RETIREMENT PLAN
Update

Wealth Management

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Because the time is now ...

The inflation equation

Investors should consider these measures to protect their retirement savings from inflation.

Every investor, especially those investing for their retirement, should be familiar with the potential impact of inflation and its power to derail dreams of financial security. At its most basic, inflation is simply the steady increase in the prices of goods and services over time within an economy. As general prices rise, the purchasing power of the consumer decreases.

In real terms, that means that inflation erodes the value of your long-term savings. For example, over a 30-year period, an average annual inflation rate of 3% will cut the purchasing power of a $200,000 savings account to only $82,397.

While the inflation rate over the last several years has been low, investors should still pay attention to it. If you are saving and investing for your retirement, you need to factor it into your planning because inflation has the potential to increase the amount of income you will need to maintain your preretirement standard of living. Moreover, certain expenses, such as health care costs, may increase faster than the inflation rate.

There are measures you can take now to protect your retirement savings from inflation. One of the most effective is to have a thoughtful asset allocation strategy.* When you invest your retirement savings in different types of investments, you will be able to take advantage of certain asset classes, such as stocks, which have the potential to grow faster than the inflation rate. Historically, stocks have outpaced inflation and produced higher long-term returns than bonds or cash alternative investments. However, past performance is not a guarantee of future results.

Look at the table below to compare the average annual total returns for different asset classes with inflation over the past 20 years.

20-year average annual total returns (through December 31, 2021)	
Stocks[1]	9.52%
Bonds[2]	4.33%
Cash[3]	1.31%
Inflation[4]	2.31%

1 Measured by the S&P 500 Index, an unmanaged index of stocks of 500 major corporations.

2 Measured by Bloomberg Barclays Capital U.S. Aggregate Bond Index, an unmanaged index of U.S. government, corporate and mortgage- backed securities.

3 Measured by Bloomberg Barclays U.S. Treasury Bill 1–3 month index.

4 Represented by the Consumer Price Index (CPI).

Past performance does not guarantee future results. Your investment results will be different. This chart is for illustrative purposes only and does not represent the performance of any particular investment. Investments cannot be made in an index. Stocks have greater return potential, but are more volatile than other investment types. Unlike stocks and corporate bonds, government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer fixed rates of return and stable principal.

Source: DST Retirement Solutions, LLC, an SS&C company.

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Boost your savings rate

You can also help protect your retirement savings from inflation by increasing your savings rate. When you contribute more to your retirement plan each year, you will be helping your retirement plan account keep pace with inflation. Think about contributing some or all of any bonus or pay raise you receive. Even a small increase in your savings rate can make a significant difference in your account value at retirement.

Work with a financial professional

Make sure you are on track to a comfortable retirement. A financial professional can work with you and help you monitor your account on a regular basis to ensure that your savings are staying ahead of inflation.

* Asset allocation does not guarantee a profit or protect against losses.

How exposed are your retirement savings to market risk?

Retirement plan savings can be exposed to risk in a volatile market. While no strategy offers a guarantee against losses, some strategies can help with managing the risks associated with market losses.

It's a given that the stock market is volatile and investors are at risk of suffering losses to their capital. Investors confront several different types of risks, including market risk, inflation risk and interest rate risk. Of these risks, market risk is one that all investors, but especially those who are investing for their retirement, should understand and prepare for. Essentially, market risk is the risk that the prices of securities may fall due to external factors like economic changes, world events, or investors' expectations and outlook. Investors in stocks are most likely to be impacted by market risk.

As traditional pension plans become less common, households with investments in 401(k) and other defined contribution plans increasingly bear the full brunt of turmoil in the stock market and the attendant market risk. Retirement plan investors have learned that declines in the major stock market indexes, such as the S&P 500, the Dow Jones Industrial Average and the NASDAQ, occur relatively frequently and have been occasionally severe over the last half century. One of the most severe downturns occurred during the February-March 2020 period in the early months of the COVID-19 pandemic, causing the value of equities in employer-sponsored retirement plans and household portfolios to fall by $14.2 trillion.[1] While the stock market has since recovered, it remains volatile and retirement plan assets remain exposed to risk.

While all investors have to temper their hopes for gains with the realization that the market can also deliver losses, they should also take concrete measures and employ strategies that can minimize both the potential for and the impact of capital losses. While no strategy offers a guarantee against losses, some strategies can help with managing the risks associated with market losses.

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Assessing your risk tolerance

Start by determining your risk tolerance. Your tolerance for investment risk is your ability to accept the chance of losses from an investment in return for the possibility of higher returns. You can measure your tolerance for investment risk by answering several questions:

When will I need the money?

If your retirement is a decade or more in the future, you may be able to take on more risk with your investments. If your investments experience losses in one year, you should have time to recover from them. However, if retirement is close, you may be better off reducing the percentage of your portfolio that is allocated to stocks and increasing the percentage allocated to bonds and cash equivalent investments. Essentially, this is a move from a strategy that stresses growth to one that focuses on earning a more modest return and preserving any gains you have made.

Would a big loss derail my future plans?

Ask yourself what would happen if your portfolio were to decline 15%, 20% or 30% in value? Would a loss of that size mean that you would have to postpone buying that dream retirement home or delay your planned retirement date by a year or more?

How large of a loss can I handle?

Like many others, you may overestimate your ability to handle a loss. If you put the loss in real dollar terms, you may have a better understanding of your tolerance for investment risk. How would you react if your $450,000 retirement plan portfolio fell by $45,000 or more in a severe market correction? What other assets, if any, do you or your spouse have for retirement?

Implementing risk management strategies

Once you understand your timeframe for investing and your tolerance for investment risk and determine what other assets you may have available for retirement, then you are in a better position to take measures to protect against market turmoil. The key to success in investing is to balance risk and potential reward. You can accomplish this by having a well-diversified portfolio and an appropriate asset allocation strategy.*

Diversification helps you manage risk by spreading your plan assets among a broad mix of different investments. Doing so allows you to take advantage of the fact that securities usually do not move in the same direction at the same time. The idea behind diversification is that the strong performance of one investment can offset the weak performance of another.

Spreading your portfolio among different asset classes, an approach known as asset allocation, takes diversification a step further. Investors who have a higher risk tolerance may decide to allocate a relatively large portion of their portfolios to stocks because of their greater return potential, while investors with a lower risk tolerance may choose a more conservative asset allocation.

As always, the input of a financial professional can be very helpful when you are crafting a strategy to protect your retirement savings from market turmoil.

1 Center for Retirement Research, Boston College, Issue Briefs, June 2020, How Exposed are Retirement Savings to Market Risk?

* Asset allocation and diversification do not ensure a profit or protect against losses in a declining market.

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