Wealth Management

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REGISTERED INVESTMENT ADVISOR

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Choice of Retirement Start Date

Timing is more important than many realize.

Investor rule of thumb: Time in the market is more important than timing the market. Here's evidence for that statement. Start with the following set of hypothetical returns:

Hypothetical returns

Year	Return
1	-28%
2	-4%
3	-2%
4	8%
5	3%
6	10%
7	12%
8	8%
9	18%
10	25%

Although there is a wide variation from year to year, ranging from a 28% loss to a 25% gain, the average return for these ten years comes to a modest 5%. What would happen to $100,000 invested at these rates?

Saving begins during a bear market

Year	Return	Value $100,000
1	-28%	$72,000
2	-4%	$69,120
3	-2%	$67,738
4	8%	$73,157
5	3%	$75,351
6	10%	$82,886
7	12%	$92,833
8	8%	$100,259
9	18%	$118,306
10	25%	$147,883

Would it be better if you could reverse the sequence of returns? How much more money would you end up with if you could start off with that stellar 25% year?

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A Case for a Corporate Fiduciary

The following is based upon a true story (names have been changed).

Alex was in the market for a boat slip. He found one, owned by a brother and sister, Jack and Jill. They had inherited it from their father. However, they seemed emotionally tied to the slip, which was odd because neither of them owned a boat of their own. Jack and Jill needed to meet Alex, and when they did, they concluded that their father would approve of him.

Further investigation revealed that they didn't own the boat slip after all; it was owned by a trust established by their father. They didn't have the right to sell it, at least not yet.

Additional background

The story of the trust was pieced together over a period of months of interactions. The father in this story had remarried. He had two children of his own, and his second wife, Janet, had a son named Sam.

The father attended an estate planning seminar on the benefits of having a living trust. He was sold on the idea. He wanted to protect his second wife while also providing a significant inheritance for his own children. A lawyer was hired to draft the

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Saving begins during a bull market		
Year	Return	Value $100,000
1	25%	$125,000
2	18%	$147,500
3	8%	$159,300
4	12%	$178,416
5	10%	$196,258
6	3%	$202,145
7	8%	$218,317
8	-2%	$213,951
9	-4%	$205,393
10	-28%	$147,883

For savers, the sequence of returns makes no difference at all. Yes, in the second example the nest egg breaks through the $200,000 level, but that evaporates under the weight of the large loss. During the accumulation years of the financial life cycle, the important factor is being invested for as long as possible, to be confident of participating when the markets enjoy good years.

A very different story for retirees

Retirees are concerned about outliving their financial resources, and with good reason. There are not many options for a retired person to boost his or her income other than selling assets. What is a sustainable withdrawal rate for a retiree? At what withdrawal rate can a retiree be reasonably confident that he or she won't exhaust the available retirement capital?

Timing is everything, in trying to answer this question. If retirement commences during good economic times, the nest egg has a strong chance of lasting decades. But retirement during a down year can wreak havoc on a retirement portfolio.

Let's begin with the $147,883 that was saved in the earlier example. Assume that the retiree will need to draw down $10,000 annually, less than 7% of the account's value. If there is a bull market when the withdrawals begin, the account will continue to grow despite the partial consumption. The following examples use the same sequence of investment returns as the savings examples.

Withdrawals begin during a strong market			
Year	Return	Withdrawal	Value $147,883
1	25%	$10,000	$174,853
2	18%	$10,000	$196,327
3	8%	$10,000	$202,033
4	12%	$10,000	$216,277
5	10%	$10,000	$227,905
6	3%	$10,000	$224,742
7	8%	$10,000	$232,721
8	-2%	$10,000	$218,067
9	-4%	$10,000	$199,344
10	-28%	$10,000	$133,528

After taking $100,000 out of the account over ten years, this retiree still has $133,000 to work with for the balance of the retirement. However, a colleague who retires during a down market is not so fortunate.

Withdrawals begin during a weak market			
Year	Return	Withdrawal	Value $147,883
1	-28%	$10,000	$96,476
2	-4%	$10,000	$82,616
3	-2%	$10,000	$70,964
4	8%	$10,000	$66,641
5	3%	$10,000	$58,641
6	10%	$10,000	$54,505
7	12%	$10,000	$51,045
8	8%	$10,000	$45,129
9	18%	$10,000	$43,252
10	25%	$10,000	$44,065

At the ten-year mark, this retiree's portfolio is just one-third the value of that of one who retired during a bull market. The years of high returns are applied to a much lower account balance. When even modest withdrawals are coupled with poor investment return, a retirement nest egg can shrink quickly.

What can one do?

The choice of a start date for one's retirement will be influenced by many personal factors. The health of the financial markets is typically low on the list of concerns, but these tables suggest that perhaps it shouldn't be.

The concern becomes acute when the market suffers a major retreat after setting new highs, as happened last year. There are steps that can be taken to protect against market uncertainties.

• *Reduce spending.* Someone who already has retired doesn't have the luxury of becoming "unretired." Unpleasant though it may be, when the markets head south, some spending plans may have to be deferred or eliminated.

