Episode #164: How to Protect Your Retirement Accounts Before the Upcoming Election

Video Transcription

Hi, welcome to another episode of "Money Script Monday." My name is Brian Manderscheid. Today, I want to teach you how to protect your retirement portfolio before the upcoming election. Now, I do want to mention that I'm not here to make a political statement, and politics are definitely a polarizing topic in this country. Instead, I want to focus on the math and the facts. Now, if we look at the stock market, the S&P 500, over its history, there's actually been a 20% decline in the stock market every seven years, roughly. So, if you look at a 65-year-old who's going to retire and have a 21-year retirement, he or she is likely to have three major stock market drops, or if not more of that retirement timeframe. Regardless of if it's this election or the next selection or all the elections moving forward, there'll always be some elements of uncertainty. And the point of today's presentation is to understand what uncertainty is, how that may affect your retirement plan, as well as some proven solutions that may put you on a path for a more successful retirement.

First, let's talk about the elements of uncertainty. Now, a lot of this is tied obviously to the upcoming election, which is getting here pretty shortly here in November. That's causing many people to have anxiety about the results and what's going to happen. It's also creating anxiety in the stock market. The stock market doesn't like uncertainty, and that's generally reflected in stock prices. We also have a potential power transition. How is that going to work? And are we going to even know the results of the election the night of the election? With mail-in ballots, will it take a week? How's the stock market going to react to that? A fall, winter, or a second wave of the COVID-19, what's that going to look like with both the flu season and COVID on top of that? How is that going to affect the stock market and the economy? The delay or potentially even no second stimulus package. It seems like both parties are so far off on what they're looking for, and there's not a lot of common ground that may delay or even eliminate a second stimulus package. Again, an uncertainty the stock market doesn't like. Additional government lockdowns. If there are a large spike and COVID cases, is that going to mean we're back to working at home and government or businesses shutting down? How's that going to affect your employment, the economy, and the stock market in general?

A government shut down. So, the government needs revenue in order to operate. If they run out of revenue before their fiscal year, they have to actually go to Congress to get more revenue to run the government. If both parties are so far apart, that could be a potential issue, and we may have a government shutdown, and we've seen in the past. And then on that note, government's spending and debt. 2020 was the largest federal deficit we've ever seen, and the national debt is a runaway train with no clear sight on how that's going to be paid back. And lastly, civil unrest. Definitely, something that's going on throughout the country. So, there's a lot of elements of uncertainty facing us in the fourth quarter of 2020. And while there always will be uncertainty, there are a lot of headwinds we have in the stock market. And again, as I mentioned, the stock market doesn't like uncertainty, and that could reflect in a double-dip or stock market drop around the upcoming election.

Moving on, let's talk about portfolio rebalancing. A very common technique and strategy that's done in the financial industry is we had this huge violent sell-off in March of 2020. We had three to four weeks of just constant declines down. But since then, the last six months, we've had a pretty consistent and actually pretty robust rebound. We've hit new stock market highs and are currently hovering around that. The effect that may have on your portfolio is because of the stock market run-up, you may be overweight in equities. So, for example, let's say you have 70% of your retirement portfolio in stocks or equities and 30% of your retirement portfolio in bonds or fixed accounts. Because of the big swing we've had upwards, you may be overweight in stocks, and based on your goals and your risk tolerance, maybe a 60/40 portfolio, 60% in equities and 40% in bonds are ideal based on your situation. Because of the big run-up, your portfolio is out of whack. You may want to take 10% or take some gains off the table and put back into the fixed or bond account in order to make sure that you're bringing your portfolio back to equilibrium, taking some gains off the table before the next upcoming election with all this uncertainty facing us.

So, let's move on to a fixed account alternative. But first, let's talk about bonds. I mentioned that, based on your risk tolerance and goals, you might want to have a portion of your portfolio in bond accounts. Now, looking at current interest rates as of September 24, 2020, a 10-year treasury was only 67 basis points or two-thirds of a percent. While treasuries are considered a safe haven, that's a very low, historically, rate of return, and you may want to look for a better yield so that you may look at Moody's Seasoned Aaa Corporate Bonds which, as of September 24, 2020, the interest rates are about 2.33%, so about two and a third. But again, these are still at or near historic lows.

