Retirement Security & Strategy

The Psychology of Retirement Account Decumulation



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"No wonder Bill Sharpe, the father of modern finance, called retirement finance the most daunting topic he has ever worked on." (1)

Why is retirement finance so daunting?

Retirement finance can be daunting because the strategies employed at the beginning of the decumulation phase of investing can impact the quality of life an individual will be able to enjoy in their sunset years—a period that deserves all the best benefits earned from a lifetime of hard work.

The two principal risks in decumulating retirement assets are calculating: (1) longevity, and (2) the amount of money needed to last a retiree's lifetime. Both determinations contain a great deal of uncertainty.

Today, we know individuals who retire in their mid-60s have a life expectancy of about 20 years. However, there is a strong correlation between one's current health and longevity. A healthy 60-year-old man or woman will very likely live longer than 20 years. The averages tell us approximately 28% of men and 39% of women will live past the age of 90—25 to 30 years post retirement.

How much money will an investor need to fund a 25 to 30 year retirement? Here again uncertainty is high. Most retirees begin with a budget of what they expect to spend over the years, but, an unexpected health crisis or other emergency can alter the effectiveness of that plan. A good rule of thumb for individuals planning for retirement is to expect *more*. Expect to live *more* years than you think and expect to be faced with *more* financial obligations than you would otherwise plan.

Knowing you have to solve for *more* years and *more* money than you might expect, the proper allocation of retirement assets thus becomes the most important decision an investor will make. This final decision is made even more problematic given the current investment landscape.

Today, the yield on the 10-year U.S. Treasury bond of less than 2% is materially below the average yield of 7% during the1980s and1990s and 4% during the first decade of 2000. At the same time, equity returns in the stock market between 1982 and 2000 averaged 18%. Over the last decade, the average return in the broad stock market decreased to 13%. Today, equity returns going forward are expected to be closer to 5%–10% per year.

Thirty years ago, the average retiree lived half as long and enjoyed future investment returns nearly twice as high as today. Put differently, today's retirees will live twice as long while their future investment returns will most likely be half the historical average. Knowing this, the financial calculus for retirees requires equities to play a much bigger role in an investor's portfolio while bonds must play a smaller supporting role.

(1) *Secure Retirement, Connecting Financial Theory and Human Behavior*; Jacques Lussier, CFA; CFA Institute Research Foundation; 2019.

EquityCompass

At EquityCompass, we have thought about these questions long and hard. In addition, we have rigorously tested various asset allocation strategies seeking to address the long-term objective of providing a 4% withdrawal rate, increasing by 3% annually to offset the effects of inflation, to produce an income stream for the longevity of a retiree's life—30 years. We recommend investors embrace a retirement account strategy that overweights common stocks and underweights fixed income securities.

Overweighting equities and underweighting bonds lies at the heart of the psychological challenges retirees encounter regarding decumulation. Risk tolerance studies reveal older investors are especially adverse to price volatility. We also know stock prices bounce more than bond prices, but, pacifying a psychological need for a "smooth ride" at the expense of achieving enough income to fund the later retirement years is not a smart tradeoff. If you ask an older retiree their greatest fear, it is not mortality—it is running out of money.

We believe a three-pronged approach to equity investing is ideal for retirees. One portion of the retirement portfolio equity should be invested in high-dividend-paying stocks that yield 4%–5% to help provide not only safety of current income, but growth of income as well. We believe high-dividend-paying stocks need to play an increasingly larger role in an investor's portfolio, even replacing a significant portion of that which was once dedicated to long-term bonds.

A retiree's equity portfolio should also include high-quality, large cap growth companies that are in a position to compound growth by reinvesting cash profits back into their business. This, in turn, will generate more future growth that is essential for the long-term capital appreciation needed to fund income withdrawals over a 30 year period.

In addition to high-dividend-paying stocks and secularly advantaged growth stocks, we believe it is prudent to include a risk management strategy to a retiree's equity portfolio. The purpose of an equity risk management strategy is to provide equity-like returns (higher than the bond market) when stock market conditions are favorable, with the ability to dial-back the allocation to cash when technical and/or fundamental indicators begin to deteriorate.

