Episode 298: Why Take Risk if You Don’t Have to?

Hey there. My name is Kevin Nuber. Thank you so much for watching today's Money Script Monday video where I want to ask the important question, “Why take risk if you don't have to?”

I think there are probably a few different people that might be watching this video right now. Perhaps you are approaching retirement, you're about to retire, or maybe you're a few years into retirement. But maybe there's one thing that you all have in common with each other, and that is that you have money in your retirement portfolio and you're maybe wondering what's going to happen to that money when I retire.

You see, anyone who has enough money in the retirement portfolio, they've done that by making significant sacrifices in their life. For example, they've been working hard at a career for 30 years, they've probably gone to college, worked hard, and done a lot to make sure that they can have enough money. In the process, they've paid a mortgage, they've sent their kids to school, they raised a family, they might have paid for a wedding or two, and in the process, they saved a substantial amount of money in their retirement portfolios. They made sacrifices today so that they would have enough money in the future in the form of their retirement.

So if that sounds like you, then I say congratulations. You did what it takes to have enough money in your retirement portfolio. But now that you're there, you're starting to wonder, is this enough money? And you're starting to realize that you're going to have to start drawing money out of those accounts when you retire because your income, your earned income, is going to be gone and this is going to be the primary source of your income for the rest of your life. If this sounds like you, then you're not alone. Welcome to the retirement world. This is the anxiety people deal with when going into retirement.

Now, what if I told you that the number one thing that determines the success or the failure of your retirement portfolio has nothing to do with the decisions you make as far as how much money you're going to spend, how much money you're going to save, how much you're going to travel, or any of those types of decisions, or even perhaps the year in which you choose to retire. And it has everything to do with something that's completely out of your control. You have no control over it. Would that make you feel good or would that make you feel even more anxious?

Well, this is the truth of going into retirement. You see the success of your retirement is going to be very much determined by what's going to happen in the stock market and the economy in the first five to seven years that you retire if you have all of your money at risk. You see if you choose to retire and then suddenly you have a poor 3, 5, or 7 years immediately after retirement, it's going to be very difficult to have a successful retirement outcome. That is if all of your money is exposed to risk.

So the question I have for you is why take risks if you don't have to? I want to show you today the difference between that risk tank, having all your money in that bucket exposed to market risk, versus putting money in somewhere that's safe so that you don't have to worry about losing money if the stock market goes down, and do a comparison of those two accounts to see which of the two you might prefer.

In order to do this, I'm going to use an example. This example is going to be $1,000,000 of retirement assets. Now you might have more. You might have less. That doesn't matter, it's all going to be relative. You're going to retire at age 65. I'm going to show that this is just until age 85. I hope you live much longer in retirement, but this is just for 20 years. I'm going to say what if we would draw 4% per year from that retirement portfolio? You're thinking right now, well, 4% is only $40,000. If I have $1,000,000 in my retirement portfolio, I should be able to take out more than $40,000, right?

Well, the prevailing wisdom is that 4% is the safe withdrawal rate. I'm going to show you exactly why that's the safe withdrawal rate. One of the reasons is we're going to inflate that at 3% per year so that the income is going to go up every single year. And I'm going to go over a market history and see how your retirement portfolio has actually performed. Now, I'm not going to pick investments, I'm not going to pick mutual funds or any kind of stocks or anything like that. I'm just going to say your money is invested in the S&P 500. This would be like an S&P 500 ETF, for example. And I'm going to use the starting date of the year 2000 and I want to show you 2 scenarios. I want to show you the scenario first where the first five to seven years are not favorable versus the scenario in which they are favorable and show you what that outcome is.

So let's take a look at that first scenario. In the year 2000, let's say that you retire. Now we all have the benefit of hindsight today and we know what happened immediately after the year 2000. We had a few two to three years in a row where the stock market was negative. And then we know what happened for the rest of the decade, it was called the Lost Decade because we had almost no rate of return in the stock market for that period of time. But if you retired in the year 2000, you didn't know that was going to happen. So you have no control over that. So you retire in the year 2000, you take out your $40,000 of income.

