

WILL I HAVE ENOUGH?

By Marc Bellefeuille MBA CFA FRM CFP

That was a year most investors would like to forget! So much for the narrative that we were in for the roaring 20's, 2022 felt more like 1973. Pernicious inflation, hawkish central banks and a geopolitical conflict in continental Europe has led many experts to question their strategies. In the backdrop of all this uncertainty is the reality that boomers are aging out of the workforce. By 2023, all the baby boom generation will be over the age of 65. A question that may need to be asked is whether the investment strategies that got us this far are the correct ones for the future.

Too often investors have been conditioned to base their investment decisions on how their portfolios perform relative to the market in general. This is not how big pension funds conduct themselves. They will compare the portfolio managers, whom they hire to pick stocks and bonds, to their relative benchmark. But the overall portfolios polished institutional managers are built and maintained to achieve a required return within a stipulated range of variability. As an example, a pension may be set up to achieve an annual compound rate of return of 6% with a standard deviation (up or down variation) of no greater than 8%. This does not mean the returns will consistently be 6%. The portfolio is managed to achieve a return between -2% and 14% with an average return of 6% longer term. Using these statistics, the portfolio manager could confidently assume that the portfolio would not draw down by more than -18% in depressed market year.

The question comes down to what is known as the Accumulation versus the Decumulation phases of investing. When it comes to retirement saving, we can think of it like an annuity. Savers accumulate the capital over their working lives in their pensions or other retirement accounts and then once the pot is large enough, according to the mathematical geniuses we call actuaries, an income stream is paid back to the savers for the balance of their lives.ⁱ One of the most important assumptions to make this all work is the rate of return. By convention average rates of return are used to produce the retirement income calculation. Average returns mind you can provide a false sense of security as actual returns can often have a wide dispersion from the average. Consider the following example:

Table 1

Year 1	6.00%
Year 2	-11.00%
Year 3	21.00%
Annualized Return	4.51%

The annualized return the investor received over the 3-year period was 4.51%, however the returns varied greatly from year to year. During the accumulation phase this may work in the investor's favor as

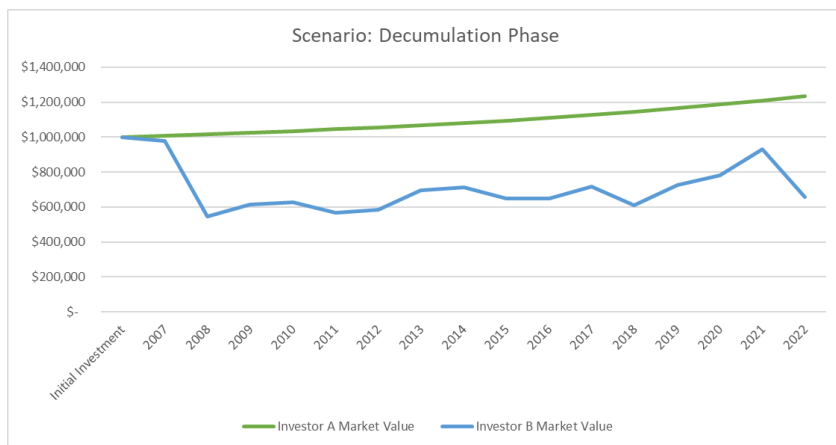
their contributions during year 2 could help them accumulate investment units at lower prices. In their retirement years, when they are no longer adding to their savings the results may not be as favorable. An investor who is now drawing on their portfolio for their retirement income could experience far different results from what they based their planning upon.

Consider the following, an investor with a beginning portfolio value \$1,000,000 at retirement who requires an annual income of \$75,000. (Taxes and the effects of purchasing power are not considered in this illustration but are important factors in retirement planning) In the example below Investor A achieves the average annualized return on the S&P 500 over the past 15 years of 8.26%. Traditional planning suggests that the portfolio would be worth \$1,234,461 at the end of 15 years while successfully delivering the retirement income over the years. However, when we consider the variability of the returns from year to year on the S&P 500, the actual results would have been significantly lower.

