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How to Retire in a Bear Market

There's still hope if you quit working when markets aren't cooperating

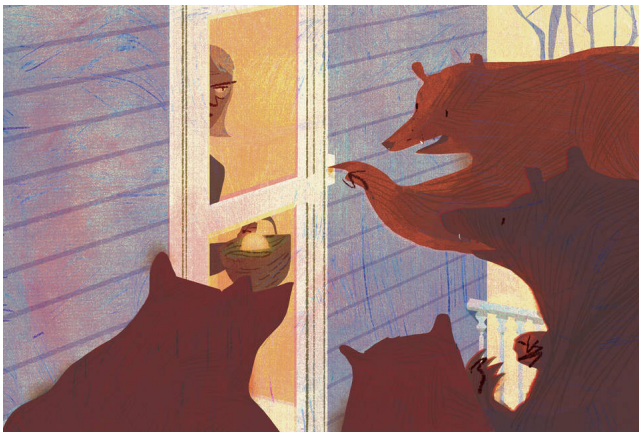


ILLUSTRATION: A. RICHARD ALLEN FOR THE WALL STREET JOURNAL

By **ANDREA COOMBES**

March 6, 2016 10:13 p.m. ET

For the first time in about seven years, investors approaching retirement may be facing one of their biggest financial fears: retiring into a bear market.

Before 2015, the stock market rose for six years in a row, despite many hiccups. Even last year, market averages set highs before sliding, and stocks are still in the red so far in 2016.

Now, savers have to think about “sequence of returns” risk: If they are forced to make withdrawals early in retirement from a portfolio that is declining precipitously, there will be fewer shares left over to benefit when the market eventually goes back up. That, in turn, raises the risk they could outlive their assets.

8 Questions to Answer About Investing for Retirement

Everyone hopes to enter retirement with enough money to pay the bills. The key is understanding how to save and invest long before you retire.



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Obviously, the easiest thing to do is keep working, if you're willing and able to do it.

By delaying retirement, you can avoid withdrawing money when your portfolio is down and continue adding funds to your nest egg. "Those contributions might be especially powerful if you're deploying money into stocks when they're falling," says Christine Benz, director of personal finance at mutual-fund researcher Morningstar Inc.

Many people, however, don't want to—or can't—delay something they may have been anticipating for years. Here, then, are other moves retirees can take to mitigate bear-market risk.

1. Tap a 'buffer' asset

Ideally, retirement savers prepared in advance for sequence-of-returns risk by putting one to three years of income in cash. "If you're using that to spend from, that will keep you from having to invade

your long-term assets when they're at a low ebb," says Ms. Benz.

If you don't have such a cash cushion, pulling money from an asset other than a retirement portfolio is an option—assuming you have other assets, such as **cash in a life-insurance policy** or a home.

In recent research, Wade Pfau, a professor at American College and principal at McLean Asset Management, found that opening a reverse-mortgage line of credit—despite the significant upfront loan costs—can help protect retirees from sequence-of-returns risk. Reverse mortgages let homeowners who are 62 and older borrow against their home, with the loan due with interest when the borrower moves, sells or dies. These complicated loans, which require no monthly payments, have their fans and detractors.

Mr. Pfau's research suggests opening the credit line at the start of retirement, then letting it sit until needed. He describes the upfront loan costs as akin to an insurance premium.

A home-equity line of credit is another option and has lower upfront costs, but retirees without a current income source may not qualify. Plus, with reverse mortgages backed by the federal government (known as Home Equity Conversion Mortgages), the unused portion of the credit line grows over time based on the loan's interest rate, and the lender can't change the amount. That usually isn't the case with home-equity lines of credit.

2. Downsize

Don't like the idea of a reverse mortgage but moving to a smaller home has always been part of your long-term retirement plan? Now may be the time to consider that option, if the home-sale proceeds would help you delay or reduce portfolio withdrawals.

"People may want to 'unlock' what is for many people their biggest asset—their home," says Michael Falk, a partner with Focus Consulting Group Inc. in Long Grove, Ill.

