How Does Investing Change in Retirement?

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Of all the dentists I have met in the past twenty years, all but nine will be living from a portion of the capital in their portfolio. In other words, their nest egg will not produce enough income to finance their retirement lifestyle alone. They will also be "eating into" their savings. This isn't necessarily a bad thing. You worked hard for the money and should enjoy it in retirement.

The issue is that in order for your nest egg to outpace inflation, you need exposure to the stock market. Bonds, GICs and annuities are simply paying too little to keep pace with inflation. Since you will have exposure to the stock market, there will be times your portfolio is down. This exposes you to the "Sequence of Return Risk".

What is the Sequence of Return Risk?

Sequence of return risk is the danger that while your investments may provide a good long-term average return, the order in which those returns are received annually has a negative effect.

Take the chart below as an example. It would appear that you would have been better off investing in the stock market, the S&P/TSX Index – XIU with its average annual return of 8.06% rather than the bond market, the Bond Index – XBB with 6.16%.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
S&P/TSX Index - XIU	(14.90%)	(14.00%)	25.30%	13.60%	26.10%	18.90%	11.00%	(31.17%)	31.94%	13.84%	8.06%
Bond Index – XBB	5.80%	9.80%	6.20%	8.10%	6.10%	3.70%	3.30%	6.41%	5.41%	6.74%	6.16%

However, look at the chart below. If you invested $100,000 in both securities and started withdrawing 8 percent of the portfolio annually, you would have actually been better off in the bond market, XBB.

	Stocks XIU		Bonds XBB	
Year	Annual Return	Portfolio Value at Dec 31st	Annual Return	Portfolio Value at Dec 31st
		$100,000		$100,000
2001	-14.90%	$78,292	5.80%	$97,336
2002	-14.00%	$60,451	9.80%	$98,091
2003	25.30%	$65,721	6.20%	$95,677
2004	13.60%	$65,571	8.10%	$94,778
2005	26.10%	$72,597	6.10%	$92,072
2006	18.90%	$76,806	3.70%	$87,183
2007	11.00%	$76,375	3.30%	$81,796
2008	-31.17%	$47,063	6.41%	$78,526
2009	31.94%	$51,539	5.41%	$74,341
2010	13.84%	**$49,565**	6.74%	**$70,813**
			Better off	**$21,248**

After 10 years, the value of the portfolio invested in bonds is higher by $21,248

Why is that?

If your portfolio declines and you withdraw money, there are fewer dollars available to participate in the recovery.

How the Wise Dentist Invests ...

These charts illustrate two important tenets that should be at the foundation of your investment strategy.

1. Investing at this stage is not about getting the best return, it is about getting the most consistent return.

2. The greatest risk you face isn't that the stock market will decline. It is that the stock market will decline and you will need to sell out to fund your retirement.

Introducing the 4-year Rolling Reserve

Here is the conundrum;

a. With interest rates at historic lows, you cannot buy an annuity or invest in a GIC or government bond and expect to outpace inflation. As such, you need to have exposure to the stock market.

b. However, it is a well-known fact that at certain times the stock market will decline and even crash. Remember 2008?

c. You need to take a consistent dollar amount out every month to finance your retirement cash flow.

At McNulty Group, our clients have faced this problem for decades and it is the reason we created the 4-year Rolling Reserve. To do this, we looked at the rolling annual returns of various stock markets since 1950. By rolling annual returns we mean January 1, 1950 – January 1, 1951, January 2, 1950 – January 2, 1951 etc. There were many corrections and crashes in this period. However, we found that the times that the various stock markets remained in a negative position for more than four years amounted to a miniscule percentage.

The wise dentist knows which account his/her retirement spending money is coming from for years to come. If you ensure that the money is set aside for four years in those accounts, then you mitigate the risk that you will retire during a bear stock market. You will also realize that the money that is invested in the stock market has years to recover from any potential corrections or stock market crashes.

Granted, you will earn very little interest on the money set aside in money markets or short-term bonds for four years, but we consider this lost earning ability to be an insurance premium so that you will always have your retirement paycheque.

Feedback can be sent to info@mcnultygroup.ca

Mark McNulty is President of McNulty Group of Raymond James, a firm responsible for managing more than $375 million of Ontario dentists' retirement savings. McNulty Group helps professional families transition from a life of successful practice to a stress-free retirement. Mark is the author of The Transition Coach 2.0—A Canadian Dentist's Guide to a Perfect Retirement, and the $6 Million Dentist: Successful Succession in 7 Modules. In 2017 Mark was chosen as the Canadian Financial Advisor of the Year at the Wealth Professional Awards. For more information please visit www.mcnultygroup.ca

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