• *Smooth portfolio volatility through sound asset allocation.* By balancing portfolio assets among a variety of investment classes—large stocks, small stocks, short-term bonds, long-term bonds, and so on—expected returns may fall within a narrower range. The lowest lows will be avoided—along with the highest highs—and the risk of outliving one's money may be reduced. ■

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Above:
Jeanne Calment, 1895, at age 20

Below:
A detail of Irises by Vincent Van Gogh, The Getty Center

A Novel Way to Beat Estate Taxes?

The longest recorded human life span is 122 years, 164 days. The record is held by Jeanne Calment, who lived in Arles, France. Born in 1875, Jeanne reportedly had an encounter with Vincent Van Gogh at her uncle's shop. She was the first person verified to have lived to 116 years.

When Jeanne was 90 years old, she had outlived her daughter and her grandson, and had no other heirs. She agreed to sell her apartment to a lawyer for a small lifetime annuity, retaining the right to live in the property until she died. The lawyer was then 47 years old. The monthly payment was 2,500 francs, about $433.

Unfortunately, the lawyer died of cancer at age 77 while Jeanne was still alive, so he never did get to occupy the apartment. His estate had to keep paying the annuity. The total annuity payments reportedly were double what the apartment was worth.

Possible fraud

Doubts have been raised about the authenticity of Jeanne's age, according to a recent item in Smithsonian.com. A new research paper has found several inconsistencies in her life story. For example, a passport issued to Jeanne in the 1930s describes an incorrect eye color and height. In an interview, Jeanne spoke of a maid who had accompanied her to school. In fact, that maid was ten years younger than Jeanne.

Jeanne had a daughter, Yvonne, who died in 1934. After Yvonne's death, Jeanne moved in with her son-in-law and grandson. The son-in-law never remarried, though he was only 42 when he was widowed.

The researchers believe that Yvonne did not die in 1934, her mother did. Yvonne then assumed her mother's identity, she became Jeanne Calment.

Why would she do it?

Jeanne and her husband owned a small shop together. When she died, under French law at that time her husband would have had to pay a 38% death tax on his wife's ownership share of the business. There would be no tax bill at all if Yvonne died instead of her mother.

Many doubt the researchers' theory, and there is no conclusive proof. Could an identity switch happen without friends and neighbors noticing it? If anyone did notice it, could the secret be kept by so many for so long? But it was a period of tumult in France and in the world. The story does have a certain plausibility.

Planning today

The threat of death taxes is much reduced for most Americans. The amount exempt from federal estate taxes is $11.4 million per person in 2019. However, the minority of states that continue to have inheritance or estate taxes typically impose them at much lower wealth levels.

Freedom from death tax does not mean freedom from estate planning. Providing a road map for the orderly disposition of one's property at death is a fundamental financial responsibility. ■

Corporate fiduciary . . . CONTINUED

trust, which would include his home, the boat slip, and some $400,000 in investment assets. The trust included a restriction on the selling of the home.

The trust became irrevocable at the father's death. The trust beneficiaries were the surviving spouse, Janet, and the father's children, Jack and Jill. Jill and Janet were named as trustees.

Jill spent $3,500 on a lawyer to learn about her responsibilities as trustee. However, the investment did not do her much good.

Janet asked the probate court to replace Jill as trustee with her son, Sam. In making the request, it appears that the trust agreement presented to the court was miscopied. A clause that stipulated a trustee could only be replaced for misconduct, which was at the bottom of a page, was not included in the version given to the court.

Jill should have contested being replaced as trustee, but she had already spent $3,500 on a lawyer and did not want to incur additional expense. The change of trustees was approved by the court.

Jack and Jill did not hear much about the trust after that. Sam lived in another state, and was not very communicative. They did not get reports or statements of the trust assets. The house was sold, in violation of the trust terms, and Jill thought that fraud must have been involved.

When Janet died, the remaining trust assets passed to Jack and Jill. But all that was left in the trust was the boat slip. There was no accounting to explain what Sam did with the rest of the trust assets.

The reason Jack and Jill had such odd emotions about the boat slip was that it was all they received from their father.

Collectors Corner

The Natural History of British Birds by Edward Donovan. Christie's offered this edition of 244 hand-colored engraved plates in five volumes at auction in late 2018. Donovan (1768-1837), an Anglo-Irish writer, natural history illustrator, and amateur zoologist, created these plates, including this one of a puffin, from the 1790s to 1819, delicately and smoothly painting copper with gouache, giving his illustrations the appearance of being watercolors. Interestingly, although his books on fauna from around the world still are used as references, Donovan himself traveled little. His extensive collections of specimens were purchased mainly from the collections of others or at auctions from voyages of exploration. He died penniless, leaving a large family destitute. This book fetched $3,500 at Christie's.

Image courtesy of CHRISTIE's IMAGES, LTD.

Two mistakes

The father in this case didn't completely trust his wife to protect the financial interests of his children, which was why he liked the idea of the trust. That instinct proved to be sound. But had he named a corporate trustee, the protection would have been much better. He may have thought he was saving the expense of a trustee's fee by naming his wife and daughter as trustees, but that was penny wise and pound foolish. A corporate trustee provides reporting of trust assets as a matter of course.

The second error was in Jill not taking the role of trustee seriously enough. One of the drawbacks to choosing inexperienced relatives for trusteeship or estate settlement is that they will incur fees for professional services to be able to do the job properly. Jill's unwillingness to spend that money, and her failure to demand more of the trustee, led to the loss of nearly all of the children's inheritance. ■

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