3. Cut costs

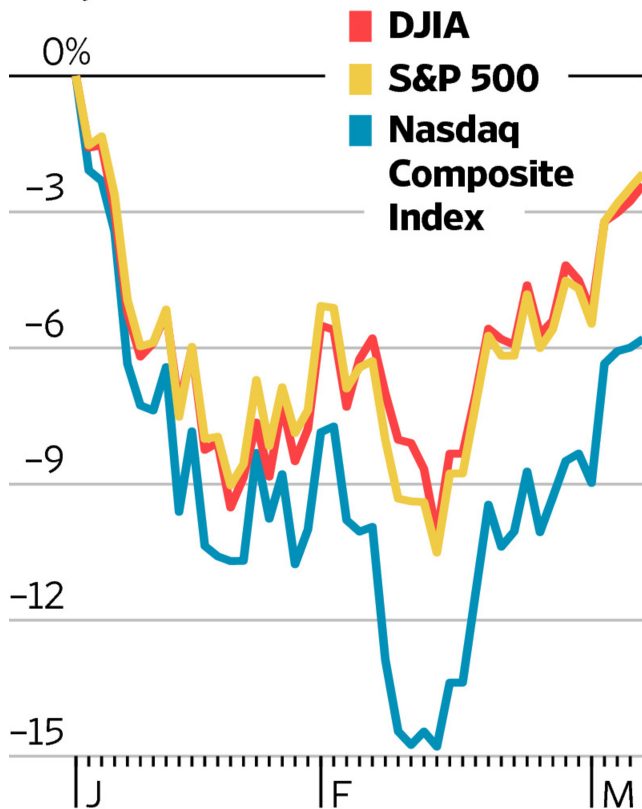
Trim expenses to reduce portfolio withdrawals. "Get in the frame of mind that when times are tough, 'I'm pulling back a little,'" says Tom Fredrickson, a Brooklyn-based financial planner with Garrett Investment Advisors LLC.

Put another way: Adjust your withdrawal rate. The oft-cited "4% rule"—in which you withdraw 4% from your portfolio the first year of retirement and increase that dollar amount each year for inflation—assumes you generally increase spending each year. "Taking less in weak markets and potentially taking more in up markets are strategies to help sustain a portfolio," Ms. Benz says.

It might be tempting to make an early grab for Social Security benefits

Rough Markets

The Dow, Nasdaq and S&P for the year so far.



as a lifeline when markets are in turmoil. Think carefully before doing that.

Your benefits increase by about 8% annually each year you wait up until age 70, says Gordon Bernhardt, president of Bernhardt Wealth

Source: FactSet

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Management in McLean, Va. That higher dollar amount “could also benefit a surviving spouse if we assume the spouse with the higher income delays collecting his or her benefit and predeceases the other.”

4. Lock in income

How about exiting the stock market entirely—and permanently?

Mr. Pfau describes a strategy of “funded ratio management,” in which you look at your funded ratio—all of your assets and income against your total spending needs through retirement. (This requires calculating the present value of both your future Social Security benefits and other income sources, as well as future liabilities.)

If a plummeting portfolio has you headed into the “retirement at risk” zone, “it could be reasonable to bail, to lock in your income and avoid the risk that maybe the market will fall another 10%,” he says.

There is no hard-and-fast rule about when to make that jump, Mr. Pfau says. “If you’re at 135% funded, you’re in pretty good shape. But if,

with market declines, you start getting down to 110 or 105, you might want to think about locking in.”

One option is to move the money you had in stocks into an annuity.

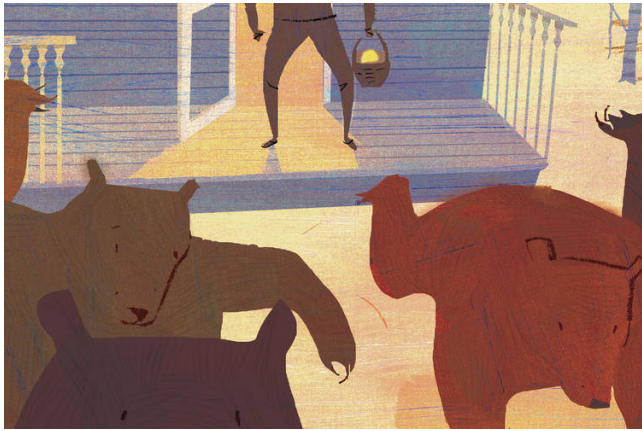
“You give up future upside and you’re also eliminating future downside,” he says.

