Your *Best* Is Yet To Come

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The Story

The characters in this story are fictional and are not actual customers. This hypothetical example is for informational purposes only. Your actual experience will vary. Your own decisions should be made in light of your own financial situations.

Roger and Cathy had a goal with a magic number. The number was $500,000 and the goal was to retire.

Like a lot of people, they weren't really going to "retire." What they had planned was much more meaningful.

They had dreamed their whole lives of traveling around the world. They wanted nothing more than to tour the Imperial Palace in Beijing's Forbidden City, eat croissants along the Champs-Élysées and gaze upon the great pyramids in Giza.

After sharpening their pencils, they figured that if they could save $500,000, between their pensions, social security and savings, they could go on that trip.

They had been close before. <u>Really close</u>.

In 2007, they got all the way to $465,000. They started looking at flights. They updated their passports.

Then the markets crashed and Roger and Cathy's savings crashed with it — all the way down to $225,000 before it started heading back up again.

Now, after five long years of saving and sacrifice, they've hit their magic number. They have their $500,000 and they are ready for their next big adventure in life.

Risk Assessment

Before heading out on their long-awaited dream trip, Roger and Cathy thought it would be a good idea to sit down with a financial strategies firm that focuses on retirement. That's us.

The first thing we did was discuss their goals, their dreams and the things they wanted to focus on in order to bring meaning and fulfillment to their lives. That part, as you can imagine, was pretty easy. (Remember the trip around the world?)

Next, it was time to find their "uncle point." Your "uncle point" is the point where you have lost so much money in your portfolio over the course of a year that you cry, "Uncle!"

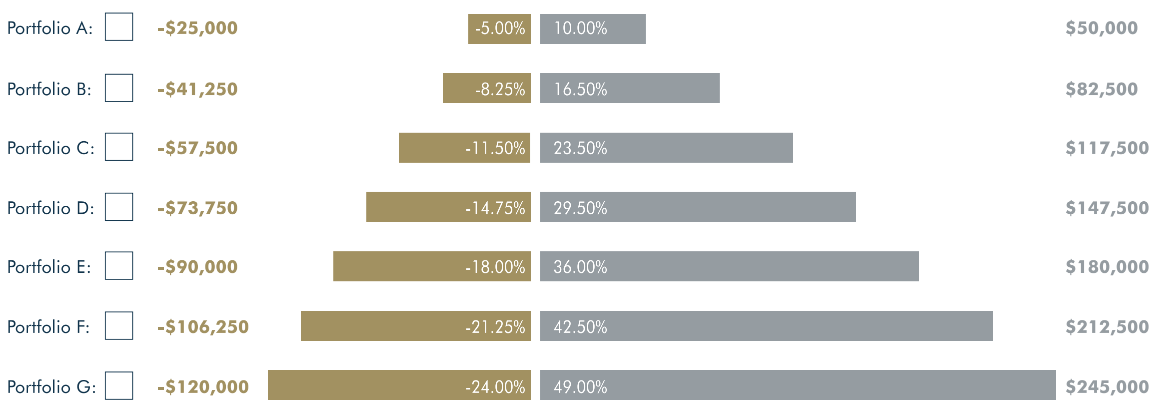
For Roger and Cathy, it looked a bit like this:

RISK ASSESSMENT EXERCISE

Prepared for: Roger and Cathy

The graph below shows the potential range of gains and losses in each of seven hypothetical portfolios at the end of a 1-year period. The number to the right of each bar shows the best potential gain for that portfolio, while the number to the left of that portfolio shows the worst potential loss. Given that this is the only information that you have on these seven hypothetical portfolios, which one would you choose to invest in?

Current Portfolio Value: **$500,000**



This hypothetical graph is for illustrative purposes only, is no guarantee of return or future performance, and does not depict the actual performance of a specific product or its investment options.

We simply asked Roger and Cathy how much they were willing to lose over the course of one year before they cried, "Uncle."

Cathy was certain that portfolio A, with a 5 percent loss, was too risky. She didn't want to lose anything ever again. Can you blame her?

Roger, on the other hand, felt that portfolio C was more representative of his feelings. This wasn't too surprising, as it's common for one spouse to be a bit more risky than the other.

