

All investors knowingly take some risk of losing money, but there comes a time in all of our lives when, unless you do something about it, risk of loss morphs into the risk of ruin. We all run the mandatory gauntlet of ruin as we transition from our working lives into our retirement years. Losses sustained during this transition period can devastate lifestyles even if markets subsequently recover. That is why Professor Moshe Milevsky calls this the Risk Zone. Most RIAs are unaware of this risk so it is exceedingly high. It could and should be much lower, as we explain in the following. Unless you feel

extraordinarily lucky, you want to protect your clients against sequence of return risk. It's a risk that can and has blindsided many investors. Don't let this happen to your clients.

The simplest and most dependable way to manage sequence of return risk is to keep your clients' investments safe during the Risk Zone that spans the five years before and after retirement. This will of course create opportunity costs if markets perform well, but it is a price well worth paying because you only get to do this once. Your clients' savings are likely to be at their highest as they transition from working life into retirement, so there is more to lose. Behavioral scientists tell us that we feel the pain of loss much more than the benefits of gain. "Save and protect" is a very good mantra for retiring with dignity.

IRAs are exposed to excessive loss in the Risk Zone. The Employee Benefits Research Institute (EBRI) [report on IRAs](#) reveals that equity allocations are approximately 55% across all ages, a surprising reality. Target date funds (TDFs) are also exposed to excessive risk, with an average 55% allocation near the target date. This is the allocation that lost 30% in 2008, and risk has increased since. To guard against the devastation that lies ahead, IRAs and TDFs should have very low risk in the 5-10 years before and after retirement, but they don't. TDF glide paths provide a good model for managing IRAs, but these glide paths need some important modifications.

Outside the Risk Zone a modified TDF glidepath makes sense. Target date funds are more aggressive when you're young and move to defend as you approach retirement. The problem is that off-the-shelf TDFs are not conservative enough at the target retirement date to defend against sequence of return risk, so this needs to change. Risk at the target date should be much lower to defend against sequence of return risk, with no more than 10% in equities and the balance should be in very safe assets like Treasury Bills and short term TIPS. In other words, the "glide path" for defending against sequence of return risk is similar to TDFs when you're younger but much safer as you pass through the Risk Zone.

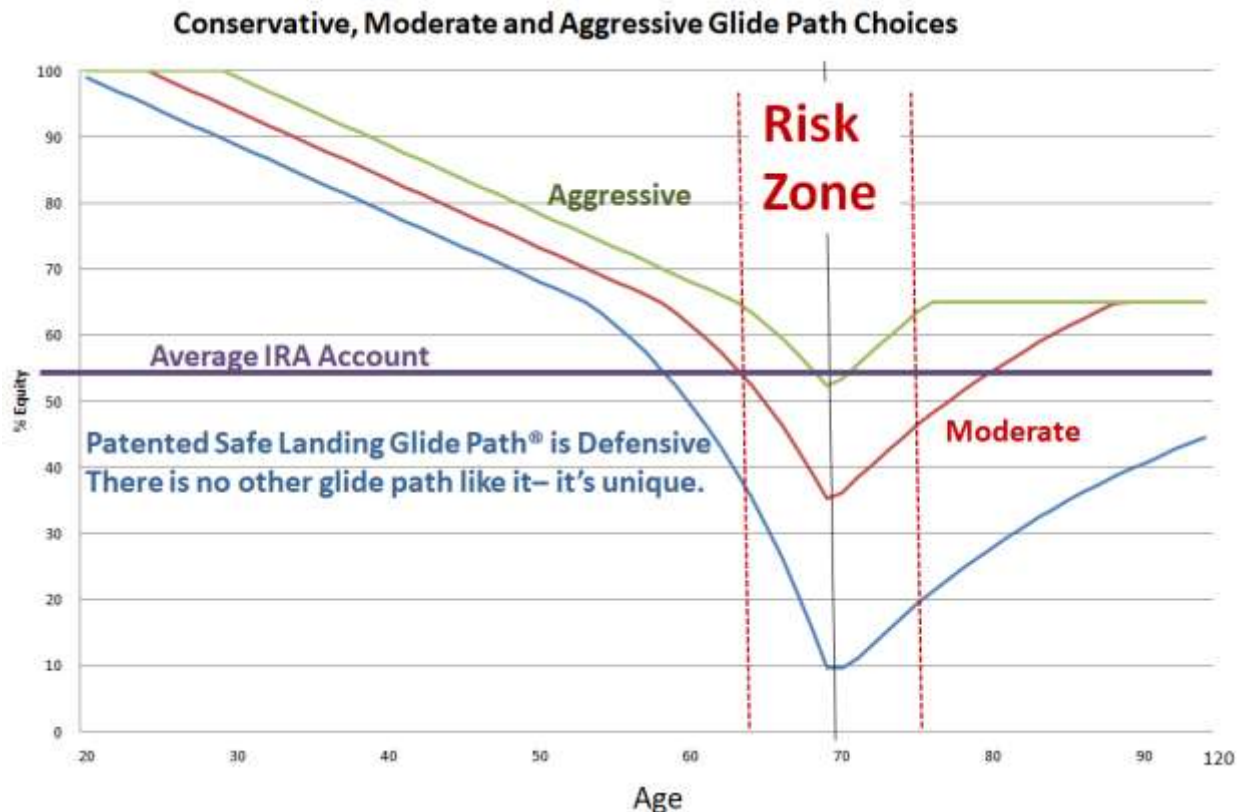
Moving beyond the Risk Zone into retirement most retirees cannot live on T-bills and short term TIPS, so there needs to be a re-risking in retirement, although no mutual fund TDF does this. What is the "right" glide path beyond the target date? This question is addressed in Dr Wade Pfau and Michael Kitces' [Reducing Retirement Risk](#)