You may be selling low but it isn’t because “you freaked out and panicked,” Mr. Pfau says. “It’s because you are realizing that, if you want to maintain your lifestyle, it’s time to lock it in.”

5. Shop carefully

Stocks are on sale, right? Sure, but they might get even cheaper, warns Ms. Benz. “The energy sector is probably a great example. A lot more could go wrong before things get better.”

If you’re bargain hunting, she says, make sure “you have an appropriately long time horizon and that maybe you’re offsetting those names you’re buying with more defensive positions.”



Keep

ILLUSTRATION: A. RICHARD ALLEN FOR THE WALL STREET JOURNAL

diversification in mind, too, Ms. Benz says. Rather than making a big bet on one company or a single-sector fund, consider a value-oriented stock fund or exchange-traded fund for “broadly diversified exposure to unloved sectors,” she says. And review your holdings before you start buying into deals. That energy ETF you’re eyeing? The manager of your value-oriented stock fund might be focused on the energy sector, too, Ms. Benz says. “Check to see what your weighting there looks like.”

Finally, she says, “dollar-cost averaging into positions can help ensure a range of purchase prices in case some of these unloved holdings fall further still.”

6. Don’t panic

This is also known as: Stick with your investment plan. For investors with diversified portfolios, their losses “aren’t nearly as big as the market,” says Rick Kahler of Kahler Financial Group in Rapid City, S.D.

“These dips are to be expected.”

What’s more, it’s never a good idea to manage investments based on headlines. You’ve read the U.S. may be heading into a recession? Don’t make portfolio changes based on that fear because you’re too late, says Charlie Bilello, director of research at Pension Partners LLC in New York. “By the time they hear about the recession in the news, the markets are already pricing that in.”

7. Don’t believe everything you hear

That said, just because everyone is saying something doesn’t mean it is right for you. Take the idea that you shouldn’t sell in a down market. Generally, that makes sense—but selling might be the right decision for you, depending on your individual circumstances, Ms. Benz says.



For the first time in seven years, people getting ready to retire are doing so after a down year for the market. PHOTO: ISTOCKPHOTO/GETTY IMAGES

“If you’re 64 and you have an 85% weighting in equities, maybe lightening up on equities is the right answer for you,” she says.

Of course, if you can tolerate the volatility financially and emotionally, waiting is usually more prudent, says Mr. Bernhardt. “If their portfolio needs to be adjusted to fit their risk profile, I’m going to try to discourage them from making it during this market downturn,” he says. “Let’s wait for a rebound.”

8. Consider a Roth conversion

There can be silver linings to a bear market. It might be a good time to shift assets from a traditional individual retirement account into a Roth IRA. Since Roths are funded with after-tax dollars, taxes will be due on the amount converted. However, the saver will be able to make tax-free withdrawals from the Roth after age 59½.

PREVIOUS COVERAGE

- How to Survive a Bear Market (<http://www.wsj.com/articles/how-to-prepare-for-a-bear-market-in-stocks-1425870192>) by E.S. Browning (March 8, 2015)

“The idea is that there’s a selloff and then over a period of time, it floats back up and you get the benefit of that account without having to pay taxes on the amount that it grew by,” says Garrett’s Mr. Fredrickson, who advises converting only assets you don’t need immediately.

Still, think carefully about the tax bill if you don’t have any money set aside, warns Mr. Pfau. Selling stocks at a loss to pay the conversion tax bill, he says, is “amplifying the sequence risk.”

Ms. Coombes is a writer in San Francisco. She can be reached at reports@wsj.com.

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