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YOUR MONEY

For Older Investors, Old Rules May Not Apply

By TARA SIEGEL BERNARD

The stock market's damage has already been done. And if you're one of those people near or already in retirement, you already know you're going to have to work longer, save more or spend less.

But what should you do right now with the money you have left? Should you wade back into the stock market, if you bailed out when the market was plunging? Or if you watched your investments drop and then recover a little in the last few months, should you just hold on? What happens if the market doesn't fully recover for a long time? (That happened in Japan in the '90s.)

This economic downturn has been steep enough and frightening enough to undermine the idea that the stock market, over time, will always deliver. So a lot of investors have retreated to a more conservative stance.

The wisdom of that move is debatable. The investment industry warns that becoming too defensive is costly in the long run. Its argument goes something like this: People are living longer, retirement may last 25 or 30 years and stocks are supposed to protect you from the ravages of inflation. And since stocks tend to outpace most investments over long periods of time, the industry says, your savings will do all right in the end.

But some people are no longer comfortable with that logic. There's even a new study that contends holding stocks over long periods of time may be riskier than previously thought. Robert F. Stambaugh, a finance professor at the Wharton School at the University of Pennsylvania and a co-author of the report, said most investment research only accounted for the risk of short-term market swings around the stock market's average gain over time. It doesn't factor in the fact, he said, that the average itself is subject to change.

So what should retirees and pre-retirees make of all of this?

"If another decline in the market is going to bankrupt you or put you out of business or destroy your retirement account, you should not go back into the stock market," said John C. Bogle, the founder of Vanguard and viewed by many as the father of index investing. "It's not complicated. The stock market can go up and down a lot and nobody really knows how much and when."

What's worked for Mr. Bogle may not work for you, but his method isn't a bad place to start. "I have this threadbare rule that has worked very well for me," he said in an interview this week. "Your bond position should equal your age." Mr. Bogle, by the way, is 80 years old.

That's a rather conservative recommendation, by many financial planners' standards. In fact, Vanguard itself offers products that are more aggressive. Its target-date funds — whose investment mix grows more conservative as retirement nears — recommend that people retiring in 2010 (generally, people who are 65) should split their savings evenly between stock and bonds.

Charles Schwab, by contrast, has recently reduced the risk for its target-date funds. The company's 2010 fund will allocate about 40 percent to stock funds next year, down from 50 percent in the past. "It's a reflection that our clients' appetite for risk has changed," said Peter Crawford, a senior vice president at Charles Schwab Investment Management.

But you shouldn't simply view your investments through the lens of how much you allocate to different investments (though you will need to come up with a plan). Instead, you should work your way backward. First, consider how much you will need to live when you're retired and then figure out how you'll pay for it.

Nearing Retirement

Ideally, you should have started to slowly shrink your stock position over your working career. But some financial planners have become more conservative about that. Before the market's sharp downturn, Warren McIntyre, a financial planner in Troy, Mich., typically reduced his clients' stock allocations by about 1 percent each year. Now, for older investors, he ratchets down their stocks by 2 percent each year once they reach 60. So a 65-year-old's investments would be evenly split between stocks and bonds.

Other planners are taking even more defensive positions. "We are still very concerned about the status of the economic recovery and remain quite defensive as a result," said Chip Addis, a financial planner in Wayne, Pa., who invests his clients' portfolios in only 40 percent stocks.

Of course, there's no one formula. Milo Benningfield, a fee-only planner in San Francisco, for instance, said he put a 61-year-old client in a portfolio with 60 percent in diversified stocks and alternatives (like real estate) and 40 percent in fixed-income (largely split among high-quality, short-term and intermediate-term bonds and cash). But this client can afford to take that risk — the client owns a house, rental property and has other holdings outside the portfolio.

The picture may change for pre-retirees who are 61 and close to meeting their savings goals, but can't afford to lose any money. "We would ask ourselves to what degree, if any, can you afford equities," Mr. Benningfield said. If inflation was their only concern, he might invest their money across a ladder of Treasury Inflation-Protected Securities, or TIPS, which are backed by the government and keep pace with inflation.

But since retirees generally spend money on entertainment, health care and food — whose costs often exceed the general rate of inflation — he said he might invest 40 to 50 percent of their money in a portfolio of diversified stock funds (with at least 30 percent of that in international stock funds). But, he added, "Cash is risky, stocks and bonds are risky, life is risky."

As to those investors who got out of stocks, Mr. Bogle said it might be time for some of them to get back in. "But I would take two years to do it," he said. "Maybe average in over eight quarters, and do an eighth each quarter. I am just not in favor of doing things in a hurry or emotionally."

And then? "Don't touch it," he said, emphatically. "One of my rules is don't do something. Just stand there."

Retirement

Several planners recommended different variations on a similar strategy for retirees. Set aside anywhere from eight to 15 years of your expected expenses — that includes food, utilities, housing, insurance — in bonds and cash. That way, you'll never have to tap your stock holdings at the worst possible moment.

"Once you have that in place, you feel like you can weather any economic storm," said Chip Simon, a financial planner in Poughkeepsie, N.Y.

When you have figured out how much it costs to live each year, the next step is to see how much Social Security will cover. Whatever is left needs to be financed by your retirement portfolio. And the general rule of thumb is that you shouldn't withdraw more than 4 percent of your portfolio (adjusted for inflation) each year.

There are different ways to invest your cash and bond holdings.

Rick Rodgers, a financial planner in Lancaster, Pa., invests 10 years of annual expenses in a bond ladder, with an equal amount coming due every six months. The ladder can include high-quality corporate bonds, Treasury notes, certificates of deposit or municipal bonds, depending on the retiree's tax bracket. Mr. Simon takes a similar approach using a 15-year ladder of zero-coupon bonds. He says that investors can start building the ladder in their 50s, with the first rung coming due the year they retire.

Some advisers also say you can guarantee you'll be able to cover your basic expenses by purchasing an immediate annuity from an insurance company. The annuity pays you a stream of income until you die. "You can buy four small ones from four insurers if you are worried about insolvency risk," said Dallas L. Salisbury, president of the Employee Benefit Research Institute. "And if you are just worried about inflation protection, you can do TIPS."

But you should probably delay any annuity purchases because payouts rise with interest rates. With current rates so low, and the possibility of inflation later, advisers said it's best to wait a few years. You can also research inflation-adjusted annuities, but you'll receive lower payouts in the beginning, Mr. Benningfield said, adding: "Less than most people can stomach."