Retirement mistakes. In Part-1, we explore the mistakes that investors make due to bad advice, poor research, and emotional distress.

> *"The art of a happy retirement is in the creation of meaningful circles and the beauty of the variations among them. It?s a consistent rotation around sources of fulfillment and purpose that create a force of their own. In that moment, the art of living emerges.? Rich Rosso.*

The internet teems with irresponsible retirement advice. Guidance for retirees and those planning for retirement is often wrong. Financial pundits fail to distinguish wealth accumulators or those still working, from people who depend on portfolio distributions to meet household spending needs. The genesis of mainstream financial advice came during the most significant bull market in history. For some reason, the rules never changed. They remained rarely challenged. As most readers know, our writers challenge the status quo daily and have been doing so for years. We are witnessing in real-time, a Main Street economic crisis that rips a large hole in the ability of most Americans to save and attain a secure retirement. These rules ensure investors, including retirees, take on as much stock market risk as tolerable regardless of long-term valuations, risk vs. reward conditions, and portfolio withdrawal rates required to meet household expenditures. Stocks are seemingly the solution to every retirement pitfall. Sadly, as the pandemic lingers on, our financial planning team witnesses first hand how once-successful retirement plan scenarios, fail. Formal plans, primarily created by brokerage firms and their salespeople, have collapsed from 90%+ probability of success to 40%. It comes down to a sad fact: Lives have changed. ***We are helping to put them back together.***

Why Did This Occur?

Continued unwarranted optimism over future returns for stocks, the failure to consider how equity valuations matter over five to ten-year cycles, inability to showcase how a series of adverse performances, especially early in retirement, can negatively affect success over a lifetime, and aggressive asset allocations; too aggressive for those three to five years from a significant life change. In 2018, we adjusted variables in our financial planning software to reflect lower future returns for every asset class. Also, we match inflation to specific goals, such as out-of-pocket healthcare costs. We monitor changes, update accordingly. It's an ongoing responsibility as fiduciaries. In Part 1, I've identified the common mistakes our team observes. More coming in Part 2.

Risk #1: Failure To Understand "RISK MITIGATION"

People close to or in retirement must make risk mitigation a priority. No longer money-making, earnings machines, retirees should mentally alter their mindset from one of accumulation to distribution. Retirement is the cycle of life where the tree of wealth grown and nurtured over decades requires the harvesting of the fruit. Indeed, the tree of wealth continues to bear fruit. However, retirees don't plant new trees. Well, money ones, anyway. Recognition of risks real or possible, with a plan to tackle them, are crucial to survival. **Market risk, emotional risk, health risk, long-term care risk, longevity risk, are all critical to consider.** Several mitigated. A holistic financial plan, along with an intuitive, studied advisor, can help tenured and newbie retirees identify and tackle the risks that weaken or kill the tree of wealth.

Risk # 2: Lack Of Mental Preparation For Crossover Risk.

Crossover risk, the emotional toll of walking the bridge from career and earnings to one that depends on wealth accumulated, can be as shaky as walking a rickety suspension crossing between two mountain tops. The Passu bridge in Pakistan reminds me of conversations I have with new retirees, especially men, about crossover risk. Those who form a vision of retirement, and develop the nuts and bolts blueprint on how to get there, consider the Passu to retirement an experience. Men, especially after their careers are over, find they've lost some of who they are, a sense of purpose. They feel invaluable. Depression is palpable. Women appear to be more resilient and willing to accept change. I've witnessed spouses help their partners cross over and act as coaches to make the transition easier. In the age of pandemic, when a growing number of tenured employees find themselves suddenly faced with unemployment and tough financial decisions, those who envisioned and created an exit plan years ago, tell me how seamless the transition has been so far. It doesn't mean they like it; it means they've mentally and financially prepared for the risk. They've considered the qualitative elements necessary to remain social and viable. They have concrete plans to continue contributing to their communities, families, and society as a whole.

