Switching to “safe” investments at retirement and living off the resulting income has long been the conventional investment wisdom for retirees. Certainly, it is hard to quarrel with the underlying objective of generating a steady income from stable investments. But eliminating your higher-risk investments with growth potential — in other words, common stocks — in favor of lower-risk bonds and/or cash equivalents could endanger your long-term financial welfare.

Decades of income need
Despite its appealing simplicity, a strategy focused solely on income-oriented investments may be a poor move for a retiree who has a good chance of needing income for two decades or more. Consider one likely result if, early in retirement, you spend all or most of your investment income. Your portfolio could experience essentially no growth. And, without growth, even low inflation will hurt you over time. At a long-term inflation rate of 3.1 percent, every dollar of your income or assets will lose half its purchasing power over about 22 years. Before age 85 — not an unusual age for retirees these days — you could be forced either to draw much more heavily on your principal than you planned or to reduce your living standard. Of course, future inflation may be lower than 3.1 percent, but it is just as likely to be higher.

An investment and an income strategy
A much more advantageous plan for managing your portfolio during retirement may be to look at both your investment strategy and your income strategy separately.

Asset allocation. The investment strategy would center on finding an asset allocation that considers your investing time horizon and the degree of risk you can tolerate. Many planners suggest that new retirees stay with a diversified asset mix that includes a substantial percentage of stock investments. While riskier than other investment types, stocks and stock funds will preserve your potential for continuing growth to counter the effects of inflation on your purchasing power. Including bonds in your mix can lower overall volatility and also add some growth potential. By also investing in cash equivalents, you would reduce overall portfolio risk and have a source of readily available cash. Without the cash investments, you could be forced to liquidate an equity or bond position at a loss when the securities markets are in a downturn.

Your annual draw. Your income strategy should focus on developing a plan for spending your investment assets. No universal rule is available for determining a withdrawal rate. It is very much an individual choice. Your needs, including whether you desire to leave an inheritance, and your investment situation should govern your decision. The choice is not easy because the best answer depends on what you assume your portfolio’s future returns will be. Keep in mind, however, that you will have some room for flexibility. If you experience good investment results early in retirement, you may decide to spend more. With a market decline, you may need to take less from your portfolio.

Your income strategy should also anticipate which investments you will sell if you need more than your dividend and interest income. You may decide, for example, first to sell shares from funds with the lowest recent returns or to reinvest your capital gains distributions in some years and spend them in others.
Adjust as you go
When you look ahead to an open-ended retirement, resolve to keep your options open. Decide what you will do with your investments, but be ready to make adjustments as market conditions and your needs change. Choose a prudent withdrawal rate, but be prepared to adjust it as your investment experience changes.

For further information on retirement planning
We invite you to visit mybmoretirement.com or call the My BMO Retirement Line at 1-800-858-3829.