Now the stock market has gone down. Not a very good scenario. Then it happens again in the second year. You pull out your $40,000 again, and now you only have $600,000 in your retirement portfolio, 2 years into retirement. Imagine what that would feel like. You work your entire life. You make all these sacrifices, you retire, and two years into retirement, 40% of your retirement portfolio is gone. I think that would make one very anxious. You'd probably be looking for another job trying to figure out how you're going to go back to work, being frugal, spending no money in retirement, and a lot of stuff is going through your head.

Well, it doesn't get much better after that. The stock market does start going up, but you're still pulling out the income every single year to supplement your retirement. And we all know what happened here in 2008, 2009, and shortly thereafter. If we go all the way out here to the end at age 82, you've run out of money and you've exhausted your entire retirement portfolio.

Now you're thinking, well, what kind of rate of return am I earning? Your rate of return is 6%, but it's not the rate of return that's the important thing in this scenario. You earned 6%, you took out 4% per year and you still ran out of money and it has entirely to do with what happened in these first five to seven years you went into retirement. It was an unfavorable period of time and it's something you have no control over. So if you don't know what's going to happen in the next five to seven years after the day you retire, maybe taking risk is something that you don't want to have all do with all of your money.

I know you're thinking Kevin. You're just cherry-picking some sort of start date here. The year 2000, we all know what happened immediately thereafter, and it was just a bad scenario. And yes, that's true. I'm trying to illustrate a point, and that is we don't know what's going to happen in the 1st 5 years. What if the first five years are really bad? What I'm going to do instead is I'm going to take that same, that same series of rate of return and instead of starting out with a bad first five years, I'm going to start out with a really good first five to seven years. And let's look at that scenario.

So that's this green line right here. In the first year, it goes up by quite a bit. You take out your $40,000 and you still have one over $1.4 million. That's awesome. You know, you're thinking my retirement is going to be is going to be fantastic. If this is how it pans out, well, it continues to pan out like this. Your retirement assets keep going up. You keep pulling money out, and at one point you even have almost $3,000,000 inside of your retirement portfolio. That's fantastic. There's nothing you need to worry about in retirement. Yeah, sure it goes down, and here at the age of 85, you end up having more money than you actually started with on the day you retire, everything is fine.

But guess what? You actually earn the same 6% percent rate of return in this scenario as you did in this scenario when you ran out of money. This right here, this is the definition of risk. You see what risk means, is that if you put all your money into a risk tank, you can have one of two outcomes. You can have an outcome in which you run out of money or that you have plenty of money. Which of those two is it going to be? It has entirely to do with something completely out of your control and that is what happens in these first, early years.

So why take risk? Why have all your money in this risk tank if you don't have to? What if there was a safe account, a safe bucket where you can put your money in? By putting your money in there, you can make sure that if the stock market goes down, you're never going to lose any money, OK? But in exchange for that, you can't earn an unlimited amount of rate of return.

So in this example, I'm still going to use the SMP 500. I use the start year of 2000. It doesn't matter the start year all that much, and I'm going to say there's a floor, there's a floor so that if the stock market goes down, you just earn zero. Zero is your hero. You don't lose any money. But if the stock market goes up, you're only going to earn 10, so you're always going to earn between 0 and 10% every single year. Well, what does this scenario look like over the same period of time?

That's right here on this blue line, notice in the first year you take out your $40,000, the stock market is negative, but you earn a 0%. So you're still negative, but you're not all the way down here. Well, every single year you're earning somewhere between 0 and 10. You're taking out your 4% withdrawal rate with inflation, and in the end, you have exactly the same amount of money that you put in. And by the way, this rate of return is 5%.

Which of these two outcomes is more preferable to you? Would you prefer to have a much more predictable retirement income portfolio in which you have a greater certainty of what the outcome is, or do you want one in which you can have this wide range of results, one that results in success and one that results in failure? If you're thinking that you would prefer to have the one that maybe is in the middle, then why take all the risk? If you don't have to, why put all your money in that risk account if you can put some of your money, or a portion of your money, into that safe account and make sure that you have a much more predictable retirement income? Thank you so much for watching.