There are really two problems with that. Problem number one is, if you put 30% to 40% of your portfolio in bond accounts at historically low returns, it's going to drag down the total return on your overall portfolio. The risk or issue number two is that the way bonds are priced if they're priced inversely to interest rate movement. So, what that means is, if interest rates increase, the value of your bond accounts starts going down. Right now, we're at a point where the stock market is at or near an all-time high, and interest rates are at or near an all-time low. Well, Fed Chairman

Jerome Powell said that interest rates are likely to stay low through 2023. At some point, interest rates may start an upward trend. And if you have 30% to 40% of your money in bond accounts, that may potentially get crushed when the interest rate cycle starts to switch around and go in the upward direction.

How do you mitigate some of that interest rate risk? Well, the answer is annuities for a portion of your portfolio in that fixed section. There are a lot of different annuities out there, but just to give you two simple annuities to look at, number one is a five-year MYGA or multi-year guaranteed annuity. It basically offers, in this case, a guaranteed interest rate of 2.75, which is the highest rate as of September 24, 2020, for a five-year period with a guaranteed walkaway at the end of that five-year period. So, essentially, you're getting a guaranteed rate of return, and after five years, you can walk away with your principal plus the interest that you've earned. Now, this is definitely a higher rate than what we're getting in the bond world, but it still may not meet your return objectives. A second option would be a 10-year fixed indexed annuity with a return profile of between 3% to 4%. Now, that's going to give you obviously better rates of return than the MYGA, as well as the bond options here mentioned.

Annuities are definitely not for everybody, and there are some considerations we want to talk about are both pros and cons. So, first, let's talk about the additional benefits that annuity provides in addition to the higher interest rate of potential earnings. First is lifetime protected income. In our planning process, we typically like to have our clients to have a base level of protected income that covers their essential retirement expenses. What they absolutely need to be covered in retirement. Protected income is made up of social security, pensions if you may have them. And if those two aren't enough to meet your essential income needs, we tend to add in annuities to be that third leg of the stool to provide a stable base of protected income to, again, cover your essential needs in retirement.

Number two is tax deferral. If these bonds are not in a retirement account, they're in a non-qualified account, they're not in an annuity, you're going to get a 1099 from the government asking for taxes on the interest that you've earned. With a non-qualified deferred annuity, that money grows tax-deferred, so you're not going to get taxes due when you receive gains. And lastly, a 0% annual floor. With this fixed indexed annuity, the worst-case scenario is we have the turmoil around the election and a big stock market drop; the worst-case scenario is zero. You don't earn a rate of return, and your account value goes flat, it doesn't go down, it just goes sideways. The trade-off for a 0% floor is they're going to have some limiting factor on the upside, whether a cap or participation rate. If the stock market does 10% or 20%, you're not going to capture all those earnings. But the benefit is if the stock market goes down 10%, 20%, you don't suffer any of those losses.

So, those are some of the benefits. Let's talk about the considerations. Number one is definitely liquidity. With an annuity, your money is essentially locked up, in this case, for a 5 or 10-year timeframe, and there are surrender charges assessed if you were to walk away from the annuity. Now, many annuities do have some sort of free withdrawal privilege, so you can access a portion of your money, but the majority of your account is locked up for that timeframe. So, we want to make sure that the annuity is only a portion of your portfolio because there are liquidity concerns, and we want to make sure you have outside assets to cover rainy day funds and other unexpected emergencies.

Fees. Absolutely a concern when buying an annuity. There are actually some annuities out there with 3% to 4% or even higher fees with inside the contract, which substantially decreases the ability for that annuity to grow over time. Conversely, there are annuities with no fees. So, if you are fee-conscious, you definitely want to talk to your advisor about some of those annuity options; what are the fees? And are there any annuities out there with no fees? And lastly, carrier ratings. Crucially important. The guarantees that the annuities provide are based on the claims-paying ability of the insurance company, which is one of the reasons why we typically recommend working with using companies to make sure that your money is safe and protected with inside the annuity.

To wrap things up and bring things full circle, we talked about elements of uncertainty, mostly surrounding the upcoming election. We talked about the concept of portfolio rebalancing and the fixed account alternative, which is an annuity. There'll always be elements of uncertainty, whether that's stock market risk, whether that's inflation, or sequence of return or even long-term care or medical costs. There are various risks that you'll face in retirement, which is why it's important, now more than ever, to contact the advisor who sent you this video. They can create a custom plan for you that helps mitigate and reduce the risks and uncertainties that will face you, whether it's the election or other risks that are coming up on the horizon. So, please contact the advisor who sent you this video to create a custom report, to create a plan, to put you on a safe, comfortable, and successful path for retirement. Thank you very much. We'll see you next time.