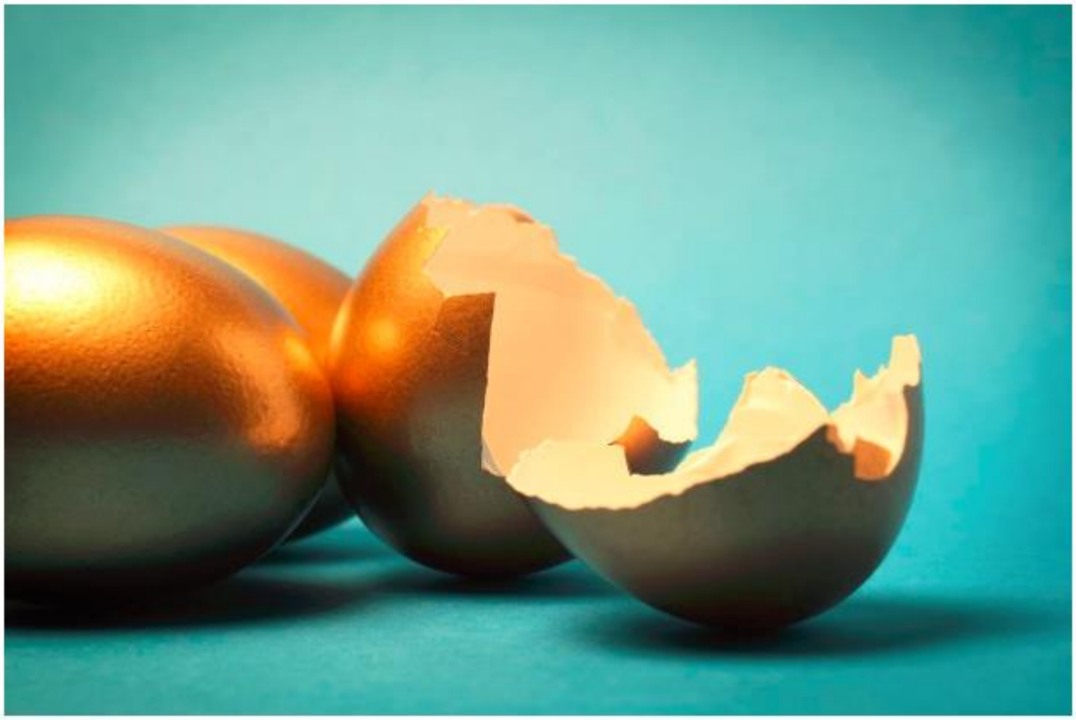
THE WALL STREET JOURNAL.

How to Protect a Retirement Plan in a Down Market

To avoid selling stocks at depressed prices, have a Plan B

The Wall Street Journal

By: Michael A. Pollock



Lack of preparation can sometimes force retirees into selling stocks at a bad time, like during a market correction. Here are some strategies to help avoid that. PHOTO: ISTOCKPHOTO/GETTY IMAGES

Market corrections are a worry for all investors, but they can pose a particularly big problem for people who have just retired and are starting to dip into savings.

Each time retirees sell stock, it digs a hole out of which their portfolio must climb to keep producing the same amount of income over time. The more they sell—and the earlier—the deeper the hole.

This doesn't mean it's always bad for a retiree to sell stock. Selling when the market is strong can be not only profitable but responsible, especially as a way of keeping portfolio allocations in line with investment goals. Selling during a correction, however, when stock prices may have fallen to a fraction of their recent market value, not only might yield a lot less return per share, it could cause a retiree to run low on resources sooner than expected.

"If you get off course at the beginning, it could be very difficult to recover," says Dan Keady, chief financial planning strategist at New York-based financial services firm TIAA.

Despite recurring volatility, most retirees must hold some stocks to keep pace with inflation. For those investors in particular, it's important to have a Plan B to cover ongoing financial needs so that if stocks crater, the retiree can avoid being forced to sell shares at depressed levels.

Mr. Keady recommends being proactive and taking steps ahead of retirement, like projecting spending needs, matching them against expected income and creating a reserve with something other than equities to help cover shortfalls. Being better prepared also might include planning ways to cut spending.

