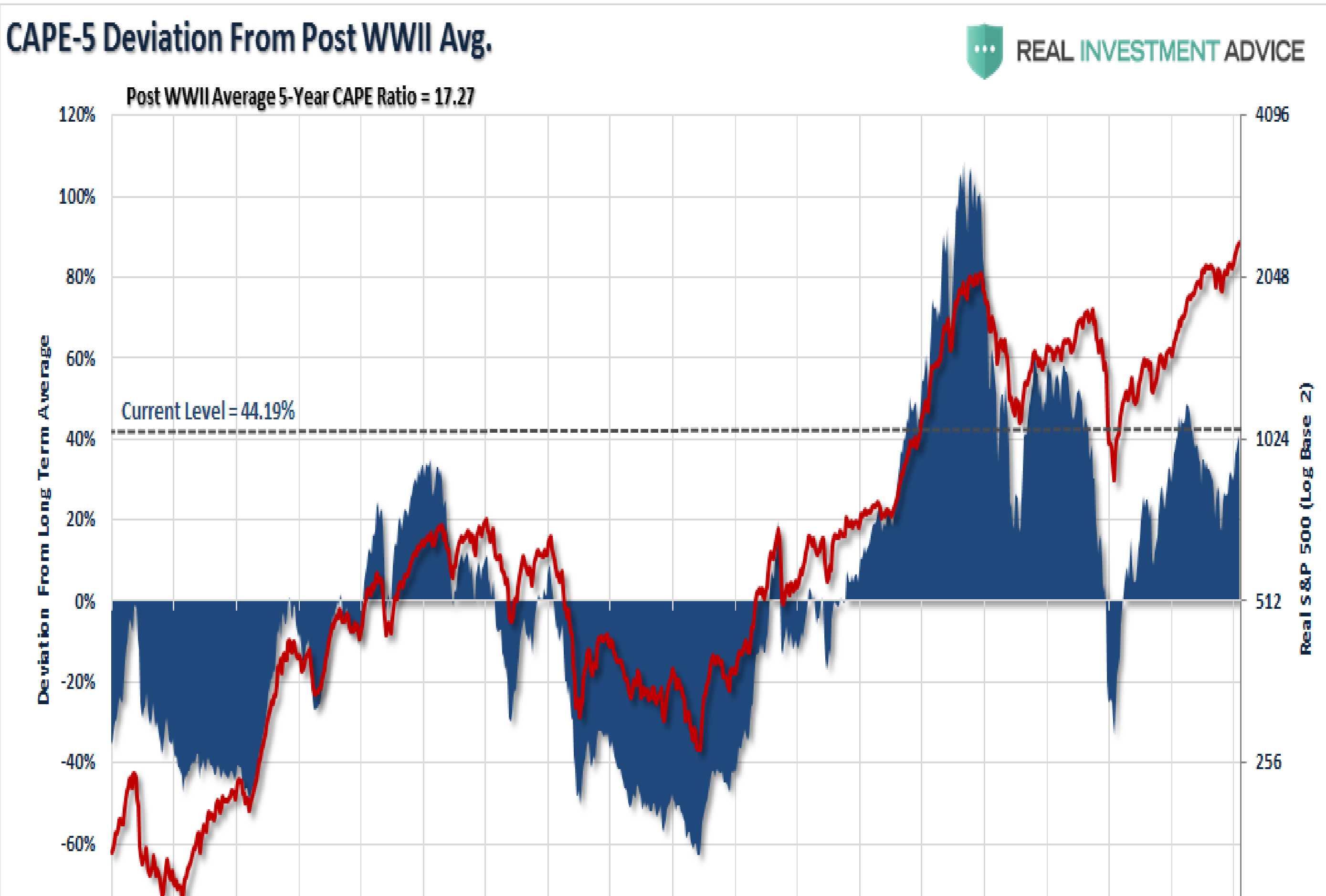
Financial planning industry thought leader Michael Kitces CFP•, CLU•, ChFC•, RHU, REBC and professor of retirement income at the American College Wade D. Pfau Ph.D., CFA, penned a seminal work for the Journal of Financial Planning titled "*Reducing Retirement Risk with a Rising Equity Glide Path*." ?During the accumulation stage as personal wealth is building and human capital potential is high, a financial planner will assess risk attitude, time frame, and create a portfolio asset allocation accompanied by a method to rebalance on a periodic basis. **I call this ?Plan A? for accumulation.•**In addition, an ongoing saving and investment plan needs to be fine-tuned and monitored to help a client achieve an important financial life benchmark such as creating an inflation-adjusted income stream that will continue throughout a 20 to 30-year retirement period. It?s customary for a financial professional, depending on individual circumstances, to reduce portfolio equity exposure as a retirement date approaches and ostensibly increase the allocation to conservative selections like fixed income (bonds) cash and ultra-short duration bond holdings earmarked as reserve for withdrawals. Is this the right thing to do? **On the surface, the portfolio strategy appears to be effective; it?s appropriate to shield a retiree from future *(or current)* unfavorable stock market conditions and the subsequent time required to recover from an**

unfavorable sequence of market returns *(below-average or negative)*, especially in the face of periodic portfolio withdrawals.•However, the common tendency for planners to ***maintain a reduced exposure*** to equities as the retiree ages can be a mistake per the analysis. From experience, financial planners have a tendency to decrease equity exposure in retirement portfolios as life expectancies and time frames shorten. According to the research, this common tactic of employing a declining equity glide path can generate worse results than maintaining an ongoing, reduced allocation to stocks. Reducing equity exposure over time is a very common ?Plan B? strategy. *B stands for boring*. Planners don?t intend for retirees to deal with the distress and loss of wealth that can occur with an aggressive allocation to stocks so boring is appealing. Retirees feel vulnerable enough as their human capital or ability to generated wage income decreases and they need to depend on the portfolio to satisfy living expenses. **The study results are counterintuitive to traditional thinking**: To maximize the level of sustainable income in retirement, it appears best to?