

# Quality Asset Management

*Grow Your Wealth with Peace of Mind*

## How can you Plan in a World of Uncertainty?

*By Gil Hanoch, August 2011*

After experiencing the 2008 recession, many feel it is difficult to plan for the future. The recent stock decline scared them, and now they are torn between preparing for (1) a similar decline in the future, and (2) the erosion of assets due to lifelong withdrawals that increase with inflation. This article provides principles that can help you prepare for an uncertain future.

A common instinct, after a severe decline, is to put substantial assets in cash and bonds, to be prepared for a repeat decline. This leaves the investor vulnerable to both longevity and inflation risks. While the psychological impact of a recent severe decline is far greater than all preceding gains, you should consider the likelihood and risk of each case. A rule I use is:

Plan for the most expected, and be prepared for the worst.
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Most people live a long life, and the life expectancy keeps growing very rapidly. The investment that best supports income that grows with inflation is globally diversified stocks. By focusing your investments in stocks, you are prepared for the most expected, but may not be prepared for the worst.

A globally diversified stock portfolio can decline for a number of years. Here are ways to address this risk:

1. A zero-cost solution is to limit the withdrawal rate from the stock portfolio. If you can limit your withdrawals to 3%-4%, depending on the portfolio, you are likely to fully recover from the worst of the declines. This is thanks to the limited negative impact of the declines to money you actually take out during the decline.
2. If your withdrawals are larger than 3%-4%, you can defer retirement if possible. If you can defer to the point of limiting the withdrawals to 3%-4%, you go back to having a zero-cost solution.
3. Alternatively, a limited allocation to cash and bonds can support the excess withdrawals during declines. Such allocation should be strictly limited to supporting withdrawals during severe declines. Otherwise, it compromises your preparation for the most expected – many years of withdrawals that grow with inflation. Determining the size of this allocation requires a very careful analysis by an experienced professional.
4. In addition to the discussion above, you are subject to the risk of panic during declines. While you may survive a decline in stocks if you limit the sales to covering immediate expenses, most people (including professionals) panic during the worst of declines and sell stocks excessively. The solution is to find an investment advisor with proven iron discipline.

### To Summarize

Individual investors face two main financial risks: (1) severe market declines; (2) lifelong withdrawals that increase with inflation. Given how painful severe declines are, some people focus on the risk of declines on the account of the risk of lifelong-withdrawals. A better solution is to plan for the most expected (longevity), and be prepared for the worst (severe decline). This can be done by an allocation to a globally diversified stock portfolio, managed by a disciplined investment advisor, with an optional allocation to cash & bonds that depends on the withdrawal rate.

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