Bear markets characteristically align with economic contraction. In his seminal tome ? *?Anatomy of the Bear ? Lessons from Wall Street?s Four Great Bottoms,?* which should be required reading for advisors and professional investors, author Russell Napier provides comprehensive analysis of market where stocks cycle from overvalued to undervalued (14 years on average) coupled with chronological events which marked bear market bottoms of 1921, 1932, 1949 and 1982. Mr. Napier found that economic and market troughs occur together which busts a popular myth that stock market activity leads the economy by six to nine months. In fact, the economy can lead the stock market perhaps because investors wait for validation that the economy is undergoing a sustained recovery or central bankers are riding in with liquidity reinforcement. Per research conducted by the Center on Budget and Policy Priorities (CBPP.org) on the Great Recession, U.S. economic recovery began in June 2009; the stock market bottomed only three months earlier thus validating how the economy and markets are a capricious couple.

The professionals are doing their homework, opining as to the reasons behind the market sell off; we share those insights daily at Real Investment Advice. However, although I?m interested and participate in the research, along with my colleagues the primary concern is to stem the damage to client wealth. Those close to or in retirement who are primarily dependent on variable assets like stocks and bonds to provide a steady retirement income paycheck, are in greater peril when face-to-face with the bear. The financial industry showers accolades on investors who earn their stripes by riding markets to bottoms and maintain discipline to wait the time it takes to recover. Per Greg Morris in his book *?Investing with the Trend: A Rules-Based Approach to Money Management,?* on average it takes 6 years to recover a 20% loss in the S&P 500. If you?re 25 and accumulating assets, I understand the ?*be bold to hold?* mentality although I disagree. Risk is risk. Risk knows no age. A favorable risk-reward profile in markets benefits all investors; a less favorable risk-reward scenario damages all. •The axiom that more risk portends greater returns is one of the most stalwart of financial industry myths. At 65 years-old and in distribution mode, a 20% loss along with the recommended withdrawal rate of 4% creates a scenario which places long-term financial security and future cash flows in jeopardy. So, for those in retirement or seeking to retire within the next five years, here is your bear market three-point awareness list:

Inflation isn?t your greatest threat; principal erosion is the enemy.

Inflation gets cast as the eternal villain in your retirement plan. It?s a ruse. The inflation boogeyman's motive from a financial industry perspective is to maintain portfolios over-allocated to stocks just to collect managed account fees. Academic studies coupled with personal experiences with clients who have been in distribution phase for two decades, have encouraged me to dig deeper and chronicle retiree spending habits. I have yet to encounter a retiree who requests every year an increase in distributions by the rate of inflation. Sure, lump sum withdrawals are taken for large expenditures like new automobiles or big trips, especially during market periods such as last year when significant profits were taken. I've coined this spending outside of day-to-day expenses as ?bonus spending.? Unlike recreating a paycheck in retirement to take care of everyday needs, the big expenditures occur when stock allocations prosper, and profits are harvested. If you must pick a sword to fall upon during bear markets, don?t fret over inflation. Fret over eroding principal. Bleed a little over 2% inflation; or watch wealth hemorrhage if you follow dangerous and popular financial dogma such as ?sit tight? or ?they?re only losses on paper.? Do the math. Trust your gut. The bear market of 2007-2009 saw the stock market drop 57% in 17 months. Bear market price declines average 43%. *It?s not too late to safeguard your portfolio*. Some of the strongest counter-trend market bounces occur during bear markets, therefore you?ll be provided numerous opportunities to sell stock holdings at better prices. In addition, an all-or-none strategy to liquidate all stock holdings has proven to be ineffective. Consider maintaining 10-20% equity exposure throughout the cycle if possible.

Monitoring annual withdrawals and the willingness to alter them begins NOW.

Based on all the perilous narratives pervasive in the financial services industry, it may be a challenge for retirees to understand that a systematic withdrawal rate from variable assets requires surveillance and the willingness to make changes to preserve portfolio longevity. Lifetime, predictable income can only be safely derived from Social Security, pensions, immediate annuities, and as income riders applied to various types of annuities. In other words, volatile assets such as stocks require retirees to monitor annual withdrawals and take corrective actions if warranted. James B. Sandidge, JD in his paper *?Adaptive Distribution Theory,?* for The Journal of Investment Consulting, describes The Butterfly Effect for retirees. The effect refers to the ability of small changes early on in a process that lead to significant impact later. Depending on the length of this bear and damage incurred, systematic withdrawal rates may need to stay the same (do not increase cash flow requirements in any year during the first 5 that has a negative return) or reduced altogether. In 2008-2010, I had distribution clients tap alternate sources of income including reverse mortgage lines of credit and policy loans against permanent life insurance policies. In 2011, we used portfolio gains to pay off these credit sources. In January of this year, I adjusted returns down for every asset class (less for international and emerging markets), in our financial planning software. We've been having the discussion with newly-minted retirees that stocks may face a generational headwind along with heightened volatility and adjusting expectations accordingly. We examine rolling three-year portfolio withdrawals vs. overall portfolio progress and income production. One of our responsibilities is to make sure retirees in distribution mode understand the investment terrain and can adjust accordingly.

Try not to panic. I know. Easier said than done.

Portfolio erosion can cause great distress, especially for newly-minted retirees who require withdrawals to survive. I?m not going to minimize the scary feeling. I respect it and believe in the awareness stress creates. However, utilizing emotions instead of rules to exit markets can jeopardize the health of your portfolio. It?s understandable if the volatility is just too much. In that case, selling stocks down to a level that allows you to become less emotional is acceptable. Make sure to discuss an exit strategy with your financial partner. If advised to hold on for the long term, or your requests for liquidation are minimized, then it?ll be up to you to take control and do it yourself. At the least, seek out a second opinion immediately. Preferably from a registered investment advisor and fiduciary such as Clarity. As I wrote for RIA back in October:

> *One lesson to never forget: Markets can and do indeed prosper during tough economic cycles due to fiscal and monetary stimulus. Markets falter when rates increase. As the Fed continues to drain liquidity from the system, target a neutral rate, normalize*

> *(whatever that is), all of us as investors may finally understand how painful it can be for stocks, again.*

I continue to stand by this premise.