The illustration for Investor B displays what happened when withdrawals occurred with the actual calendar year return is applied. Investor B underperformed Investor A by \$575,766. What may be even more concerning to Investor B is that their portfolio has been reduced by 34% from the initial investment despite having been invested in the same investments as Investor A over the exact same time frame. The impact of this difference in performance could have a material impact on the balance of the investor's retirement.

Year	Annual Return	Investor A	Annual Return2	Investor B
		\$ 1,000,000		\$ 1,000,000
2007	8.26%	\$ 1,007,600	5.48%	\$ 979,800
2008	8.26%	\$ 1,015,828	-36.55%	\$ 546,683
2009	8.26%	\$ 1,024,735	25.94%	\$ 613,493
2010	8.26%	\$ 1,034,378	14.82%	\$ 629,412
2011	8.26%	\$ 1,044,818	2.10%	\$ 567,630
2012	8.26%	\$ 1,056,120	15.89%	\$ 582,826
2013	8.26%	\$ 1,068,355	32.15%	\$ 695,205
2014	8.26%	\$ 1,081,602	13.52%	\$ 714,197
2015	8.26%	\$ 1,095,942	1.38%	\$ 649,053
2016	8.26%	\$ 1,111,467	11.77%	\$ 650,446
2017	8.26%	\$ 1,128,274	21.61%	\$ 716,008
2018	8.26%	\$ 1,146,469	-4.23%	\$ 610,720
2019	8.26%	\$ 1,166,167	31.21%	\$ 726,326
2020	8.26%	\$ 1,187,493	18.02%	\$ 782,210
2021	8.26%	\$ 1,210,580	28.47%	\$ 929,906
2022	8.26%	\$ 1,235,574	-21.10%	\$ 658,696

Table 3



Large market drawdowns can have a material effect on portfolios in the decumulation phase. Investors should consider the variability of returns as well as the potential drawdown effects as a stress on their investments and ultimately their retirement. It's important for investors to challenge the status quo to

ensure their portfolios continue to serve their objectives. The insights gained by doing so could lead to more income security in retirement while potentially shielding their investments from unnecessary risks. Careful consideration is always recommended when making financial decisions. It may make good sense for some retirees to reflect on their portfolios and to seek out some advice on protecting their retirement.

The views and positions presented are those of the author and are not necessarily the opinion of BMO Private Wealth. The data presented is for illustrative purposes only. Actual results may vary. Nothing presented in this article is meant to be considered financial advice. Readers are cautioned on making any financial decisions based on this text. We recommend investors seek advice from an accredited advisor prior to making any financial decisions.

BMO Private Wealth is a brand name for a business group consisting of Bank of Montreal and certain of its affiliates in providing private wealth management products and services. Not all products and services are offered by all legal entities within BMO Private Wealth. Banking services are offered through Bank of Montreal. Investment management, wealth planning, tax planning, philanthropy planning services are offered through BMO Nesbitt Burns Inc. and BMO Private Investment Counsel Inc. Estate, trust, and custodial services are offered through BMO Trust Company. Insurance services and products are offered through BMO Estate Insurance Advisory Services Inc., a wholly owned subsidiary of BMO Nesbitt Burns Inc. BMO Private Wealth legal entities do not offer tax advice. BMO Nesbitt Burns Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. BMO Trust Company and BMO Bank of Montreal are Members of CDIC. ® Registered trademark of Bank of Montreal, used under license.

ⁱ https://en.wikipedia.org/wiki/Baby_boomers

ⁱⁱ [What Is Accumulation? How It Works in Finance and Example \(investopedia.com\)](#)

ⁱⁱ [Table 2 - Annual Return B: S&P 500 Composite Total Return – BMO Private Investment Counsel Inc. Market Indices Database](#)