Chapter One

Retirement: When Investing Becomes Serious

"Truth will ultimately prevail where there is pains to bring it to light."
– George Washington

The investment world isn't what it should be.

The bear markets of 2000-2002 and 2007-2009 shattered the confidence of investors and shredded their retirement dreams. More recently, the rise of high-frequency trading and roller-coaster volatility has only heightened fears. Investors have been burned too many times—they no longer trust the stock market.

Wall Street to the Rescue?

At the same time, Wall Street firms have made things worse. They have developed an endless array of ingenious investment products that appear to solve investors' fears. The narrative goes something like this: "You can reduce risk by diversifying across a wide range of asset classes, just like they do at the Harvard and Yale endowment funds." The menu of fund choices is broader than ever before: hedge, commodity, currency, real estate, energy, and so forth.

This would seem to be the perfect set of solutions. The managers often have national reputations, and yet ordinary investors are able to gain access to their expertise. However, there is a cost. After stuffing excessive fees and sales commissions (to entice advisors) into the products, client returns are likely to be sub-par at best. Moreover, there are often liquidity restrictions, making it difficult to cash out of the products. In many cases, these products have only lined the wallets of advisors, not those of their unfortunate clients.

A 2011 study by the National Bureau of Economic Research (NBER)[1] provides striking evidence that advisors often put their interests first at the expense of their clients. The research noted that advisor self-interest in generating fee income may lead to "faulty advice." In this study, trained auditors visited financial advisors posing as clients. The authors concluded, "Advisors encourage chasing returns, push for actively managed funds, and even actively push them on auditors who begin with a well-diversified low-fee portfolio." This type of behavior is a big reason why I wrote this book.

Retired or Planning to Retire: Investing Becomes Serious

The purpose of this book is two-fold:

1. Expose common investment myths and misconceptions.
2. Offer investors who are retired or planning to retire a simple and sensible investment strategy they can use to achieve their goals.

Some of the portfolios I see from new clients are nothing short of disgusting. They are the products of hunches, media hype and commission-driven greed. It's unfair and it's wrong. The investment business should be better than that. Investment advisors ought to be focused on the clients they serve, not the assets they can gather or the commissions they can collect.

For the retired or those planning to retire, this environment is even more disheartening. You've reached a time in your life when you would like to start living off all your hard work. But the market is so volatile that it doesn't seem to make sense anymore. Worse yet, you can't seem to find an advisor you can trust. The question gnaws at you: does my advisor really put my interests first? Or is my advisor just out to make the sale, grab a commission, and move on to the next prospect?

This book was written specifically for you: the retired or planning to retire. Maybe you plan to retire sometime in the foreseeable future, perhaps in the next five, ten or even fifteen years. I refer to this growing legion of future retirees as "pre-retired." Being pre-retired or retired, you face more complex investment challenges than younger investors. A major loss during retirement or in the five or so years before retirement can completely derail a financial plan. Worse yet, it can compromise the remaining years of your life.

Why five years? That's roughly the length of a typical market cycle—both up and down. If you sustained a major loss more than five years before retirement, you may be fortunate enough to see the market recover to previous levels before you need to start taking withdrawals for living expenses. That brings up another risk of being retired: taking withdrawals on a declining portfolio balance will accelerate the loss of your nest egg.

While a younger person usually has enough time to recover from a major loss, the prospects become much more unlikely as we get older. Our time horizons become shorter, and the stock market doesn't always cooperate with our personal timelines. Plus, it's more difficult—sometimes impossible—to get back into the workforce with a good-paying job.

The challenges you face as a retiree or pre-retiree are many and daunting. This book is intended to help you manage your investments effectively, avoid major losses that can wreck your finances, and enjoy a retirement filled with peace of mind.

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1. "The Market for Financial Advice: An Audit Study" by Sendhil Mullainathan (Harvard University), Markus Noeth (University of Hamburg), Antoinette Schoar (MIT). National Bureau of Economic Research, April 2011.