[with a Rising Equity Glide Path](#), where they compare and contrast increasing equity glide paths to flat glide paths in retirement.

K&P conclude: ***the results reveal that rising glidepaths are even more effective, especially when they start off conservatively. The most favorable (i.e., least adverse) shortfall actually occurs with a glidepath that starts at only 10% in equities and rises to “only” 50% in equities.***

In other words, a V-shaped glide path defends against sequence of return risk and is the best path in retirement for making savings last a lifetime. The bottom of the V is the Risk Zone and should be no more than 10% in equities.

The following glide path provides optimal protection in the Risk Zone, but some investors prefer to be less conservative, so we’ve created the two additional more aggressive glide paths shown in the following.



Note the departures from the average IRA account balance. The average IRA account balance is [55% in equities regardless of age](#). This is likely a throw-back to the old 60/40

rule that provides good diversification. We've learned a lot since the 1980s and TDFs have played a big role in our evolution. Here's a summary of the differences:

- All glide paths are more aggressive than the average IRAs of young people, prior to the Risk Zone
- The Safe Landing Glide Path is more defensive than the IRAs of people over 60 years old
- The Moderate path is safer for people between 65 and 80, but more aggressive for those older than 80.
- The Aggressive glide path is generally more aggressive than IRAs of all ages

The other way RIAs can help their clients save enough is by guiding them through their spending in retirement, as discussed in the next section.

## **Keep it: Spend wisely**

Financial planners recommend that retirees use [The 4% Withdrawal Rule](#) that stems from a [1994 study](#) by financial planner William Bengen. After testing a variety of withdrawal rates using historical rates of return, Bengen found that 4% was the highest rate that held up over a period of at least 30 years. The 4% withdrawal rule spends 4% of savings in the first year, & then that dollar amount increases by inflation in each subsequent year.

The Kitces and Pfau (K&P) study mentioned above finds that the 4% Rule is currently not the slam dunk it used to be. The study estimates the success probability of a 4% Rule to be more than 90% using historical capital market assumptions, but this probability drops to about 75% in today's market environment. Many pundits have proclaimed the 4% Rule dead, at least for now, because real interest rates are zero, but this study says there's still life in the Rule, but not the vitality there used to be.

Also as described above, K&P find that an increasing equity allocation in retirement is optimal for supporting the 4% Rule. This is why the glide paths shown above have a "bounce back" in retirement.

## **Conclusion**

Saving enough is the primary means to a comfortable retirement, but there's more. Retirement savers need to earn a good return on those savings and, most importantly, those savings need to be protected from losses, especially in the Risk Zone. Then the end game is to spend those savings wisely in retirement.

These are all common sense statements, but current practices are not sensible. Workers do not save enough and the most popular investments – IRAs and TDFs -- will someday destroy the little savings that beneficiaries have. It's a shame.

There are better ways and fortunately some advisors are pursuing them. We can help. We are about to launch a Robo Analyst called Age Sage that guides investors through the Risk Zone along the glide paths shown in this article. Please contact me for more information:

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