Does Your Retirement Strategy Match Your Life-Stage?

By Chris Abeyta
Published January 1, 2013

Usually the first question a financial advisor will ask a new potential client has to do with the client's perceived risk tolerance. The question goes something like this: "So, tell me about your risk tolerance. Are you conservative, moderate, or aggressive when it comes to investing?" Sometimes the client is asked to fill out a questionnaire to help the client determine their "risk tolerance." What most clients don't realize is what is really being asked is, "how much can you stomach losing if we see another or several more major market downturns during your investment tenure or lifetime?"

This question dates back from, in today's standards, an ancient and outdated investment strategy called The Modern Theory of Portfolio Management. The theory was developed back in the 1950's and began to gain mainstream traction in the 1960's. The idea was to diversify one's portfolio with different market sectors that were not completely positively correlated. A portfolio would be divided up among large capital, mid-cap, small-cap, international and bond funds. If you were on the aggressive side you would have fewer bonds and more equities and possibly more international funds. If your risk tolerance was rated as more conservative you would have a higher percentage of bond funds.

This portfolio was then and still is typically displayed as a pie chart on many financial statements. This strategy tended to work very well in helping people protect and grow their wealth especially during a four-decade run from 1960 to March of 2000. But, in early 2000 the first major crack in this strategy revealed itself in a big way with the bursting of the tech bubble and then again on 9/11/2001. The market dropped in double digits for 3 years in a row, and the diversified pie chart portfolio crashed with losses up to 50%. We saw the failure of this strategy again in 2008-2009 when some portfolios lost up to 50% in a matter of 7 months. What amazes me is that after a 12-year season of a globally connected world where 70 percent of the market is driven by computer trading, most financial advisors, as well as individuals in retirement or approaching retirement are still using a failed strategy in the attempt to manage risk and provide lifetime income through retirement.

The first question advisors should be asking and clients should be asking themselves isn't "how much can you afford to lose?" but rather, "What season of life are you in?" You see, when it comes to Life-Stage Financial Planning there are three seasons, and your season is what determines your strategy. The first season we call the Accumulation Phase, and it starts when you get out of college or get a job and begin to put away money for retirement. It ends about 12 years prior to the age you wish to retire. Your goal during this season is GROWTH. You have many years to work, earn, save, increase your income and accumulate wealth.

The second season in life-stage financial planning is what I call the "Retirement Hazard Zone." Most people don't realize, but this is where your retirement lifestyle is secured or lost. Most people carry the same strategy they used for 30 or so years in the Accumulation phase into this phase, and this is probably the number one mistake people make.
Protect Your Retirement: Insurance and Annuities

Does Your Retirement Strategy Match Your Life-Stage?

By Chris Abeyta
Published January 1, 2013

If you have been a diligent saver over those 30+ years you now have some money. Your human capital is beginning to wane and very soon your investment capital (life savings) is going to have to start replacing your paychecks when you no longer work and move into retirement. This is where your goals have to make an intentional change. Priority one is protection with growth being priority number two. We already saw how twice in the 2000's people lost 50% of their life savings in a short period of time. It can take 40 years to build up a life savings and can take 7 months to lose 40% of it. Hits like this during the Retirement Hazard Zone can be unrecoverable. Typically when someone fails to transition appropriately to a strategy that matches this phase and sustains a significant portfolio decrease there are four implications:

1. Work longer - pushing retirement back
2. Lower your retirement lifestyle
3. Risk running out of money
4. Leave nothing to your heirs

Life Stage Financial Curve®

R = Optimal Retirement Point
The third phase of Life-stage Financial Planning is called the Income Phase. This is where you are no longer working and taking income from your assets to live on. Your nest egg has to provide lifetime income for you and your spouse. Three major challenges during this phase are the loss of a spouse with a pension and/or a social security check, keeping up with inflation, and long term care expenses.

Once I educate my clients on the three different phases of Life-Stage Financial Planning the most important question I ask is, "What life-stage are you in?" Once you know what life-stage you are in we can then design a strategy that fits the life-stage.

The biggest point that I usually have to stress and help clients understand is that the Theory of Modern Portfolio Management is NOT an appropriate strategy for either of the last two phases. Let me say it another way. The old fashion pie chart made up of stocks, bonds and mutual funds has failed repeatedly over the last decade and Monte Carlo simulations show that it now has a high degree of failure and risk of running out of money. It doesn't matter how conservative you think your portfolio is; using an outdated model of financial planning is a recipe for disaster. If you were going to get heart surgery, would you want your surgeon using 1950's technology or would you want him using the most up-to-date medical advances. Shouldn't you treat your retirement strategy the same way?

Chris Abeyta is a Principal at Accelerated Wealth, a national, full-service wealth strategy firm headquartered in Colorado Spring, CO. MBA, CFEd, A+ BBB. Chris is currently the host of The Accelerated Wealth Radio Show on 740 AM KVOR highlighting financial wealth retirement strategies. For more information, call Chris at (719) 466-5627.