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Evaluating Your Risk Profile

Whether you are being prudent by completing some advance planning or you're concerned that recent market volatility is a prelude to a sharp or broader downturn, you are right to start thinking about how to transition your portfolio to a more conservative stance well before you retire. After all, investing heavily in stocks is often acceptable for young investors willing to take higher risk for higher returns, as they have time on their side to recover from market setbacks. But an overly aggressive investment strategy can leave you vulnerable to severe market downturns as you near the end of your career and earning years.

A substantial drop to the value of your portfolio just prior to, or soon after retiring can dramatically reduce the chances that your savings will be able to support you throughout a long retirement. The reason is that the combination of outsize investment losses, while simultaneously withdrawing from your savings for retirement income can so deplete your portfolio's value that it may not be able to recover sufficiently… even after stock prices begin rising again. This is known as sequence of return risk.

Unfortunately, whether due to complacency, failure to comprehend the risk one is taking, or another reason, many people fail to dial back their stock holdings as they enter the home stretch to retirement. As individual investors, it's often the case of "We don't know, what we don't know". But this is important, perhaps critical once we enter retirement. The good news is that 1) taking steps NOW to evaluate your risk profile as you approach retirement, and again as enter into retirement, along with 2) a sound withdrawal strategy, can mitigate sequence of returns risk.

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So how can you get adequate protection against market setbacks while also providing enough long-term growth potential, so your savings will be able to sustain you throughout a retirement?

First, be mindful that today's life expectancy is just under age 80 (prior to the pandemic) and has been projected to increase to 85.6 by 2060.

Start by determining a mix of stocks and bonds that is appropriate given your individual circumstances today. There is no single stocks/bonds allocation that is correct for everyone of a given age. But it's fair to say that for someone in their 50's who hopes to retire in 10 years, a 100% stocks portfolio is pushing the aggressive end of your time horizon risk-tolerance. I urge you to re-think how much risk you want to be taking as you close in on your planned retirement date.

One way to arrive at a blend of stocks and bonds that makes sense for you is to complete an asset allocation-risk tolerance questionnaire. The tool not only recommends an appropriate mix of stocks and bonds, but also shows you how that mix as well as others have performed on average in the past as well as in up and down markets.

You do not necessarily have to adopt this mix exactly. You could decide to opt for more stocks on the rationale that, since you plan to retire early, you will need more robust returns to sustain your portfolio through what will likely be a longer-than-normal retirement. Conversely you could lighten up on stocks, under the thought that you don't want to run the risk of a big setback early in retirement that could shorten the longevity of your portfolio. As a general guide, a stock stake of somewhere between 65% and 75% of assets would generally be considered reasonable for investors in their early to mid-50s.

Whatever mix of stocks and bonds you elect, you next want to think about what your overall allocation should be when you retire and or start withdrawing from your savings. The mix that makes sense for you as you enter retirement will depend on several factors, such as:

