Photo: Priscilla Du Preez

We have seen an increase in market volatility in early 2018. A steep pullback in stocks could be good news for working people who are building retirement funds, but those approaching or recently beginning retirement might be hurt.

Historically, stock market setbacks have proven to be buying opportunities for patient investors.

Example 1: Harry Walker was 50 years old in 2008, with most of his retirement savings invested in stock funds within his 401(k) account. Then, Harry's holdings dropped heavily.

Harry stayed the course and continued to buy stock funds as the Dow Jones Industrial Average (DJIA) rebounded from a 2008 low around 7,500 to 10,000 in 2009, 11,000 in 2010, and so on. Therefore, Harry has built substantial wealth, with the DJIA around 24,000 as of this writing.

Vulnerable to Volatility

Ten years later, Harry's situation is different.

Example 2: Harry is age 60 now, with $1 million in his 401(k). He plans to retire at 62, but a stock market collapse could trigger a 40% drop, reducing his $1 million 401(k) to $600,000. Harry might have to postpone his retirement or reduce the amount he withdraws from a smaller portfolio. If Harry stops working, he may not be able to keep investing and profit again from any market rebound.

Harry could avoid this potential problem by moving his 401(k) account from stock funds into cash. However, yields on bank accounts and the like are extremely low. If Harry moves out of stocks at age 60, he'll avoid market risk but also reduce his opportunity for substantial investment growth going forward.

Going for the Flow

Instead of moving 100% to cash, Harry could implement a so-called "bucket plan." These plans vary, but the key to success is to have a substantial cash bucket. Continuing our example, Harry Walker would figure out how much money he'll need for living expenses each month from his portfolio after he stops working. Typically, a cash bucket will hold at least a year's worth of cash flow.

Example 3: Harry calculates that he'll need $4,000 a month from his 401(k) or from an IRA after a rollover to maintain a desired lifestyle. If Harry needs to take $4,000 a month from his retirement plan, he would hold at

least $48,000 in his cash bucket at the start of retirement with this strategy. From the cash bucket, Harry would arrange to have $4,000 paid into his checking account each month, just as his paychecks from work were handled.

Regular Refills

Setting up the cash bucket is just the beginning of a bucket plan. That bucket must be replenished so cash can keep flowing.

One way to do this is to divide portfolio assets into two broad categories: fixed income (mainly bonds) and equities (mainly stocks). At regular intervals, money can flow from the fixed income bucket into the cash bucket and from the equities bucket into the fixed income bucket. This allows stocks to be held for the long term, which, historically, has been a winning investment strategy.

Other bucket plan strategies can be used. If this method appeals to you as a way to address possible market volatility, our team can go over your plan to illustrate how various portfolio assets can be delivered to you as after-tax cash flow.

Additional Retirement Resources

- Is your employer's retirement plan getting less attractive?
- Retirement Planning: How to get free money from your employer.
- Retirement Calculator

THIS POST ORIGINALLY APPEARED IN THE CPA CLIENT BULLETIN RESOURCE GUIDE, © 2018 ASSOCIATION OF INTERNATIONAL CERTIFIED PROFESSIONAL ACCOUNTANTS. REPRINTED BY PERMISSION.