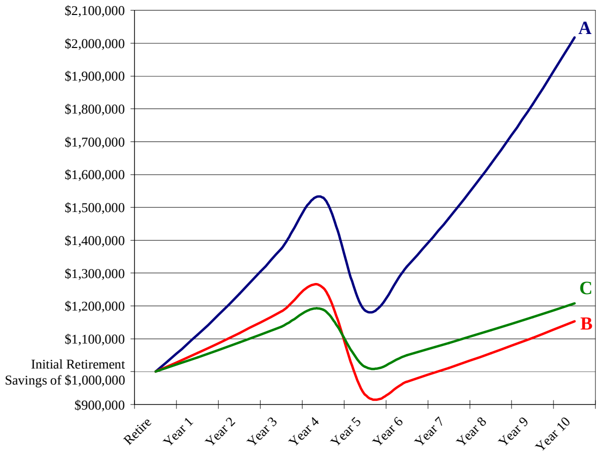
LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

Increasingly, researchers explore the question, should the investment approach used by someone accumulating retirement savings and a retiree facing the dilemma of spending their retirement savings differ? Someone accumulating retirement savings has time on their side and the opportunity to make additions to their savings. Conversely, the retiree must accept that time is not on their side and there will be no additions, only withdrawals. The performance of the stock market during the accumulation years of many current retirees has strengthened a belief that avoiding risk leads to sub-par returns and less money to enjoy during retirement. For the retiree, however, there is growing evidence that emphasis on maximizing return should be tempered with an increasing aversion to the consequences of loss.



A simple linear example can illustrate why this shift in thinking is important. Over 78 years of market history, the average return for large-capitalized stocks was 11.2%, for long-intermediate bonds it was 7.7%, while the rate of inflation was 3.1%. Historically, significant downturns in the stock market erased the returns of the previous two years. The chart on the left displays three scenarios using the above criteria, and the assumption of a significant downturn in the fifth year.

Line A shows that for a person still accumulating retirement savings—by investing entirely in stocks—the impact of a significant downturn in the stock market becomes a distant memory. Even without additional savings, the $1 million initial value of the savings doubles by the end of the 10-year period.

It is a different story for a retiree using a similar investment approach. To maintain a lifestyle supported by $50,000 (adjusted annually for inflation), the retiree must withdraw from the retirement savings regardless of the market's decline. Line B displays how this single downturn keeps the value of the retiree's savings from regaining its previous high mark. If the next ten years are similar, the retiree's savings will not improve. Add a *minor* downturn that only erases one year of the stock market's performance any time during the two 10-year periods and regaining the initial value of the retiree's savings becomes unattainable.

Line C displays what happens if the retiree initially selects a more balanced approach with the retirement savings. With 60% in stock and 40% in bonds, the market decline is subdued. Although the high mark attained with this different approach does not exceed the one attained by initially investing the entire savings into stock, the retiree's savings grows to a new high mark and exceeds the value of the all-stock approach by the end of the ten-year period.

The model used for these three different scenarios is admittedly simple. The truth is, simulation studies using actual annual data for the current century and most of the past reveal the situation can get much worse. This is especially true when a retiree encounters a period of extremely volatile annual returns or when hyper-inflation causes the ongoing distributions for maintaining the retiree's desired lifestyle to erase much of the investment returns. That is why our investment approach to a retiree's savings includes an added focus to the consequences of encountering difficult markets.

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