*raise*?equity exposure throughout retirement. Retiree portfolios that begin with a 20-40% allocation to stocks and increase to 60-80% generally increase the success of retirement income sustainability and reduce the impact of shortfalls compared to static rebalanced asset allocations. The heart of Kitces? and Pfau?s research is ?Plan U? (for unorthodox in my opinion) ? or a ?U-shaped? allocation. Here?s how it works: Stocks are a greater share of a portfolio through the accumulation/increasing human capital *(earning power)* stage, decrease at the beginning of retirement, and then increase as a lifecycle strategy throughout the retirement period. Intuitively, the ?U? makes sense. I have been employing this U-shaped glide path since 2001. I implemented it initially based on the loss I felt clients could experience as they retired in the face of lofty price/earnings valuations for stock markets during the dot-com boom. I also believed we were at the beginning of a secular sideways market cycle reminiscent of 1966-1982. I never discount luck when I make an accurate assessment of the macro-environment. The process keeps me humble and open-minded to change when cycles do. Today, before clients retire, I analyze stock market valuation using the?Lance Roberts? [CAPE 5- Ratio] as a method to estimate investment, specifically stock market risk a retiree will experience for a given level of return. Based on the analysis, stock returns will be driven by headwinds which comes down to increased odds of lower forward returns. Based on Lance?s post-World War 2 CAPE-5 average of 17.27x and a current deviation of 44.19% above the historical earnings average, it makes sense for those 5 years or sooner from retirement to reduce equity exposure in preparation for retirement.



Prospective and new retirees can tempt fate by maintaining an aggressive portfolio stance. However, keep in mind, once distributions begin, investments must be closely monitored and a sell discipline enforced. Stocks should be trimmed into market strength to keep the cash bucket full and avoid a forced liquidation of investments through periods of market weakness. For investors brave enough to take on this portfolio risk, there have been only three times over the last 70 years such a deviation has been experienced: 1996, 2003 and 2013. I personally believe this is a gamble you should walk from. Although valuation metrics like Lance?s are far from perfect when it comes to short-term market performance, I would rather err on the side of caution. Per the study, I feel better about the occasional underperformance in the face of sequence of returns risk, especially during the first decade of retirement.