Today, more than ever, it is important that investors understand exactly what they own and why they own it. Seeking to achieve an income stream that will last not for just 10 to 20 years, but for 20 to 30 years, will require equities to play a bigger role in a retiree's portfolio. Effectively combining high-dividend stocks, growth companies, and an equity risk management strategy along with a smaller allocation of bonds, in our opinion, can help retirees enjoy much needed income withdrawals well into their 90s.

To better help investors appreciate the economic performance of the Core Retirement Portfolio please refer to page 5 for a discussion and analysis of portfolio growth in the decumulation phase.

Robert G. Hagstrom, CFA, joined EquityCompass as a Senior Portfolio Manager in April 2014 and launched the Global Leaders Portfolio in July 2014. In 2019, Robert was named Chief Investment Officer of EquityCompass. Prior to joining EquityCompass, he was the Chief Investment Strategist of Legg Mason Investment Counsel, and before that, the Portfolio Manager of the Growth Equity Strategy at Legg Mason Capital Management for 14 years. He has also served as President and Chief Investment Officer of Legg Mason Focus Capital and General Partner of Focus Capital Advisory.

Robert is the author of nine investment books, including *The New York Times Best Seller, The Warren Buffett Way, The Warren Buffett Portfolio: Mastering the Power of the Focus Investment Strategy, and Investing: The Last Liberal Art*. He earned his Bachelor and Masters of Arts degrees from Villanova University and is a member of the CFA Institute and the CFA Society of Philadelphia.

CORE RETIREMENT PORTFOLIO (CRP)

As of 12/31/2019

Highlights

- **Growth-oriented asset allocation**
  - Targets a 75/25 stock/bond allocation for higher growth prospects than available through generationally low bond yields
- **Equity allocation that focuses on high-quality large-cap stocks to seek income and growth with lower volatility**
  - Seeks to generate income through high-dividend-paying stocks
  - Provides diversification and opportunity through global equity exposure
- **Tactical equity allocation helps mitigate the impact of large stock market declines by reducing equity exposure**
  - Helps respond to market conditions and longer-term trends

Objective

A multi-strategy approach designed to fund retirement withdrawals by addressing four essential needs: income, capital appreciation, stability, and risk mitigation.

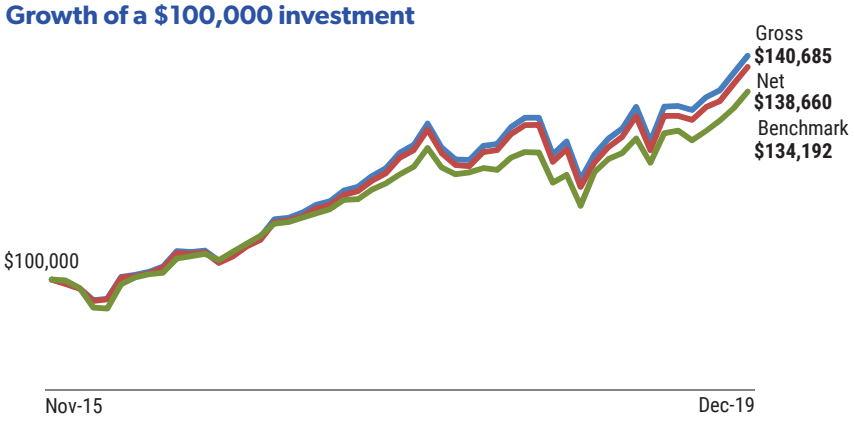
Portfolio Characteristics

Inception	November 1, 2015
Number of Holdings	58
Benchmark	
25% Russell 1000 Value TR	
25% MSCI ACWI Index	
25% HFRI Equity Hedge Index	
25% Barclays U.S. Intermediate Aggregate Bond Index	
Annual Turnover - 2019 (%)	18.1

Performance Overview

October 31, 2015 - December 31, 2019 | Past performance is no guarantee of future results.

