Investment Myths Debunked

By Editor Test   *Wed, Sep 21, 2011*

Rod Greenshields of Russell Investments questioned the value of conventional financial wisdom in a lively presentation at the FPA Experience 2011 conference.

Retirement strategies were major topics at the FPA Experience 2011 conference in San Diego last week, with hundreds of advisors turning out for slide presentations on systematic withdrawal, the pros and cons of annuities, and tax-savvy distribution tactics.

A highly entertaining session—one that was aimed at debunking conventional investment wisdom—was presented by Rod Greenshields (pictured above) of Russell Investments. Its unassuming title—“Retirement Investing Insights: Building Personalized, Robust and Flexible Strategies”—gave little hint of what he would say.

Among other things, Greenshields contested the orthodoxies that time reduces portfolio risk and that a retiree’s biggest worry is the risk of portfolio failure. His slides suggested that time magnifies the variation of cumulative returns and that the magnitude of portfolio shortfall in retirement deserves more attention than the probability of shortfall.

Greenshields described annualized returns, for instance, as a “fiction.” The averaging of annual returns merely allows stock market upswings and downswings to cancel each other out and make it seem that a buy-and-hold strategy eliminates equity risk, he said. He showed in a slide that, starting from any given year, the possible annual returns of a 60% equity/40% bond portfolio converge to a range of about 10% after 20 years.

But “no one gets annualized returns,” Greenshields said. Instead, investors get *cumulative* returns, and these tend to diverge with the length of the holding period. In a second slide, he showed that, after 15 years from any given year, possible cumulative returns from a 60/40 portfolio expand to a range of over 400% after 20 years. “Time magnifies risk,” he said. “It doesn’t magically make risk disappear.”

Politely assailing other common misconceptions, Greenshields asserted that “the retirement risk tolerance questionnaire is dead” as a client assessment tool. Instead, advisors should gauge their clients’ *risk capacity* by mapping their assets to their liabilities and determining, as a pension fund manager might, their “funded ratio” and the size of a potential surplus or shortfall.

Greenfields challenged the conventional wisdom that equities are essential to reducing the risk of portfolio ruin (exhaustion of assets prior to death) for retirees by showing that a high-stock portfolio is more likely to produce a larger (and therefore more painful) shortfall than a high-bond portfolio. Both considerations are important.

In one slide, for instance, he showed that, over a 20-year liquidity horizon, at an inflation-adjusted withdrawal rate of 6%, portfolios of 100%, 80% or 60% equities had a “probability of shortfall” of about

60%, 64% and 70%, respectively. By comparison, portfolios with bond allocations of 100%, 80% and 60% had shortfall probabilities of about 100%, 95% and 80%, respectively.

In a subsequent slide, however, Greenshields showed that "total shortfall" is greater with greater equity allocations. At a 6% inflation-adjusted withdrawal rate, an all-stock portfolio could produce a maximum shortfall (from initial wealth) of about 77% over a 20-year liquidity horizon. All else being equal, the maximum shortfall for an all-bond portfolio would be about 56%. In short, the notion of "stocks for the long-run" doesn't apply blindly in retirement.

Greenshields did not recommend annuities as a retirement drawdown tool. He said he preferred basic systematic withdrawal to "esoteric" strategies. But he suggested that advisors use the price of an income annuity (available at www.immediateannuities.com, he said) to help clients see if their assets were in surplus—that is, greater than the price an annuity that would pay them an income great enough to meet their basic retirement spending needs.