Rodger on Retirement

Asset Allocation—One Factor of the "Retirement Calculation" You Can Control!

There are several variables involved in the "retirement calculation," of which a detailed analysis is beyond the scope of this article. With respect to some factors, you have little or no control. For example, it is fairly evident that you have little or no control over market returns and interest rates. We all want the markets to return 12% year in and year out. We also want our CD's to earn 8%. Regrettably, neither of those desires is possible the last time I checked.

Further, you have only limited control over your longevity, or the length of your life. You can certainly influence your longevity by eating healthy foods and getting plenty of rest, in addition to engaging in regular exercise and avoiding smoking. However, if heart disease or some dreaded sickness runs in your family, you may have less ability to influence these variables.

But you do have control over your methods of asset allocation and the types of accounts holding these assets. Asset allocation refers to the percentage of your assets you place in different types of investments. You may choose to be an aggressive investor, allocating a majority of your assets to equities, or you may choose to be a more balanced investor, allocating your assets to a mixture of stocks, bonds and perhaps real estate. The types of investments that you place in different types of accounts, such as taxable accounts versus tax-favored accounts (IRA, SEP-IRA, HSA or Roth IRA) may also have a major influence on the after-tax returns you enjoy in retirement.

Corollaries of asset allocation are portfolio diversification and risk mitigation. There are many different strategies to diversify a portfolio. Some methods are effective, others less so. Your goal is to own a portfolio of assets that complement each other. I have issues with anyone who insists that their diversified portfolio of technology stocks or real estate investment trusts are truly diversified. Keep in mind that, as you approach retirement, your goal is to own a portfolio of assets sufficiently diversified to help mute major market declines. You are not looking for the next big score by having 30% of your portfolio in gambling stocks, biotechnology or the energy sector. Also, you will want to mitigate the risk in your portfolio, but in conjunction with your desired returns. For example, while fixed-income assets (e.g., bonds and CDs) are usually viewed as conservative in nature, a heavier allocation of fixed-income assets in your portfolio might actually expose you to a higher risk of outliving your assets primarily due to such allocation's inability to keep pace with inflation.

No discussion about asset allocation would be complete without touching on the idea of portfolio rebalancing. In the simplest terms; say you had a portfolio that was evenly allocated between just two asset classes—stocks and bonds. At the beginning of the year, you had 50% of your funds in stocks and 50% of your funds in bonds. Let us further assume that at year-end, the stock portion of your portfolio increased by 20% and the bond portion did not increase at all. When you review your statements on December 31st, you would notice that you no longer have an even 50/50 split between your assets. Percentage wise, you would now have more funds allocated to stocks and less to bonds. You will want to discuss with your advisory team how and when you will reallocate portfolio balances so that your portfolio does not stray too far away from its intended weightings, as portfolio allocation might greatly influence the amount of cash flows generated by your portfolio.

In summary, asset allocation is important, controllable and should be reviewed with your retirement planning professional—who is the quarterback of your team!

*Opinions expressed are those of Rodger Alan Friedman. All opinions are as of this date and are subject to change without notice. *Asset allocation and diversification do not ensure a profit or guarantee against loss. Investing involves risk, investors may incur a profit or loss regardless of the strategy or strategies employed. Rebalancing a non-retirement account could be a taxable event that may increase your tax liability.*

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