Growth of a $100,000 investment



Risk Statistics (3-Year, Monthly)

	Portfolio	Benchmark
Standard Deviation (%)	8.11	7.09
Sharpe Ratio	0.99	0.89
Beta	1.10	1.00
R-Squared	0.93	1.00
Alpha (%)	1.08	0.00
Batting Average (%)	63.89	100.00
Up-Market Capture (%)	120.05	100.00
Down-Market Capture (%)	112.47	100.00

The growth of $100,000 chart presented herein is for illustrative purposes only. The chart illustrates the growth of $100,000 should it had been invested at the time of inception and includes reinvestment of dividends. It does not assume withdrawals or contributions. Any results shown above may not represent the actual experience of individual investors. Individual account performance may differ due to, e.g., account size, cash flows, investment restrictions, economic factors, and fees.

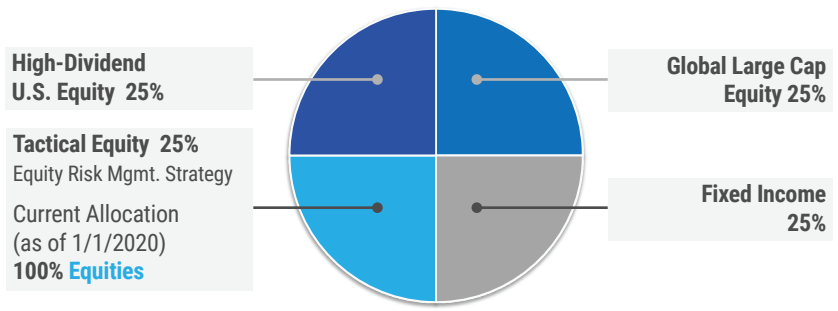
	Total Returns			Annualized Returns			Calendar Year Returns			
	3-Mos	6-Mos	YTD	1-yr	3-yr	Inception	2016	2017	2018	2019
Gross %	5.67	7.03	19.05	19.05	9.74	8.54	8.14	16.95	-5.08	19.05
Net %	5.58	6.84	18.64	18.64	9.36	8.16	7.77	16.55	-5.41	18.64
Benchmark %	5.64	5.98	18.33	18.33	8.00	7.31	8.17	13.09	-5.87	18.33

As of 12/31/2019; Inception—November 1, 2015; Net of fee calculated net of 35bps manager fee only; Benchmark = 25% Russell 1000 Value TR / 25% Barclays U.S. Intermediate Aggregate Bond Index / 25% MSCI All Country World Index / 25% HFRI Equity Hedge Index The information provided herein is supplemental to the GIPS performance presentation. To obtain a compliant presentation or a list of our composite descriptions and/or policies for valuing portfolios, calculating performance, and preparing compliant presentations, please call (443) 224-1231 or send an e-mail to info@equitycompass.com.

CORE RETIREMENT PORTFOLIO (CRP)

As of 12/31/2019

Portfolio Allocation



Holdings By Market Cap

	%
Large Cap - > $10 bn (%)	91.45
Mid Cap - $3.5 - $10 bn (%)	7.06
Small Cap - < $3.5 bn (%)	1.49

Top Equity Holdings By Weight

	%
SPDR S&P 500 ETF	12.68
PowerShares Russell 1000 Equal Weight	11.80
QUALCOMM, Inc.	2.98
NIKE, Inc.	1.60
Philip Morris International, Inc.	1.49
LVMH Moët Hennessy Louis Vuitton SE	1.31
Mastercard, Inc.	1.29
Apple, Inc.	1.29
Alibaba Group Holding Ltd.	1.26
Brookfield Asset Management, Inc.	1.24

For illustrative purposes only and not intended as personalized recommendations. The yield information included is as of the period indicated and should not be considered a recommendation to purchase, hold, or sell any particular security. There is no assurance that any of the yields noted will remain and may vary over time. The specific securities identified and described herein do not represent all of the securities purchased, sold, or recommended to advisory clients, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. A complete list of all recommendations made by the firm is available upon request.

