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Stopping the losses before retirement

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If you are preparing to retire within the next five years, you have some important decisions to make — and one of the most important involves your retirement income strategy.

Whatever your post-work plans involve, it is important to make sure your portfolio can sustain the lifestyle you hope to lead. This may mean travel, a second home, donating money to charities, or leaving money to your heirs. However, employing the growth-with-risk strategies of your working years, during the modest-yield-with safety years of your retirement, can be a recipe for disaster.

There are two recommendations older workers should consider. The first is to understand the amount of risk in each of their investment products, and the second is to consider a "financial second opinion."

There are two types of investments – colloquially called "red money" and "green money."

Red money consists of stocks, mutual funds and any investment that subjects you to loss in the stock market.

Green money products consist of savings vehicles that protect the investor from losses and still provide a reasonable rate of return, such as fixed index annuities.

Red-money products tend to be the primary source of investment income for workers in the early-to-middle stages of their working years, 30 through 55 years of age.

As you approach retirement, it becomes clear that your focus needs to shift to preserving your savings, as much or more than growing your accounts. At this age, the one thing you can't afford is the risk of significant losses, amid market declines like the ones we saw in 2000-2002 and 2007-2009.

In determining an appropriate amount of risk for an investor, one time-tested rule of thumb used in the financial world is the "Rule of 100." The basic premise is that the older you get, the less money you should have at risk. To arrive at this number, subtract your age from 100 to reveal the percentage of red, risk-based money your accounts should contain. According to this rule, the exposure to risk in the portfolio of a 62-year-old should be no more than 38 percent of the account's value. Much younger investors should, accordingly, allow for more risk in their investments.

For many, an FIA can be a valuable piece of the retirement puzzle

According to this rule, people in their 50s should begin putting more of their savings in green money vehicles than in red. However, the lack of return that many green money vehicles provide may dissuade people from using them.

Financial 'second opinion'

In many cases, they are right. Products such as CDs and savings accounts provide a guarantee that they will not lose their value, and in the case of savings accounts, provide ample liquidity and access. However, as of late April, the average savings account only offered 0.2 percent annual interest, and the average five-year CD only 1.3 percent, making it hard to justify them as a viable component of an investment portfolio.

There is another option. Fixed index annuities (FIAs) provide the same security and wealth protection as bank accounts and CDs, but tend to have much better returns.

According to a recent Wharton School study, the 1995-to-2009 annualized returns of FIAs have been in the 5-to-8 percent range, interest paid based upon linkage to the growth of a market index. And since they are insurance vehicles, they do not lose money when the stock market declines.

For many pre-retirees, an FIA can be a valuable piece of their retirement puzzle.

Regardless of what investment vehicle a person chooses, as you near retirement, it may be time to consider a "second opinion" on your financial strategy. It's often the case that the adviser who got you to retirement isn't necessarily the best adviser to get you through retirement. The same stockbroker who grew those assets at risk, very often does not have the skill set, training or experience to also handle the new, larger safety-focused portion. NHBR

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