Positioning Your Retirement Portfolio

Although the recession has been riddled with economic obstacles, the recovery that follows hopefully will be ripe with financial opportunities. When it comes to retirement planning, now is the perfect time to set new goals and rethink old strategies.

According to Mike Kruchten, Vice President and Senior Financial Consultant for First Midwest Financial Network, the U.S. economy is like a typewriter that's evolved into a computer. Although it's changed its shape over time, its fresh face was built on a very familiar foundation.

"There's a saying: Markets don't change; people do," Kruchten says. "Things have changed, but the fundamentals are still there."

Like the typewriter in response to technology, the U.S. economy is changing in response to the global economic downturn. Even in the face of recession, however, its fundamentals – including those that govern retirement planning, such as diversification and risk management – remain the same.

"Retirement planning is very important. The downturn hasn't changed that," Kruchten says. "What it has changed is people's willingness to ask for help. That's the downturn's silver lining. It has put investors in a position to ask for professional help in determining what their retirement goals are and whether they're putting away enough money to reach them."

More people are asking for retirement planning assistance, according to Kruchten, because retirement portfolios across the board have taken a substantial hit, and now is the time to rebuild them.

The New Normal

According to Jeffrey Kleintop, CFA, Senior Vice President and Chief Market Strategist for San Diego-based LPL Financial, post-recession, the fundamentals of retirement planning will be the same. Everything else, however, will be different.

"As a result, a more thoughtful approach – and perhaps a more active approach – is warranted when it comes to investing for retirement," Kleintop says.

In decades past, investors favored a buy-and-hold strategy for growing their nest eggs. And because the market for many years supported an always-upward trend, it worked – until the dawn of the 21st century, that is.

"For a long time, people felt like buy-and-hold was the right approach," Kleintop says. "They'd buy into the market and basically hold onto that money, which would grow a tremendous amount over time, and then they would have a lot of money to spend in retirement. Now people are realizing that buy-and-hold isn't all it was cracked up to be because markets are a lot more volatile than that."

Risky Business

It's not just investors' approaches to retirement planning that must adapt to the new economy, according to Kleintop. It's their entire definition of it.

"It used to be that you'd measure your success by the return reported on your quarterly statement," he says. "Now there's much more to it than that. Investing today means not just thinking about the return on your investment but thinking about your whole financial well-being."

As a result, retirement means a lot of different things now, Kleintop says. In many cases, for instance, people might have elderly parents they need to take care of, or they may have health care liabilities they didn't factor into the equation many years ago. "The whole range of obligations associated with retirement has changed," he says.

Because retirement has changed, so has risk, according to Kruchten. "Today, there are multiple levels of risk," he says. "Too many clients think of risk strictly as market risk. But what about inflation risk, or longevity risk, or medical cost risk? You have to look at the big risk picture when you're planning your retirement."

Although looking at the big risk picture means diversifying your portfolio so it can withstand market volatility, it also means positioning it to grow in step with the cost of living.

"I call inflation risk 'carbon monoxide risk' because you don't see it, but when it hits you, it can be devastating," Kruchten says. "I personally believe, however, that the biggest risk out there is longevity risk. With modern medicine we're living longer, and that's putting a major strain on pension funds, the Social Security system and Medicare – and on our retirement portfolios."

Old Ideas, New Opportunities

Keeping up with inflation, longevity and health care while still mitigating the risks of a volatile market requires a combination of traditional investment strategies and contemporary investment vehicles. And thanks to the downturn, that combination is easier than ever to create.

"A volatile marketplace can be unnerving, but it also creates opportunities," Kleintop says. "It's not just about stocks and bonds and cash anymore. It's about alternative investments. There are now many different ways that people can hedge their retirement risks."

So-called "alternative investments" give investors a new – and more effective – way to pursue the classic objective of diversification, Kruchten says.

For the past 50 years, conventional wisdom had investors diversifying their assets in the stock market, Kruchten says, often relying on the Morningstar Style Box categories – large value, large blend, large growth, medium value, medium blend, medium growth, small value, small blend, small growth.

"The problem with that approach is that in the last three years, with globalization, all of the boxes have started to behave like a single asset," he says. "The whole idea of diversification is that multiple assets aren't going to go in the same direction as the U.S. domestic market if it falls apart. But that completely imploded in 2008 when all asset classes went down the funnel together."

Although the theory of diversification is still an important one, Kleintop says, the means for achieving it is changing.

"Traditional diversification has failed over the course of the last few years," he says. "You could have been in real estate, commodities, stocks and bonds; all four of those have suffered tremendously, and they all went down together. What we're finding, however, is that there's a whole new toolkit available. You can still achieve diversification; you just have to look in new places to find it."

According to Kruchten, it used to be impossible for retail investors to buy alternative investments. "Because they're becoming very popular, however, there's now multiple means for an investor to buy into them, whether they buy them in mutual funds or in ETFs (exchange traded funds)," he says. "Thanks to globalization, these alternative asset classes are readily available, and may be a suitable component of your portfolio."

Planning Your Future

In up markets and in down, asset allocation is key. Before you can decide how to invest your money, however, you first must know how much of it you have and how much of it you'll need, which requires careful consideration and long-term planning.

As important as planning is, however, too few investors have actually sat down with a professional to do it. Although consumers assume it's complicated, calculating your needs takes only a few moments and produces a lifetime's worth of peace of mind, Kleintop says. "The financial well-being that comes from knowing what your needs are – and from knowing that you're on the path to achieving them – is very important and allows one to remain consistent in moving toward those goals, even in times of crisis in the marketplace."

Asset allocation and diversification cannot guarantee a profit or protect against a loss.

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