> *?As Kitces (2008) showed, in the case of a 30-year time horizon, the outcome of a withdrawal scenario is dictated almost entirely by the real returns of the portfolio for the first 15 years. If the returns are good, the retiree is so far ahead relative to the original goal that a subsequent bear market in the second half of retirement has little impact. Although it is true that final wealth may be highly volatile in the end, the initial spending goal will not be threatened. By contrast, if the returns are bad in the first half of retirement, the portfolio is so stressed that the good returns that follow are absolutely crucial to carry the portfolio through to the end.?•*

The researchers placed an academic stamp of approval on what I?ve been doing for years to help clients emotionally deal with stocks through a period they feel most vulnerable to not only market, but big life transitions. Once retirees have confidence in their retirement plans, many are amenable to adding equity exposure back into the allocation. Some are reluctant. As a retiree, how do you deal with the findings? Academic-based analysis is one thing, adding stocks to a portfolio during retirement when you feel psychologically or vulnerable to household financial shocks, is another. A behavioral cheat sheet is in order to follow the advice laid out by the researchers: **1). Decrease your stock exposure the first year in retirement and don?t worry about missed opportunities** . Focus on your overall emotional state which may change as you move from an accumulation to portfolio distribution mindset. You?ll experience what I call *?the black hole.?* A period immediately after retirement where you?ll feel a bit displaced and not in control over your future. This time of uneasiness ostensibly fades as cash-flow mechanisms are put into place and new lifestyle habits emerge. Special attention should be paid to monitoring household cash flow, budgeting, fixed expense (rent, mortgage) coverage and the worrisome mental impact I?ve noticed that goes along with establishing systematic, tax-effective portfolio withdrawals to re-create the paycheck in retirement. In other words, focus on the issues that create uncertainty (don?t let greater stock exposure add to stress), pay special attention to the basics and monitor progress with a financial partner or objective party at least every quarter. Each step, if completed successfully, will build confidence and help you feel in control of the present situation. The first year of retirement should be a time to step back from stocks when you feel most unsure about your personal financial footing. **2). As you build confidence, increase equities when valuations are favorable**. Depending on your circumstances? including your systematic withdrawal rate, coverage of household expenses and how the portfolio has progressed?consider increasing equities beginning year three. After two years of analysis, education and monitoring, I have discovered clients gain enough confidence to add additional stock exposure to their asset allocation programs. **3). Gain an understanding of how to maximize Social Security**. Social Security is difficult to grasp. Deciding how and when to claim benefits are crucial decisions especially when spouses are involved. To gain an understanding of the present value of your estimated benefits and to run different scenarios to maximize what?s available, ask your financial advisor to help you crunch the numbers. Recently, I was able to add stock exposure for a client after we increased total lifetime Social Security by postponing the receipt of benefits until age 70 for the higher wage earner. Social Security can be considered part of a fixed income allocation thus allowing you to expand your allocation to stocks throughout retirement. **4). Life expectancy. The conundrum.?**Obviously, nobody has a crystal ball when it comes to life expectancy. A decade ago a client ?predicted? he?d be ?gone in five years.? He?s still here and healthy. We held 30% in equities ten years ago. Today his portfolio equity allocation is at 45%. Those in good health and long life expectancies in their families also have additional time to weather out stock market volatility. Want to estimate how long you?re going to live? Go through the 40 questions at?www.livingto100.com which uses the latest research and medical data to estimate how old you?ll live to be. Clients with good health habits are amenable to adding equity exposure over the years. Their optimistic attitude and active lifestyle motivates them to believe that living to 100 is achievable ? therefore achieving returns above inflation is important to them. **5). Remain sensitive to your portfolio withdrawal rate**. An unfortunate series of portfolio returns during the first half of retirement can result in a fast, unrecoverable depletion of wealth in the second half. To stay on track and remain confident in a plan to boost equity exposure, complete a portfolio withdrawal rate checkup every two years. Total your cumulative net gains minus withdrawals. If a surplus exists, which means you?ve experienced more gains than withdrawals, move forward and increase your equity exposure. Work with your financial adviser or planner to determine which equity asset classes require additional exposure. Over the last three years, the retiree portfolios I?ve examined share common themes ? They are over-weighted in large-cap U.S. stocks and bonds and underexposed to international equities. Increasing equity risk to ?make up? for a deficit (you?ve spent more than you?ve gained), is a big mistake. In this case, a complete assessment is needed to review expenses, the current market environment and future withdrawal rates before stocks are increased. The research in this study will prove to be a game changer regarding how retiree portfolio asset allocations are constructed in the future. Most important are the methods employed to ease into equities which include enhanced sensitivity to the emotional state of clients, possible addition of annuitization strategies and consistent monitoring of household cash flows. Last, the financial services industry will need to be up for the challenge of breaking free from much of the outdated thinking which feeds and nurtures it. T The study mentioned and others by Kitces and Pfau, are breaking ground for fresh thinking in the retirement income distribution arena.