After a little back and forth, they agreed that they could live with portfolio B. As long as they could keep their losses each year to less than 10 percent, they figured they should be able to happily focus on chasing their future dreams.

They didn't have to hit home runs with their portfolio any more. They simply had to hit singles and doubles.

Now that their risk assessment was out of the way, it was time to learn how their current portfolio would react to a stress test if the economy or the markets decided not to cooperate.

Stress Testing A Portfolio

Stress testing a portfolio is the process of trying to forecast what would happen to your money under a variety of conditions, whether related to political changes, changes in the market, natural occurrences like population shifts, etc. The process used to be difficult, if not near impossible. The best you could ever really do was to model how a portfolio would have performed during some historic time range and just assume that an identical event may occur in the future.

We all know how unrealistic that is. Future events will never be exactly the same as the past. As a result, stress testing a portfolio could best be described as a bit clunky.

That is, until computers got really fast and the amount of data available for crunching got really big. Big data + ridiculously fast computers = much more accurate predictions.

Today, we have the tools to realistically model a variety of potential economic events and determine the likely impact on a given portfolio.

For example, what if our economy goes into a recession — or a depression? How would that affect your individual portfolio?

What if China's economy goes in an unexpected direction? How does that affect you?

What if uncontrolled government spending leads to inflation — or deflation? Again, how does this impact your money?

What about changing demographics? What if the government creates a successful immigration plan? What if baby boomers (who have been responsible for a big part of the stock market's growth due to retirement savings) decide to start taking money out of the market for retirement? Where would that leave you?

Roger and Cathy had a list of three specific areas they were concerned about:

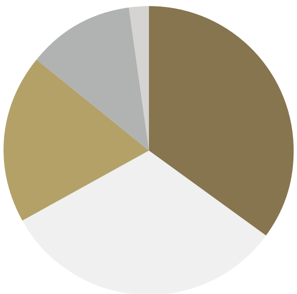
1. What if the economy goes into a recession?
2. Would changing demographics (particularly baby boomers) cause them any potential problems?
3. What about inflation/deflation?

Let's take a look at what we learned from Roger and Cathy's stress test.

Their Report

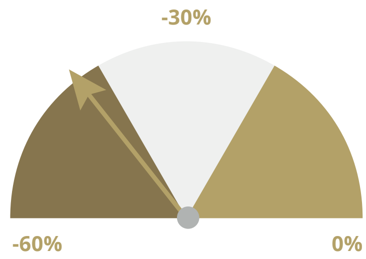
Below you can see a picture of Roger and Cathy's stress test report.

PORTFOLIO HOLDINGS



- 35.0% T. Rowe Price Equity Income (PRFDX)
- 32.0% American Funds AMCAP R4 (RAFEX)
- 19.0% DFA US Targeted Value R2 (DFTPX)
- 12.0% PIMCO Total Return Instl (PTTRX)
- Others

PORTFOLIO WORST-CASE RISK



The dial indicates the worst-case returns across all Hidden Levers scenarios

BEST CASE SCENARIOS

Scenario:	Portfolio Return:
Demographic Shift: Successful Immigration Reform	17.6%
What if the US benefits from immigration, with reform resulting in larger numbers of educated immigrants?	
Fed Street Test 2014: Baseline Scenario	8.6%
What if the economy continues to grow modestly and slowly recover from the financial crisis?	
Inflation: High Inflation	2.5%
What if dollar weakness or rising energy and commodities prices cause inflation?	

WORST-CASE SCENARIOS

Scenario:	Portfolio Return:
Inflation: Stagflation	-8.2%
What if growth is stagnant but prices keep rising?	
Inflation: Deflation: US Becomes Japan	-25.8%
What if the debt overhang caused by the housing and credit bubble takes years to overcome, causing a weakened economy and even deflation?	
Fed Stress Test 2014: Adverse Scenario	-32.5%
What if the economy falls into a recession with a severity like that modeled by the Federal Reserve's official supervisory adverse scenario?	
Demographic Shift: Baby Bust	-35.4%
What if aging baby boomers begin to decrease their spending and begin moving savings out of the stock market in order to support their retirement?	
Fed Stress Test 2014: Severely Adverse Scenario	-41.4%
What if the economy falls into a recession with a severity like that modeled by the Federal Reserce's official supervisory severely adverse scenario?	