1. How long is your savings projected to last given the size of the withdrawals you plan on taking?

2. How comfortable you are seeing your retirement savings value fluctuate with market volatility.

3. What other sources of income do you have? (Social Security, Pensions, Taxable Accounts, Home equity, etc.)

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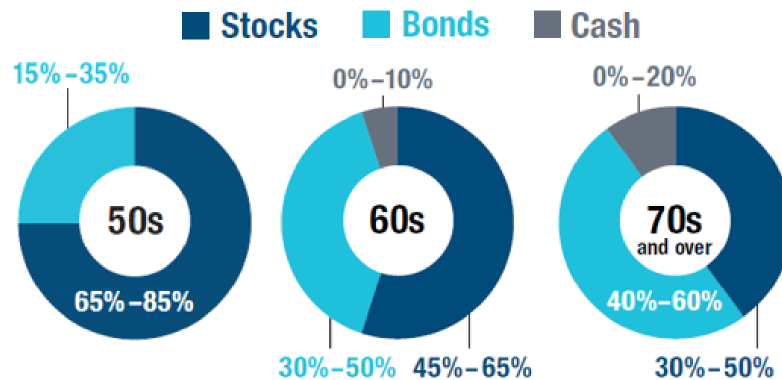
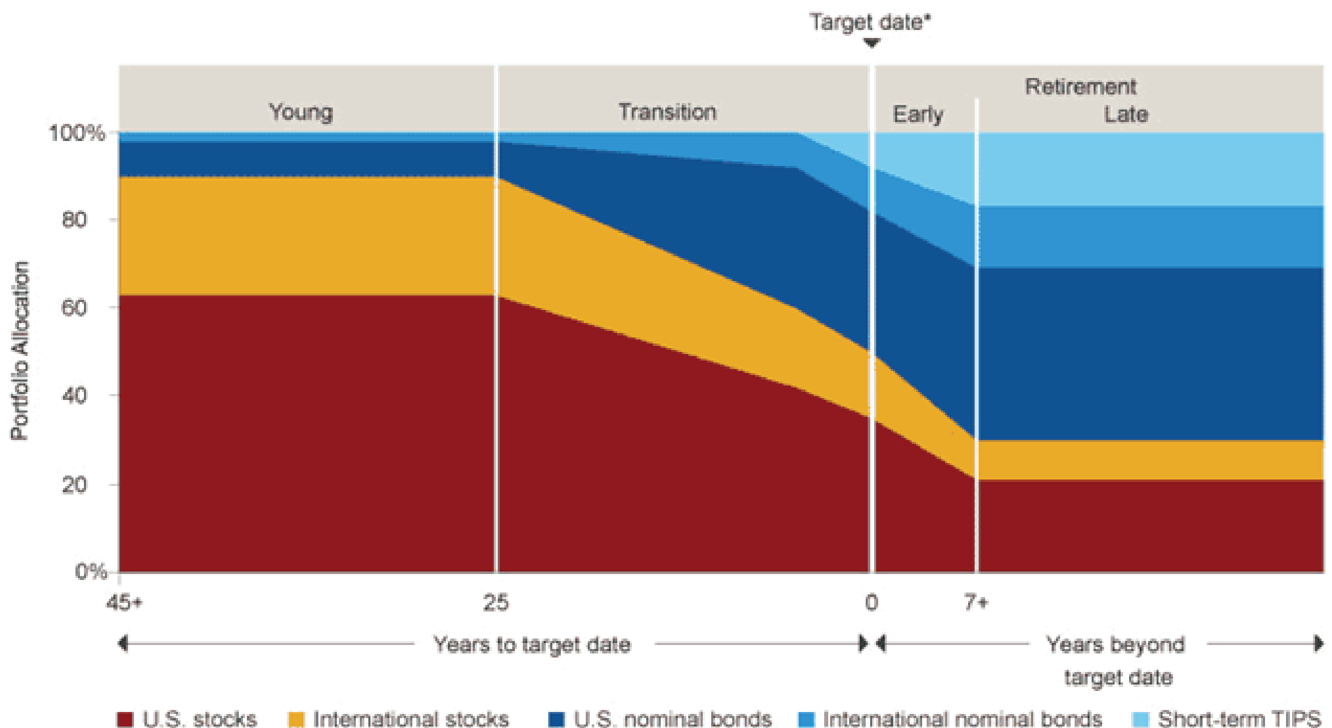
As a practical matter, however, many people enter retirement with somewhere between 40% and 60% of their savings in stocks.



Another easy strategy you adopt is to compare your current risk profile and asset allocation is to that of a like-kind Target Date Fund glide path (based on your projected retirement year) to see how you compare. You can get a sense of what sort of glide path might be right for you or if you are too heavy on risk, late in your career by comparing a typical industry glide path like the one below.



Vanguard Target Retirement Fund Glide Path

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Comparing your portfolio to the target-date retirement funds, today, 5 and 10 years from now. Is your allocation of stocks greater today? Notice how gradually stock allocations decline in the years leading up to, and then during, retirement? A typical glide path may or may not be right for you depending on your individual situation but is a simple place to start when looking evaluate current your risk profile prior to retirement.

If you are overwhelmed and or worried about your risk profile. Reach out to your MCF Advisors for further guidance and discussion on this important pre-retirement consideration.

Questions? Contact MCF Advisors.

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Evaluating Your Risk Profile

What do I need to know about investing?

EXPRESS LANE: LEARN 5 ITEMS OR LESS

what do I need to know about asset allocation?

> control your potential risk and return by adjusting the amount allocated to stocks, bonds, and cash

> allocate more stocks in the early years of your career

> gradually decrease the allocation and increase the allocation to bonds as you near retirement age

what is asset allocation?

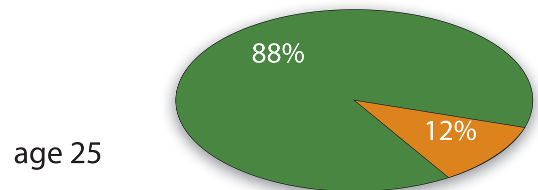
As mentioned previously in this section, asset allocation is the most important decision that you'll make initially, and the most important revision made to your portfolio over time. Asset allocation is simply how you decide to allocate (divide) your investments among the three major asset classes (stocks, bonds and cash). Independent studies have concluded that this decision is representative of over 90% of the potential investment return of a diversified portfolio, and that individual investment selection and timing have very little influence on the performance of a long-term portfolio.