Sector Allocation

	%
Information Technology	16.21
Consumer Staples	14.69
Financials	13.64
Consumer Discretionary	13.20
Utilities	8.89
Communication Services	8.11
Health Care	7.38
Industrials	5.56
Real Estate	4.77
Energy	4.46
Materials	3.09

Fixed Income Stats

	Portfolio
Wtd. Avg. Coupon	2.81
Wtd. Avg. Maturity	4.79
Effective Duration	3.87
Wtd. Avg. Div Yield	2.58
Investment Grade or Above (%)	99.80

Portfolio Management Team



Robert G. Hagstrom, CFA
Chief Investment Officer
Senior Portfolio Manager



Timothy M. McCann
Senior Portfolio Manager



James DeMasi, CFA
Senior Portfolio Manager

CORE RETIREMENT PORTFOLIO (CRP)

Portfolio Growth During the Decumulation Phase

The **Core Retirement Portfolio (CRP)** seeks to address three important financial goals for investors: (1) the ability to fund annual income needs, (2) protection against rising inflation, and (3) longevity.

CRP's four sleeves include high current income, growth, stability, and an equity risk management strategy. In order to achieve an estimated 4% withdrawal rate* that seeks to last 30 years, we believe long-term growth and capital appreciation are essential strategies needed to meet this financial goal.

If/when investors take an income distribution each year, a portion of the distribution is funded by common stock dividends along with fixed income payments and the other part is supported by the underlying growth of the portfolio.

Inevitably, there will be years when the total return of CRP is higher than the assumed 4% withdrawal rate, (2016, 2017, and 2019), and years when the total return is less, or even negative, as in 2018. The sequence at which the total return of CRP will be above and below the 4% annual withdrawal rate is unknown.

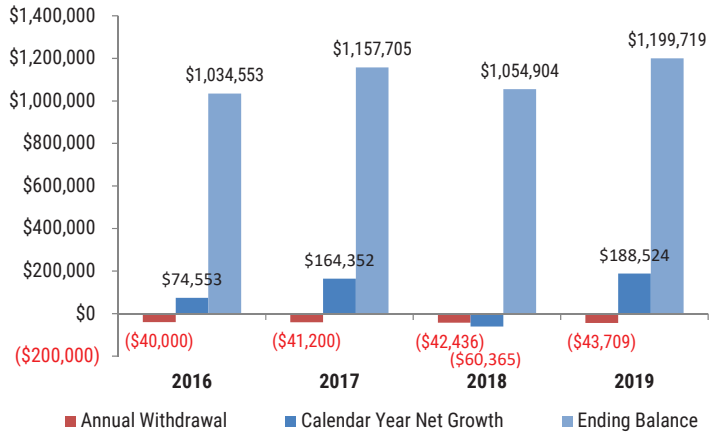
Therefore, investors should focus not on any one year of performance, but instead on whether the strategy is achieving its long-term objective as it seeks to maximize sustainable retirement income. For this reason, we have provided two illustrations to help investors better understand the economic progress of their investment in CRP as it relates to their income withdrawal objectives.

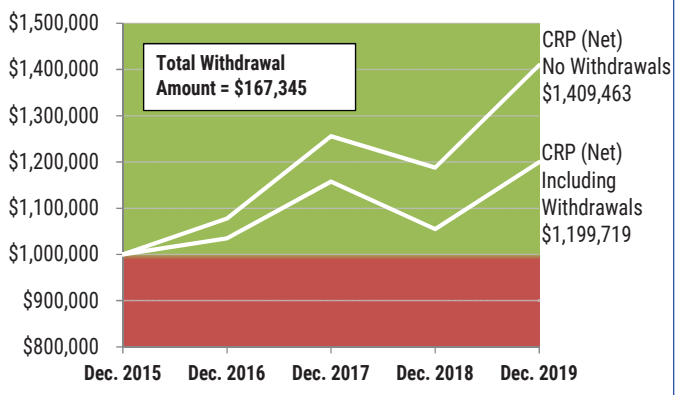
The charts below illustrate growth of the portfolio over the last four calendar years while assuming a 4% withdrawal, growing at 3% per year, and factoring in a 0.35% management fee. With an initial investment of $1 million at the beginning of 2016, this CRP account would have accumulated an ending value of almost $1.2 million at the end of 2019 and would have withdrawn $167,345 over this four year period.

