What To Tell Nervous (Older) Clients Now

By Kerry Pechter *Thu, Dec 8, 2016*

During market turmoil, the messages from "retirement income" advisors to their clients should be substantially different in their content from the messages that investment advisors typically send to their clients.

After the drama of the November election, when equity prices rose and bond prices fell, queasy investors needed some emotional Dramamine. At such delicate moments, advisors typically send out emails or make phone calls to remind clients that volatility is normal and that they should "stay the course."

I would propose that, during market turmoil, the messages from "retirement income" advisors to their clients should be substantially different from the messages that investment advisors send to their clients.

Both types of advisors may have the same immediate goal—to prevent clients from making hasty decisions. But the content of the conversation will be very different, because the risks that older clients face are very different from the risks that younger clients face, and advisors need to respond to them in different ways.

Let me explain. Accumulation-stage advisors and their clients are still seeking ("buying") investment risk. They hold long positions in bonds, mutual funds, stocks and even riskier assets with higher potential for growth. Paper gains, which put them closer to their savings goals, make them feel richer. Paper losses make them feel poorer.

As their positions lose value, they wonder if they might never reach their goals at all. In their imagination, a black abyss opens wide. They begin to panic. Their advisors have to call them and tell them, "Stay calm. Stick with the plan."

If they are young and have mountains of human capital to fall back on, convincing them to stay calm shouldn't be hard. In the right frame of mind, they might even begin to see market downturns for what they are: opportunities to pick up bargains.

Distribution-stage advisors and their clients are in a very different position. They are risk sellers. Their main task is to fund their liabilities (lifetime income needs, future health care costs, etc.) and mitigate their risks (sequence of returns risk, interest rate risk, inflation risk). If you've already begun to do that with your older clients, they should be able to relax. In the right frame of mind, they'll look at bull markets as opportunities to take profits and fund liabilities.

By all means, avoid a mismatch in messaging. If you've been treating your older, decumulation-stage clients like accumulation-stage clients, it will be screamingly obvious. Clients won't just be panicky when volatility rises; they'll be angry. Here are three things that a retirement specialist should be able to tell his or her older clients when they worry:

Relax: you've got enough cash. Nearly retired or recently retired clients all face "sequence-of-returns" risk. This isn't the same as investment risk. It is the risk that, for lack of liquidity, your client will be forced to sell depressed assets to generate current income, thereby locking in losses from which they can't recover.

But if they've already set up enough guaranteed income (either from a cash account, income annuity, pension, Social Security or even a reverse home equity line of credit) to cover their essential expenses for the duration of the downturn, you can tell them to turn off the financial news and relax. If they're nervous about their highly appreciated equities, now might be the time to sell some of them and fund a cash bucket.

No need to get hyper over interest rates. Retirees tend to hold bonds and bond funds, so they're vulnerable to interest rate risk—the risk that rising rates will depress the market value of their portfolio. Bond prices fell (and yields rose) after the election, as investors sold bonds and bought stocks in the belief that president-elect Trump will cut taxes, borrow big and finance an infrastructure boom. This may make older clients nervous, but they don't have to be. Lower bond prices mean higher yields on new bond or bond-fund purchases. If yields keep rising, the cost of annuities may go down.

"Bond news can always be presented in a negative or positive light, depending on whether we're focusing on price or yield," advisor Russell Wild told *RIJ* this week. "I try not to focus on one or the other, as they are two sides of the same coin… Keeping an eye on bond-portfolio duration, rather than price or yield, is what I tell my clients. I remind them that with a short- to intermediate-duration bond portfolio (generally 3 to 5 years), interest rate risk is real, but modest."

Your long-term needs are covered. Older clients sometimes need to be reminded that longevity risk (the cost of living much longer than expected) and health risk (the risk that unusually large health care costs will wipe out savings) are each a much bigger threat to their financial wellness than short-term volatility in the stock market.

If you've protected your clients against these risks, either by setting up a so-called bucketing strategy, or purchasing longevity insurance (i.e., a deferred income annuity that starts payments at age 80 to 85), or creating a plan to deal with the risk of disability or dementia, then you've given them concrete reasons to relax. Today's market volatility won't bother them if you've already addressed their late-life needs.

An exception that proves the rule

You may have noticed my use of the word, "decumulation." Many or most of your older clients may never enter a decumulation stage per se because they'll always earn more than they spend and they'll never need to dip into principal. In theory, you can treat them as perpetual accumulators. But you've probably found that even the well-to-do aren't immune to fear.

As behavioral economists have told us, losses carry much more emotional weight than gains do. In practice, most people, especially older people, are unhappy with the prospect of losing wealth, even if it's only on paper and even if their basic expenses are safely covered. Rich people may feel threats to the attainment of their discretionary or aspirational goals as acutely as middle-class people feel threats to the satisfaction of their essential needs.

If your older clients are exceptionally worried, maybe you've been giving them accumulation-stage advice. You may have assumed, because of their high net worth, that they are still risk-buyers rather than risk-sellers. Or you may have anticipated their investment risk but not addressed the other financial risks they face. If you do decide to think more like a retirement income specialist, you may want to start right away, while asset prices are still high and the cost of funding liabilities is still relatively low.