How to Keep Your Retirement on Track When Inflation Is Up and the Market Is Down

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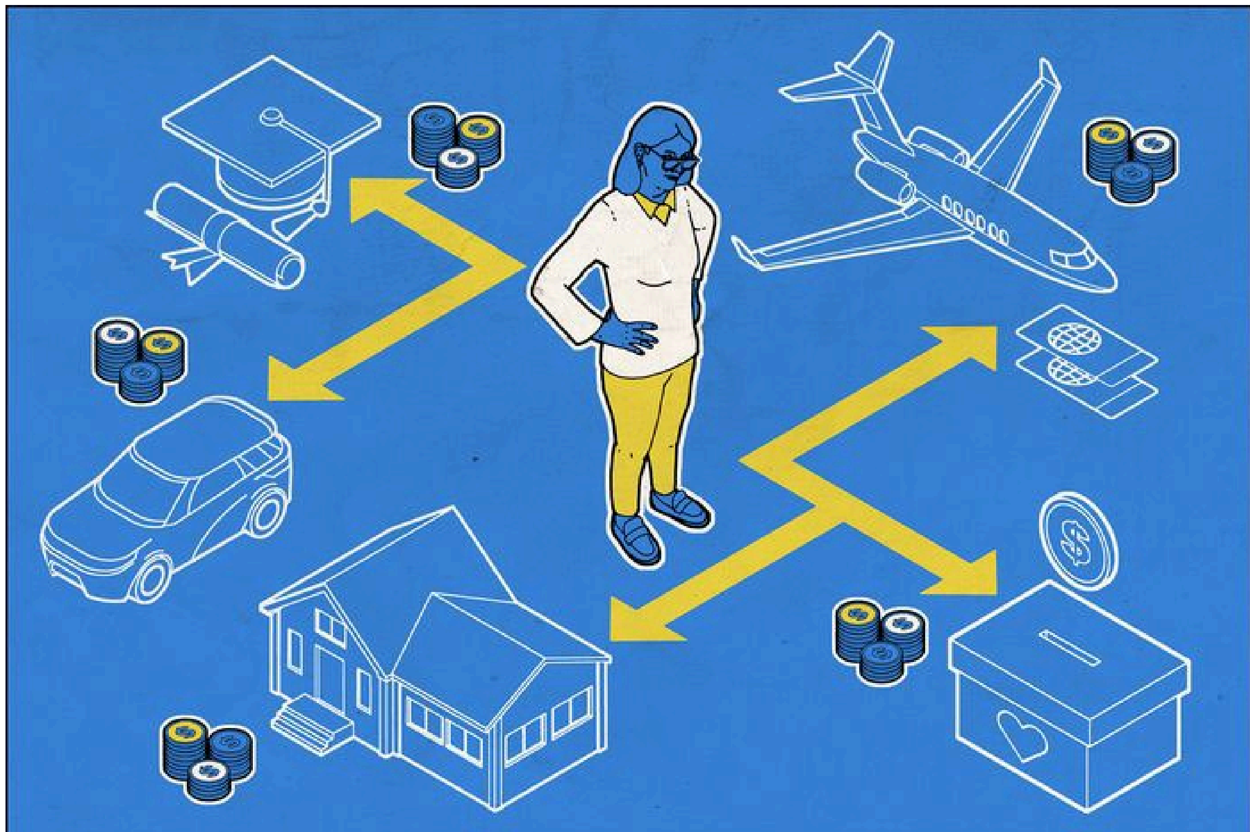

Illustration by SON OF ALAN / Lee Woodgate

Retirees and investors on the cusp of retirement are under stress this year. Inflation has spiked to multidecade highs, stocks have tumbled, and bonds—a haven in normal times—have slumped. The traditional portfolio consisting of 60% stocks and 40% bonds has had one of its worst years in a century.

No wonder retirement investors are so gloomy. Americans say they need $1.25 million to retire comfortably, a 20% jump from 2021, according to a recent Northwestern Mutual poll. A mid-November Fidelity report finds the average 401(k) balance has fallen 23% this year to $97,200. Not surprisingly, a majority of high-net-worth investors now expect to work longer than they had originally planned, a Natixis survey finds.

“Retirees are feeling the pressure,” says Dave Goodsell, executive director of the Natixis Center for Investor Insight. “Prices are going up, and the cost of living is a real factor.”

Investors’ retirement concerns aren’t unfounded, but it isn’t all doom and gloom. Rather than focusing on the losses of the past year, take a longer-term view and think about opportunities to make and save more in the next 10 years. Whether you’re on the cusp of retirement or already past your working days, exploring new tactics and committing to sound planning can help you take advantage of opportunities ahead and perhaps turn some lemons into lemonade.

“You don’t need a miracle,” says Goodsell. “You need a plan.”

Advice for Pre-Retirees

If you’re still gainfully employed, next year will present solid opportunities to build your nest egg, thanks to the Internal Revenue Services’ updated contribution limits. In 2023, investors will be able to contribute up to $22,500 to their 401(k), 403(b), and other retirement plans, an increase from $20,500, courtesy of inflation adjustments.

Employees aged 50 and older can save an additional $7,500 above that limit. Americans can also contribute up to $6,500 to their individual retirement accounts, an increase from $6,000. The catch-up contribution for IRAs remains $1,000. “You’ve got to take advantage of that,” says Brian Rivotto, a Boston-based financial advisor at Captrust, who is recommending that some clients max out their contributions.

