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3 ways to avoid the retirement fiscal cliff

By Charisse Rivers

You may have heard that putting pretax (IRA) money into the stock market is a cardinal sin. Why would someone say this? If a major market loss took place during retirement - while you had a plan to take 5% from your retirement accounts to live on all the while worrying about having to take a higher percentage than the 5% as you age through the required minimum distribution (RMD) phase - your retirement savings could erode before you realize.

Then, by the time you're 70¾, Uncle Sam wants his piece of the pie. This is the RMD that must be withdrawn yearly. At this phase, a percentage of the money you never paid taxes on must exit the retirement accounts. Even if you didn't want to take it, you still have to. Imagine 2008 all over again - but worse. If you're approaching retirement or already in retirement and a crash occurred, it could cause you to get closer to falling off the retirement fiscal cliff - running out of money.

Another event you may face, as a retiree, is the impact of returns received on investments. It's crucial to understand sequence of return risk and how it can impact retirement accounts. Your retirement nest egg can vary depending on whether the market goes up or down in the first couple years of retirement. Let's look at the same sequence of returns, with some up and some down years. If you had one million dollars and started the sequence with your 5% withdrawals in an up market (high early returns), your money would last 37 years based on random returns. If you started the 5% withdrawals in a down market (low early returns), your money would only last 24 years based on changing the exact random returns in the opposite direction.

There are a few ways to help combat the fiscal cliff from eroding your retirement:

1. 100% market exposure

It is possible to put every dollar in the hands of Wall Street, close your eyes, and hope it works out. But, hoping isn't a good plan, especially in retirement. If the plan is to park money into the buy-and-hold strategy, this could be a problem, too - unless you can afford to lose a lot. Putting 100% into the buy-and-hold strategy can crush the investment if the returns start in a downward spiral and you had to pull money from your retirement account each year to live on. But, there is hope! Though this is nothing new, most advisors don't implement it: tactical management.

The point of a tactical manager is to have an advisor who frequently keeps an eye out on the account and moves money on a consistent basis each month to help protect from the downside of the market. You'd have better chances of surviving the fiscal cliff at age 90 if you didn't have to worry about the account value hitting the floor as many experienced in '08. This type of advisor is typically a fiduciary, and this fiduciary advisor must look out for the client's best interest at all times, even before their own.

2. Advance planning for the RMD phase

Many investors wait until 70 to make a plan for the RMD phase, where monies must exit the investor's 401 (k)s and IRAs. Earmarking a percentage of this money 5 to 10 years prior is suggested. Putting yourself in advanced strategies with a level of protection could help end the worry of running out of money during retirement. Remember, once the investor (you) is over 70½ years of age, a percentage of money must come out of any retirement accounts.

This percentage goes up every year, and it's likely the account value will keep going down each year if tactical management strategies aren't implemented. Consider being 70½ years old and the market crashes 40%. You'd have to start taking money out of your account each year for the rest of your life - all while the mandatory withdrawal percentage keeps going up. From 70½ to 90 years old, the question is, "Is there a possibility the market could crash again, and could that get your account closer to running out of money?"

3. Buy income with a portion of those retirement accounts

The concept of buying income with a percentage of your retirement savings is a way to make sure, no matter which direction the market goes, you'll receive a paycheck for life. The older you get, the more income you can buy for less money. When you're buying income, you must time it just right so that you get the best bang for your buck!

By implementing these strategies, you may sleep a little better at night and not have to worry as much about the retirement fiscal cliff.

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