The amount allocated to each asset class should be based upon an investor's current time horizon (the length of time between today and when they intend to start spending money in the account - in this case, retirement age) and risk tolerance, which is the level of risk an investor is comfortable accepting Therefore, a younger person with a longer time horizon would generally be more comfortable with a large portion of their portfolio in stocks, while someone closer to retirement would begin to favor the greater stability of bonds. Therefore, it's generally advisable to allocate a greater percentage of your portfolio to stocks during the early years of your career, and then gradually reduce the allocation stocks while increasing your allocation to bonds as you near your planned retirement age. Finally, the cash asset class should be added when an investor gets very close to retirement, and this lower-risk asset class will continue to be attractive during one's retirement years.

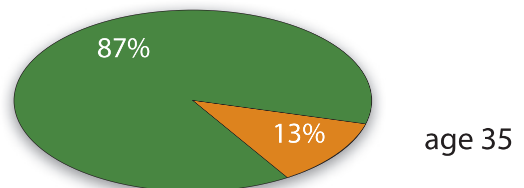
The pie charts shown here provide an example of how the average investor, with a planned retirement age of 65, might allocate their investments. These allocation models are based purely upon time horizon, so it should be noted that an investor may wish to be more aggressive or conservative than these models when factoring their personal tolerance for investment risk.

asset allocation models

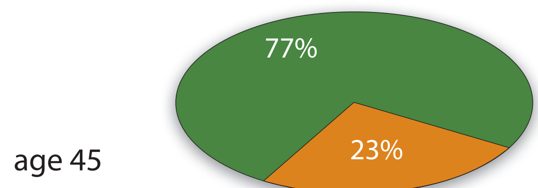
age 25



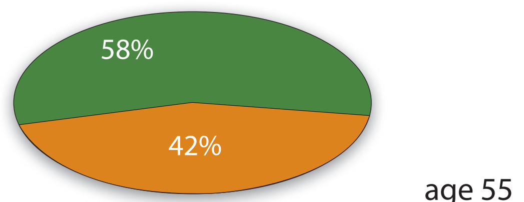
age 35



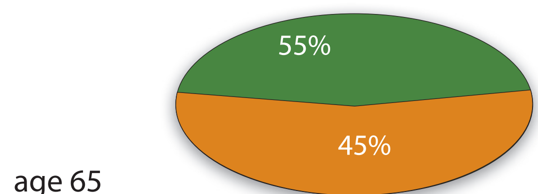
age 45



age 55



age 65



stocks bonds

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Creating and managing your own mix of investments

what is diversification?

Remember, asset allocation is the percentage of your portfolio that is allocated to each of the three major asset classes, and diversification is how you divide assets within one or more of the three major asset classes. Ultimately, the primary purpose of diversification is to reduce risk in your overall portfolio. For example, if you decided to allocate 70% of your portfolio to stocks, you would not want to invest the entire 70% in a single stock, because 70% of your portfolio would be subject to the success or failure of one company. Instead, you could substantially reduce risk by diversifying your allocation to stocks among many different companies, with different characteristics, operating in several different industries/markets.

mutual funds

One the most common methods of diversifying is to invest in mutual funds. These are investment companies that combine the assets of many individual and institutional investors into a single pool, which is invested into several, often hundreds, of different securities (stocks, bonds, etc.). Individual investors benefit by accessing the expertise and resources of a team of investment professionals who make all of the investment management decisions, and their investments are immediately diversified. Investors further benefit by sharing the investment management and operating expenses of mutual funds, which are spread across all of the fund's investors.

Every mutual fund has a stated investment objective that provides potential investors with information about the types of investments, management style and risk/reward characteristics of the fund. There are over 20,000 mutual funds available that offer a wide variety of risk and return characteristics based upon the types of investments and particular investment strategies of each fund. The table shown here illustrates the risk and reward characteristics of various types of mutual fund strategies.

Mutual funds with more aggressive investment strategies may offer potential higher investment returns, along with an increased risk of losing value. Likewise, funds with more conservative investment strategies offer greater protection from severe losses while limiting the expected investment return.

three step process

step one: asset allocation

Remember the first, and most important step is to determine an appropriate allocation of your portfolio based upon your time horizon and risk tolerance. Younger investors should have greater allocations to stocks, while those closer to retirement will want to favor the bond and cash asset classes.