Here's how the report breaks out. Based on the holdings in their portfolio, there are a few scenarios that would translate into good news for Roger and Cathy. Under "Best-Case Scenarios" we see that:

1. Successful immigration reform would be great for their portfolio.
2. The Fed's baseline scenario (what the Fed is predicting for the year) is positive.
3. High inflation is not so bad for them.

There's also some bad news in these results, listed under "Worst-Case Scenarios":

1. Stagflation and deflation are both not good for them.
2. A recession would have a significant impact on their savings.
3. Baby boomers switching to a phase of withdrawing money from the markets versus investing would be very harmful.

As you can imagine, Roger and Cathy were not interested in staying put with their money! Before going any further, though, we needed to remind them that there were other events that could happen in the world that could impact their life's savings.

Other Potential Risk Factors

One of the neat things about economic modeling tools these days is that there are literally dozens of events that we can model to gain a realistic idea of how they would impact a portfolio.

To the right you can see what we shared with Roger and Cathy regarding how other events might impact their money.

SCENARIO IMPACTS

Potential forward-looking impact listed below.

	Best Case	Worst Case
Debt Cliff	6.04%	-45.24%
Past Crashes	-26.72%	-42.86%
Fed Stress Test 2014	8.56%	-41.36%
Demographic Shift	17.55%	-35.41%
Inflation	2.51%	-25.79%
China Slowdown	1.05%	-24.99%
EU Recovery	11.51%	-22.23%
Obamacare	13.66%	-21.73%
Tech Bubble 2.0	18.90%	-20.30%
End of QE	16.44%	-19.94%
Commodities Perfect Storm	9.77%	-18.64%
Past Inflation	39.77%	-16.27%
Rising Interest Rates	6.35%	-16.25%
Domestic Terror Attack		-16.06%
Conflict in Korea		-15.32%
Housing Rebound	11.16%	-15.17%
US Credit Downgraded		-13.55%
Russia, Ukrazy	-5.02%	-13.54%
Iran	1.01%	-12.70%
Gold	0.00%	-12.47%
Syria + Middle East	13.74%	-11.78%
Bad News BRICS	16.16%	-10.85%
Municipal Bond Crisis		-10.46%
9/11/2001		-7.62%
Oil Prices	4.16%	-6.46%
Long-Term Crunch		-3.30%
Climate Change	-0.51%	-1.84%
Dollar Crash	3.44%	
Recovery Rally Continues	15.93%	

Does anything jump out at you? Do you see how many things could happen that have the potential of pushing Roger and Cathy past (sometimes well past) their “uncle point”?

If one of those events occurred, can you imagine how it would feel for them to lose their dream again?

What is nice about the report above is that it shows you how some events are good for a portfolio, while others are not so good. Intelligent investors protect themselves from the bad events first, and then take advantage of the good events as best they can.

The question is, what is next for Roger and Cathy?

How We Helped

Based on the goals that Roger and Cathy shared of protecting their portfolio so they could literally sail off into the sunset, we helped them restructure their portfolio into one that was significantly better protected against negative economic events.

We recognized together that they did not have to hit home runs. Roger and Cathy were happy with steady returns. They were okay with giving up some of the upside in the good market years in order to protect themselves in the bad years.

They've been through that before, and they were at the point in their lives where they felt like they no longer had the time or the mental aptitude to put up with that kind of risk again.

After setting up their accounts in a manner that was more appropriate for their circumstances, Roger and Cathy were able to focus 100 percent of their energy on their dream of a retirement that brought meaning and fulfillment to them.

WHAT ABOUT YOU?

What is meaningful and fulfilling to you? Is your portfolio properly structured to support that? Have you had your portfolio stress tested?

Imagine how good your future might be if you have everything aligned.

Next, imagine the consequences if you don't.

What do you think? Doesn't it make sense to get your portfolio stress tested today?

There is no obligation. It's easy. Give us a call.

877.213.7233

Our firm assists retirees and pre-retirees in the creation of retirement strategies utilizing insurance and investment products. By contacting us, we may discuss how those products may fit into your retirement strategy.

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