Passu

Oh, and about Passu. Per a traveler's blog:

> The Passu bridge is made of roughly cut, bumpy pieces of wood, and the gaps between them are random and sometimes scarily wide. it?s like something straight out of an Indiana Jones movie. A human should be able to make it across safely as long as they hold on tight and keep their wits about them, but for a smaller, four-legged animal it would be impossible. I witnessed this first hand when I saw a local man approach the bridge with a goat. If the man had tried to carry the goat across in his arms, he would not have been able to hold on to the ropes to steady himself, so that wasn?t an option. What he did instead was ingenious. He used ropes to tie the goat?s front left leg and back left leg together, creating a loop. After doing the same with the goat?s two right legs, he put his arms through the two loops and wore the goat on his back like a backpack, with the legs serving as shoulder straps.

Risk #3: A Holistic Financial Plan Doesn't Exist.

I know. Sounds boring. When people think of plans, they think investments. A plan is much more. Unfortunately, the media trains the masses to think this way by the financial services industry that treats financial plans as loss leaders and generate them for free to forge a so-called 'legit' path to commissioned product. To believe a financial plan is only about investments is like enjoying one layer of a luscious seven-layer cake. It's short-sighted. A financial plan, properly designed, will expose those risks a retiree can absorb and those that require transference to an insurance company. A holistic plan should be a function of the financial life benchmarks one seeks to achieve.

- ***Begin with needs. They are the priorities. How much do you require for rent, mortgage, insurance, for example?***
- ***Then, wants: The fun stuff and other expenses are secondary benchmarks to strive for. Day trips? A second home?***
- ***Last are your wishes: GO for the gusto! List the big bucket list items. Can your plan handle them?***
- ***The responsibility of you and your planner is to come up with a workable, personal plan that works. It's a give and take. You must remain flexible to be successful.***
- ***Perhaps it'll take saving 10% more a year, downsizing, working two more years. Regardless, an action plan needs to be created, worked, and monitored.***

Risk #4: Can't Say "No" To Family

It's a harsh lesson for some, but once learned, never forgotten. There's nothing inappropriate about boundaries and saying "no" to obligations that may place personal financial security in jeopardy. For example, we witness parents who extend themselves to co-sign for children. We know of those who lend to friends and family members only to be disappointed when meeting loan obligations fail. It's acceptable to establish in a household budget, charitable intentions, and gifts; it's honorable to help people you love who are in need. However, it's best to understand upfront what the financial impact on your situation is going to be. Know your boundaries and adhere to them. If you say 'no' enough, others will respect them, too. During the pandemic, retiree parents are aggressively providing financial support to parents and grandchildren. Those close to retirement are postponing to assist extended family makes it through. While honorable, it's best first to understand the impact of the decision on your situation.

Risk #5 Being Overly Aggressive To Make Up "Lost Time"

With stocks at 30X earnings based on Bob Shiller's CAPE 10, investors in aggressive **STATIC** portfolios or overweight to stocks, are taking a significant risk when compared to the future returns they'll achieve. At RIA, our portfolios are **dynamic**. We employ a strict buy and SELL discipline. Our 60% allocation to stocks can reduce to 10% or increase to over 70% based on conditions we monitor daily. Most money managers instruct investors to 'ride out,' bear markets, which may be excellent for accumulators. For retirees who depend on their portfolio to survive, a bear cycle can significantly reduce portfolio withdrawal rates (more on this topic in part 2).

> ***Remember retirees ? it?s not stocks for the long term, it?s stocks for YOUR TERM.***

Don't be blinded by the panacea over stocks. Markets are irrational. Emotion drives markets. Currently, twenty-something 'investors' who trade on platforms like Robinhood, suffer from overconfidence bias as they consider themselves 'market mavens,' when it's a Fed liquidity-fueled phenomenon. For now, this is the reality of greed. **Even the father of Modern Portfolio Theory, Harry Markowitz, wrote his seminal thesis originally for institutions, *NOT people*. The financial industry highjacked his work to sell a product. Plain and simple.** Unlike the cancerous dogma communicated by money managers who boldly state that in the long-run, stocks are safer than cash, stocks are *not less risky* the longer you hold them.