This being said, the illustration shows that at the end of 2019 the CRP account had approximately $200,000 in net accumulated growth, after four years of withdrawals, available for future distributions up and beyond the initial $1 million investment.

While past performance is not indicative of future results, based on our research, we believe the Core Retirement Portfolio is well-positioned to help address the income needs of clients throughout the decumulation phase of their investment life.

Core Retirement Portfolio (CRP) Calendar-Year Growth During the Decumulation Phase





The calendar-year growth chart presented above is for illustrative purposes only. Based on a $1,000,000 initial investment at 1/1/2016 and assuming a withdrawal of 4% at the beginning of each calendar year and increasing the initial withdrawal by 3% per year going forward. Growth shown net of 0.35% manager fee. Time Period: 1/1/2016–12/31/2019. Any results shown above may not represent the actual experience of individual investors. Individual account performance may differ due to, e.g., account size, cash flows, investment restrictions, economic factors and fees. Source: EquityCompass

*Note: The 4% withdrawal rate is used for illustrative purposes and is not mandated by the strategy.



About EquityCompass

EquityCompass Investment Management, LLC ("EquityCompass") is a Baltimore-based SEC registered investment adviser offering a broad range of portfolio strategies and custom plans for individuals, financial intermediaries, and institutional clients in the U.S. and Europe. Formally organized in 2008, EquityCompass provides portfolio strategies with respect to total assets of approximately$4.3 billion as of December 31, 2019.* EquityCompass is a wholly owned subsidiary of Stifel Financial Corp.

The EquityCompass team of professionals represents deep industry experience in security analysis, capital markets, and portfolio management. We are committed to a consistent investment process that relies on enduring principles, sound empirical reasoning, and the recognition of a dynamic investment environment with a global reach.

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*Total assets combines both Assets Under Management and Assets Under Advisement as of December 31, 2019. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks, and different accounting standards. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility and are generally associated with a high degree of risk. Changes in market conditions or a company's financial condition may impact the company's ability to continue to pay dividends. Companies may also choose to discontinue dividend payments. High-dividend paying stocks may carry elevated risks and companies may lower or discontinue dividends at any time. Diversification and/or asset allocation does not ensure a profit or protect against loss. Any investment involves risks, including a possible loss of principal. Rebalancing may have tax consequences, which should be discussed with your tax advisor. ***Exchange Traded Funds (ETFs) are subject to market risk, including the possible loss of principal, and may trade for less than their net asset value. ETFs trade like a stock, and there will be brokerage commissions associated with buying and selling exchange traded funds unless trading occurs in a fee-based account. Investors should consider an ETF's investment objective, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other important information, is available from your Financial Advisor and should be read carefully before investing.***

The S&P 500 Index is an unmanaged, capitalization-weighted index that includes the reinvestment of dividends but does not include adjustments for brokerage, custodian, and advisory fees. This index is generally considered representative of the U.S. large capitalization market. Indices are unmanaged, do not reflect fees and expenses and are not available for direct investment. The MSCI All Country World Index captures large- and mid-cap representation across 23 Developed Markets and 21 Emerging Markets countries. With 2,434 constituents, the index covers approximately 85% of the global investable equity opportunity set. The Bloomberg Barclays U.S. Intermediate Aggregate Bond Index Unmanaged index that measures the performance of the US investment grade bond market while removing the longer maturity portions of the broad market benchmarks. The index invests in a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States --- including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. The HFRI Equity Hedge (Total) Index (HFRIEHI) is a fund-weighted index of strategies that maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques, strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Indices are unmanaged, do not reflect fees and expenses, and it is not possible to invest directly in an index. All performance results presented are done solely for educational and illustrative purposes and are not intended for trading, or to be considered investment advice. No representation is made that any Strategy, model, or model mix will achieve results similar to those shown in these materials. It should not be assumed that any holdings included in these materials were or will prove to be profitable, or that recommendations or decisions that the firm makes in the future will be profitable or will equal the investment performance of the securities discussed herein.

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