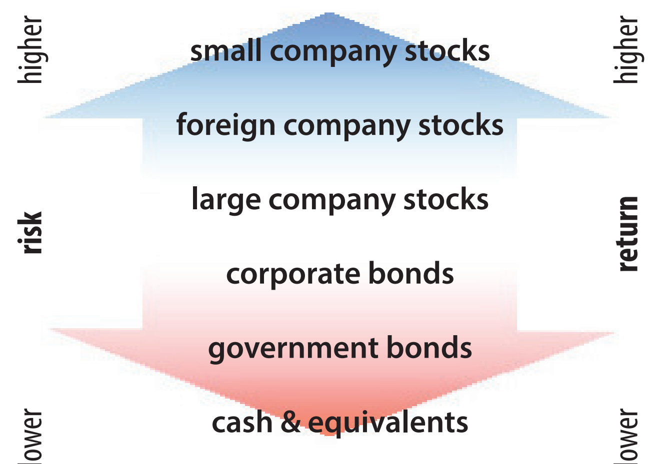
step two: diversification (choose your funds)

Your retirement plan offers a broad range of investments to choose from, which provides you with the ability to have a diverse mix of investments by adding funds from several asset classes to your portfolio. You can find more detailed information about each of the funds offered in your retirement plan in the next section of this guide.

step three: monitor and manage your portfolio

You will want to periodically review your investment mix and make adjustments so that your allocation gradually becomes more conservative as you near your anticipated retirement age. Additionally, you should periodically rebalance your portfolio so that it doesn't become more aggressive than you intended.

mutual fund asset classes



Asset Allocation Questionnaire

Successful investors adhere to a disciplined investing process. To evaluate which investment allocation may be appropriate for you and your retirement savings assets, answer the following questions regarding your time horizon, risk tolerance, and investment objectives. The result will lead you to an asset allocation strategy that may be appropriate for your particular financial needs and objectives. Asset Allocation is the process of investing money in a variety of asset classes - stocks, bonds, and/or other asset classes - that historically perform differently under various economic and/or market conditions. Combining different asset classes can result in a diversified portfolio. Diversification through asset allocation attempts to balance the level of risk with which you are comfortable and the level of return you would like to receive. *Diversification does not guarantee against a loss, and there is no guarantee that a diversified portfolio will outperform a non-diversified portfolio.

Question 1
When do you expect to begin withdrawing money from your investment account?

A. Less than 1 year
B. 1 to 2 years
C. 3 to 4 years
D. 5 to 7 years
E. 8 to 10 years
F. 11 years or more

Score (please circle one)
A. 0
B. 1
C. 3
D. 7
E. 9
F. 11

Question 2
Once you begin withdrawing money from your investment account, how long do you expect the withdrawals to last?

A. I plan to take a lump sum distribution
B. 1 to 4 years
C. 5 to 7 years
D. 8 to 10 years
E. 11 years or more

Score (please circle one)
A. 0
B. 2
C. 4
D. 5
E. 6

Question 3
Historically, investors who have received high long-term average returns have experienced greater fluctuations in their account values than investors in more conservative investments. Considering the above, which statement best describes your investment objectives?

A. Protect the value of my account
B. Keep risk to a minimum
C. Balance risk and return
D. Maximize long- term investment returns

Score (please circle one)
A. 0
B. 5
C. 10
D. 15

Question 4
Suppose you owned a well-diversified portfolio that declined 20% in a short period of time in a volatile market environment. Assuming you still have 10 years until you begin taking withdrawals, what, if any, action would you take?

A. I would not change my portfolio
B. I would wait at least a year
C. I would wait at least three months
D. I would make a change immediately

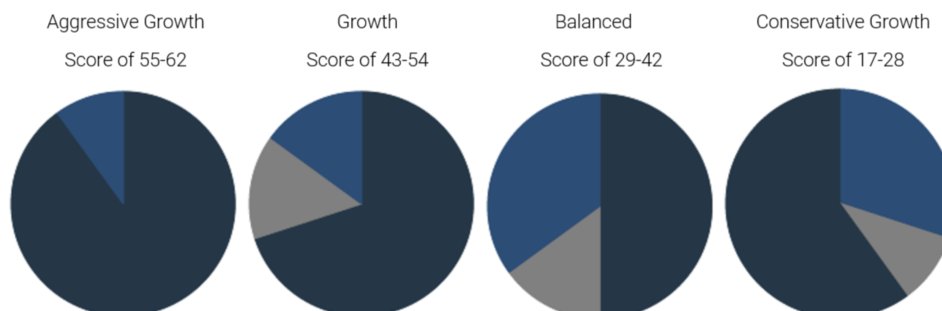
Score (please circle one)
A. 15
B. 10
C. 5
D. 0

Question 5
How do you feel about this statement "I am comfortable with investments that may frequently experience large declines in value if there is a potential for higher returns?"

A. Agree
B. Disagree
C. Strongly disagree

Score (please circle one)
A. 15
B. 8
C.0

Total Score ________



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Asset Allocation Questionnaire

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