Here are some thoughts and suggestions from advisers and planners on how to minimize the risk:

1. **First do the math.** A good place to start is to estimate how much of your monthly budget would not be covered by fixed sources of income, such as dividends, interest, pensions and Social Security. Most people mistakenly think this involves the tedious process of adding up a year's worth of receipts, says Joe Lucey, who heads Secured Retirement Advisors LLC in St. Louis Park, Minn. The much easier method, Mr. Lucey says, is to tally all the money taken from bank accounts in 12 months that hasn't been stashed away somewhere else. Next, calculate the income expected regularly from Social Security, pensions or other sources.

   Once you know what the gap between expenses and income will be, set aside a cash reserve or other fixed-income asset big enough to spin off cash to cover that gap until the market recovers. This provides a buffer, says Jim Barnash, an adviser at SGL Financial , Buffalo Grove, Ill. A retiree's regular flow of income often covers as much as two-thirds of their total spending. But it's that uncovered third that represents how much a person has to withdraw from savings to maintain a certain level of spending.

   There is no way of knowing with any certainty how long a downturn will last, and thus how big that reserve needs to be exactly. But most corrections, Mr. Barnash says, with the exception of the 2008-09 crisis, last three to nine months.

2. **Balance with safer stuff.** The non-equities part of a portfolio should be a mix of cash and bank certificates of deposit or highly rated short-term bonds, experts say.

   Money-market yields have been rising as the Federal Reserve raises short-term interest rates. Some federally insured money-market accounts now pay 1.75% to 2% a year.

   Because certificates of deposit and bonds with slightly longer maturities offer better rates than cash, advisers often create a basket of CDs or individual bonds with sequential annual maturities—a so-called ladder—to ensure a steady replenishment of cash in a portfolio.

   Buying individual bonds can be challenging for nonprofessionals, but investors could also consider an ETF that invests in short-term government bonds, says Nikolaas Schuurmans, founder of advisory firm Pure Portfolios in Portland, Ore.

   While the share price will fluctuate with shifts in market sentiment, such ETFs pose relatively little risk and could easily be sold to raise more cash, he says. Mr. Schuurmans uses Schwab Short-Term U.S. Treasury (SCHO), which charges 0.06% annually in expenses. A similar option, Vanguard Short-Term Treasury ETF (VGSH), has an expense ratio of 0.07%.

3. **Watch the equity allocation.** Although it's important to own some stocks, after about nine years of rising markets, many people may own more stocks than they think. Some also may be out of the habit of rebalancing a portfolio periodically and staying well-diversified, says **Spuds Powell**, managing director of the Los Angeles-based advisory firm **Kayne Anderson Rudnick**.

One thing to do right away: If the equity allocation has surged much above 60%—a common benchmark for how much to keep in stocks—consider paring it back, advisers say.

4. **Plan to tighten the belt.** Many people believe they will spend less in retirement than when they were working, says SGL Financial's Mr. Barnash. Actually, the opposite can be true, at least in the first few years. New retirees have more time to spend money and may indulge in expensive luxuries, such as traveling abroad.

   Retirees often don't react well to suggestions that they spend less, but "realistically, you might have to cut spending some if there is a market downturn," says Mr. Keady of TIAA. One way he suggests of imposing self-discipline on spending is to keep annual withdrawals from savings at a constant rate, which might be around 4% a year. Thus, if a portfolio's principal value fell during a market correction, an investor would be withdrawing less while stock prices were lower, reducing sequence-of-return risk.

   Advisers also sometimes suggest that people delay taking Social Security for a few years, because that can mean getting larger future Social Security payments, building in a higher level of dependable income.

   Advisers also sometimes suggest that people delay taking Social Security for a few years, because that can mean getting larger future Social Security payments, building in a higher level of dependable income.

5. **Be wary of borrowing.** Many people have substantial equity tied up in a home, and there are multiple ways of tapping it. A retiree could create a contingency reserve by taking out a home-equity loan or a line of credit and drawing against it, if necessary, during a market correction.

   But in most cases, advisers caution against that. The strategy could backfire if a correction proved much deeper or longer than usual, leaving a borrower with a hefty debt burden.

   "For people who have retired, whether they are taking regular withdrawals from savings or not, borrowing usually doesn't make sense because it tends to increase risk," says **Mr. Powell** of **Kayne Anderson Rudnick**.

Appeared in the April 23, 2018, print edition as 'How to Plan for a Down Market.'