Protecting Retirement Income Through Volatile Markets

Today, stock prices are high. That's not always true.

By **Wade Pfau and Emilio Pardo** | November 26, 2019 at 03:53 PM

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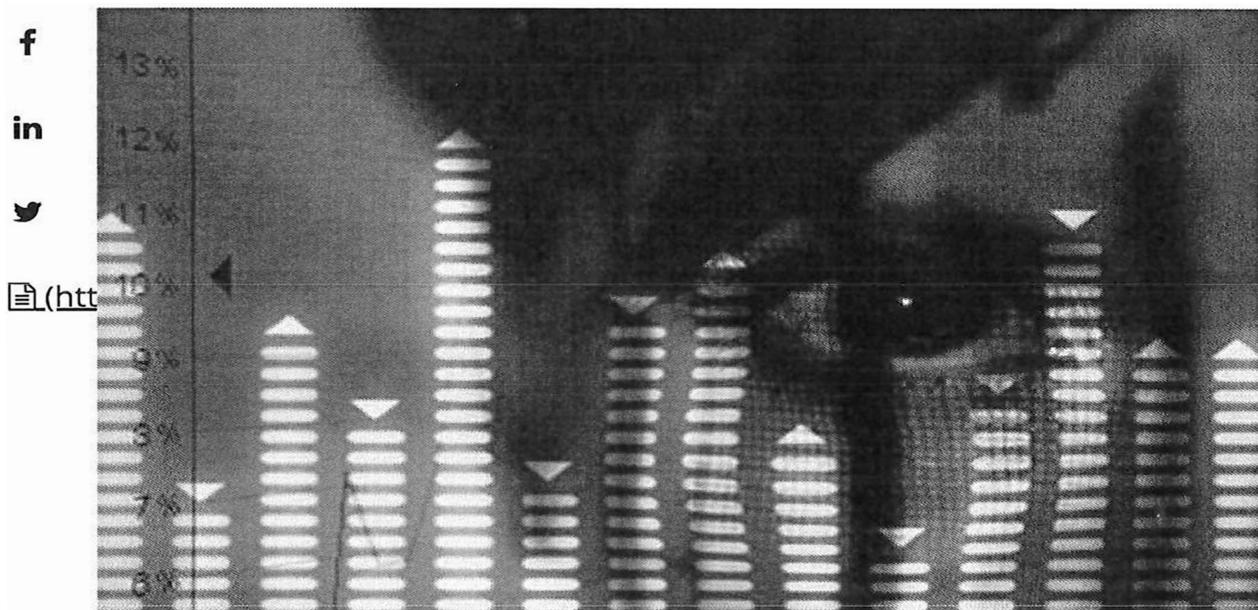

In 2019, we have witnessed frequent volatility in the U.S. markets — dramatic fluctuations in share prices that can undermine portfolio values.

With the Dow Jones Industrials Average hitting record highs in November, the ongoing trade impasse between the United States and China, and a looming presidential election, a majority of investors worldwide anticipate a significant drop in markets in 2020, according to a recent survey.

Such market gyrations are unnerving to many investors, but perhaps none more so than those who are retired or about to retire. Retirement is typically the beginning of the decumulation stage, when paychecks from work stop and retirees begin withdrawing money from their retirement accounts. Because their investment horizon is more immediate, these investors are particularly vulnerable to sharp declines in the markets. Sequence-of-returns risk – where the timing of withdrawals may have a negative impact on the overall value of the retirement account – can have significant long-term consequences on a retiree's life. Not only can a market downturn erode retirement cash flows, but many retirees and would be retirees also don't as much time as younger investors for their portfolios to rebound.

Legendary investor Peter Lynch characterized the high costs of this phenomenon when he observed: "More money has been lost trying to anticipate and protect from corrections than actually in them."

Given the historical frequency of market volatility in the U.S. stock market, investors should weigh the prospect of it occurring when they are about to retire or have
already retired. One important way for clients to help shield themselves against sequence risk is to ensure that a portion of their planned retirement income is protected from the ups and downs of the market and guaranteed to last as long as they live. It's not surprising then that Americans are increasingly looking for guaranteed income options to protect themselves.

Three in four workers (https://www.ebri.org/retirement/retirement-confidence-survey/) tell us they're interested in having an option for guaranteed lifetime income in their employer defined contribution plans.

If your clients are some of the lucky ones, pensions are one of those sources of protected lifetime income. However, today only 17% of Americans have access to one. Social Security is another source of lifetime income, but many people don't realize that it only replaces an average of 40% of our pre-retirement paycheck, leaving a large income gap that needs to be filled.

Another source of protected lifetime income, one that can help protect income against volatile markets and sequence risk, is the guaranteed income benefit that an annuity can provide.

In fact, the ability of annuities with an add-on option to protect income against market downturns is one of the primary reasons many financial advisors today recommend their clients include annuities as part of a truly diversified retirement portfolio.

Market volatility isn't necessarily adverse for all investors, especially those with a long retirement time horizon. The S&P 500 Index has produced an average annual return of roughly 10% since its inception in 1926 through 2018 (the average annual return since adopting 500 stocks into the index in 1957 through 2018 is roughly 8%: 7.96%). However, to the extent that market volatility undermines investors' commitment to their retirement plans, it can be highly adverse.

Though it's been over 10 years since the financial crisis that devastated millions of Americans' retirement portfolios, today's market volatility is a reminder that protecting your clients' income from future market downturns is always prudent. Annuities are a proven and smart way for clients to protect their income, knowing they'll always have a "monthly check" to count on every month, regardless of the ups and downs of the markets.