DO RETIREES NEED A NEW INVESTMENT STRATEGY?

 Austin L. Peterson, CFP®, CLU®,MBA | July 26, 2019
Share|

First growth, then income. If you're like most investors, you want to achieve growth while you're working and income after you retire. But that doesn't necessarily make it smart to change your investment strategy when you retire by shifting your portfolio completely out of stocks into less volatile, "income" investments like bonds and cash equivalents.

The Tax Bite

As a rule, stocks are more risky and volatile than other types of investments. Therefore, you might decide, as some retirees do, to sell your stocks and reinvest in less risky securities in order to protect the gains you've achieved. But, unless the stocks you sell are in an individual retirement account or other tax-deferred retirement account, that move won't preserve all of your accumulated gains. When you sell your stock, you'll lose part of those gains to capital gains tax.

The Inflation Bug

You may also create another, potentially more serious, risk. Without stocks in your portfolio, you increase the risk that future inflation will erode the real value of your investments and reduce your spending power.

Let's look at some numbers. Social Security's normal retirement age is gradually increasing. For someone born between 1943 and 1954, it's 66. If you retired today at age 66, your additional life expectancy would be 20.2 years according to IRS tables. No one knows what the rate of inflation will be in the future. But, over the past 20 years, (1994-2016) the Consumer Price Index (commonly used to measure inflation) has, on average, risen about 2.3% a year according to the Bureau of Labor Statistics. If inflation continues at the same average rate for the next 20 years, you'd need nearly $79,000 of income in 2036 to match the buying power of $50,000 today.

The best way to fight inflation is to have the potential to earn investment returns that will keep you ahead of the erosion in your purchasing power of inflation. The problem is there's no guarantee about the future returns of any variable investment.

A Better Way?

Instead of moving your entire portfolio out of stocks when you retire, you might consider other strategies. You could maintain your current portfolio mix until you retire. Then, gradually sell some of your stocks each year.

This strategy would slowly reduce your exposure to the risk of owning stocks and also generate income to supplement any cash dividends and interest income you receive. You'd spread out your capital gains taxes and be able to keep a large part of your portfolio invested in stocks for a considerable number of years. Another strategy would be to simply reduce the portion of your portfolio that is invested in stocks as retirement approaches. For example, if 75% of your portfolio is in stocks before retirement, you might lower that percentage to 30% or another percentage that you're comfortable with. That way, you'd still retain some opportunity to gain from any future stock market advances, but you'd also reduce your portfolio's overall risk and volatility.

When you say goodbye to your job, sticking with stocks may be a better strategy for a potentially very long retirement than moving to an all-income portfolio. If you want to know more about investment strategies during retirement, consult with your financial planner.

Share|