Failure Of Academic Research

Unfortunately, academic research that contradicts the Wall Street machine rarely filters down to retail investors. One such analysis is entitled "*On The Risk Of Stocks In The Long Run,"* by prolific author Zvi Bodie, the Norman and Adele Barron Professor of Management at Boston University. In the study, he busts the conventional wisdom that the riskiness of stocks diminishes with the length of one's time horizon. The basis of Wall Street's counter-argument is the observation that the longer the time horizon, the smaller the probability of a shortfall. Therefore, stocks are less risky, the longer they're held. Well, then it should be plausible for the cost of insuring against earning less than the risk-free rate of interest to *decline as the length of the investment horizon increases.*

Calculating The Shortfall

Dr. Bodie contends the probability of a shortfall is a flawed measure of risk because it completely ignores *how significant the potential shortfall might be.* Sound familiar? It should. We write about this dilemma frequently here on the blog. Using the probability of a shortfall as the measure of risk, no distinction is made between a loss of 20% or a loss of 99%.

> ***If it were true that stocks are less risky in the long run, it should portend to a lower cost to insure against that risk the longer the holding period. The opposite is true. Dr. Bodie uses modern option pricing methodology i.e., put options to validate the truth.***

Using a simplified form of the Black-Scholes formula, he outlines how the cost of insurance rises with time. For a one-year horizon, the cost is 8% of the investment. For a 10-year horizon, it is 25%, for a 50-year time frame, the cost is 52%. As the length of the horizon increases without limit, the cost of insuring against loss approaches 100% of the investment. The longer you hold stocks, the more significant a chance of encountering tail risk. That's the bottom line (*or your bottom is eventually on the line).*

Valuations Matter

Michael Finke, Ph.D., a professor of wealth management and the Frank M. Engle Distinguished Chair in Economic Security at The American College of Financial Services, penned a dose of reality in the article "*The Remarkable Accuracy of CAPE as a Predictor of Returns."* He outlines how CAPE remains a useful measurement of future stock returns. Since 1975, Shiller's CAPE 10 has explained 85% of the variation in forward stock returns. Michael's research outlines how CAPE's predictability remains a valid predictor of returns. Using a 1995-2020 model, he estimates the ten-year return for stocks to be approximately 5.89% with a 67% probability that returns will fall between 4.52% and 7.26%. The 10% average stock return relentlessly touted by mainstream financial media has been and continues to be a fairy tale for the long term. Per Michael's analysis: *Over the next 10-years, a hypothetical equity return of 10% is precisely three standard deviations above what the CAPE model would predict (5.89%). If returns distribute normally, a 10% S&P return has about a 0.3% chance of occurring (or a 99.7% chance of not happening).*

How We're Navigating It

In 2018, using the CAPE 10 and ***Lance Roberts' take on it, the CAPE 5,*** our team adjusted future portfolio returns for financial plans to adequately lower expectations. This strategy has paid off. **Clients who completed a plan haven't had to alter their lifestyles or cash flows due to the pandemic.** Unfortunately, RIA's estimate on future portfolio returns, a blend of stocks and bonds, is lower than Michael's. We expect balanced portfolios to provide roughly 3% average returns over the next decade. Current retirees are leaving voluntarily or forced to leave the workforce at a time of headwinds for long-term portfolio returns. Also, portfolio withdrawal rates require annual monitoring and possible adjustment. Overall, Americans are woefully prepared for retirement. The pandemic has turned a bad situation into something surreal and tragic. The ramifications of the financial destruction will last decades and require the majority of us to recalibrate our spending and wealth expectations.