Stock market returns are expected to be in the single digits for the next decade, but investors can also take advantage of the opportunity to buy stocks at far lower prices than a year ago. And bonds are yielding more than they have in decades, creating the opportunity for relatively safe returns in the 5% to 6% range. “This has been the worst year for the 60%/40% [stock/bonds] portfolio,” says UBS advisor Brad Bernstein. “But the next decade may be phenomenal because of where bond yields are now,” he says.

When Retirement Is Here and Now

Of course, many people on the cusp of retirement look at their year-end account statements with trepidation because they understand intuitively something that academics have studied extensively: Portfolio losses in the early years of retirement, when the nest egg is largest and withdrawals begin, can shorten a portfolio's life span significantly.

That phenomenon is known as sequence-of-returns risk, and a case study from the Schwab Center for Financial Research illustrates how big that risk can be. The study finds that an investor who starts retirement with a $1 million portfolio and withdraws $50,000 each year, adjusted for inflation, will have a very different outcome if the portfolio suffers a 15% decline at different stages of retirement. If the downturn occurs in the first two years, an investor will run out of money around year 18. If it happens in the 10th and 11th year, he or she will still have $400,000 in savings left by year 18.

To avoid the risk that you'll need to tap your retirement funds when the market has turned south, advisor Evelyn Zohlen recommends setting aside a year or more of income before retirement so that you don't have to draw on your accounts in a down market early in retirement. "The best protection against sequence of returns is not to be subject to them," says Zohlen, who is president of Inspired Financial, a wealth management firm in Huntington Beach, Calif.

In addition to building a cash cushion, investors can consider getting a home-equity line of credit to deal with unexpected bills, says Matt Pullar, partner and senior vice president of Sequoia Financial Group in Cleveland. "Your house is probably never worth more than it is now," he says. "If you have a short-term expense, it may be better to take out that loan than sell equities that are down 20%."

Investing While in Retirement

Rising interest rates are a potential silver lining for investors who can now earn meaningful income from their cash savings, thanks to better rates on certificates of deposit and money-market accounts.

Bernstein says he has been using bonds to generate income for his retiree clients, a task now made easier because of higher rates. "We're generating cash flow from the fixed income, ideally, for the clients to live," he says.

Captrust's Rivotto says retirees should consider pulling from the fixed-income part of their portfolio in order to give stocks time to bounce back. Even retirees need equities to provide the long-term portfolio growth necessary to sustain a retirement that could last 30 years or longer. "I tend to be more 70/30 [stocks and bonds], and that's because of longevity," says Rivotto, who is based in Boston.

Roth Conversions Are for Any Stage

Though markets have taken a beating this year, there are some silver linings for retirement investors. For starters, it may be an ideal time to convert a traditional IRA (which is funded pretax but has withdrawals taxed as income during retirement) to a Roth IRA (which is funded with after-tax dollars but has tax-free withdrawals). Roth conversions are taxable the year you make them, but the potential tax burden will be smaller for 2022, given that stocks have dropped in price. There's also an added bonus to doing so now, before Trump-era tax cuts expire in 2025 and individual income-tax rates revert to their pre-Trump levels.

Of course, an investor has to have cash on hand to pay for the taxes associated with a Roth conversion. Sequoia's Pullar suggests that clients do a Roth conversion at the same time they create a donor-advised fund, which "can relieve that pain via the tax deduction."

Another option is to do a partial conversion. The immediate tax burden will be smaller, and the Roth account may keep you from moving into a higher tax bracket in retirement, since withdrawals will be income-tax free, says Zohlen.

A conversion may also be a smart move for investors who intend to leave a Roth IRA as an inheritance for children or grandchildren, especially if they are in a higher tax bracket, advisors say. Under current rules, heirs have a decade to withdraw assets from an inherited Roth account. UBS' Bernstein says that he has done a bunch of conversions this year for his clients. "To leave your kids a Roth IRA that they can grow for a 10-year period—that's fabulous," he says.

Spending It Down

Lower stock return expectations for the next decade combined with longevity risk is a reason that some advisors are taking a more conservative approach to withdrawal rates in retirement. What's known as the 4% rule, which refers to the idea that you can spend 4% in the first year of retirement and then adjust that amount for inflation in subsequent years and not run out of money, had been the gold standard that financial advisors used when planning for clients.

"In the past few years, we've kind of moved toward 3% to 3.5% as a safer withdrawal strategy," says Merrill Lynch advisor Mark Brookfield. "We felt that stocks would have to perform a lot better over time than expected for a 4% withdrawal rate to be effective."

Regardless of which withdrawal strategy you choose, establish and stick to a budget, Zohlen says. That can have a big impact on a retirement strategy's success or failure. "What makes the 4% rule work is leaving the money in the account to work," she says.

“To me it isn’t, ‘Does the 4% rule work?’ It’s, ‘Does the client’s behavior allow us to rely on that?’ ”

Finally, don’t get carried away with the market’s ups and downs, says Sequoia’s Pullar. Perspective, he says, is an underrated part of retirement planning.

“This is my third time going through this kind of market volatility,” he says. He recalls that he proposed to his wife just as the 2008-09 financial crisis hit. “I was thinking, ‘Oh my gosh, what will I do?’ What I didn’t realize was that the following couple of years created great opportunities.” Today’s retirement investors are likely to look back in 10 years and come to a similar conclusion. As Pullar notes, “In the moment, it’s hard to see.”