AES WEALTH

Financial Guardrails

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Financial Guardrails

At retirement, your whole financial life essentially collapses down to one binary question:

Will your money outlive you, or will you outlive your money?

Many people we meet aren't sure which retirement outcome they're going to get – in part because they didn't know about this overriding question.

Fundamental to our wider Financial Life Management service, is our proven system to help ensure ***you never run out of money in retirement.***

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What are 'financial guardrails'?

When it comes to your retirement, running out of money is never an option. That said, unless it's your intention, leaving behind a huge store of wealth is also not 'winning the game'.

As such, you need a strategy that keeps you somewhere in between the two outcomes, no matter what.

However, there are two major unknowns that make this very tricky.

First, you don't have any idea how long you'll be retired, which is a nice way of saying you don't know how long you'll live (if you did, your retirement plan would be easy and you could conveniently bounce your last cheque on the same day you die). However, to be safe, we plan for you to live to 100 – which is increasingly likely given the advances in healthcare.

Second, no one knows what the markets will do. All anyone knows is that at times, they'll go way up, and at other times, they'll go way down. It's a little like starting a journey without knowing the distance to our destination, and with no map on how to get there.

Since no one knows the length of your retirement or how the markets will respond, we've devised a system, similar to walking up a winding mountain path, which we like to call "guardrails."

How does this work?

- With each nest egg of say $1,200,000, we'll typically start your retirement by taking $5,000 of income each month (5% pa).
- This income will continue, adjusted for inflation, so long as your nest egg stays between $960,000 and $1,440,000 (+/-20% of the pot).
- If we drop below $960,000, either because of bad markets or because you decide to take a big distribution (say, to buy a $100,000 car), we'll plan to temporarily reduce your income to $4,500 until your nest egg recovers.
- Conversely, if your portfolio grew to $1,440,000, we'd increase your income to $5,500 to ensure you're enjoying your wealth, and you don't leave too much until the end.
- By being willing to tighten our belts during the bad times, we can safely take a lot more income during the good times, if you wished to.

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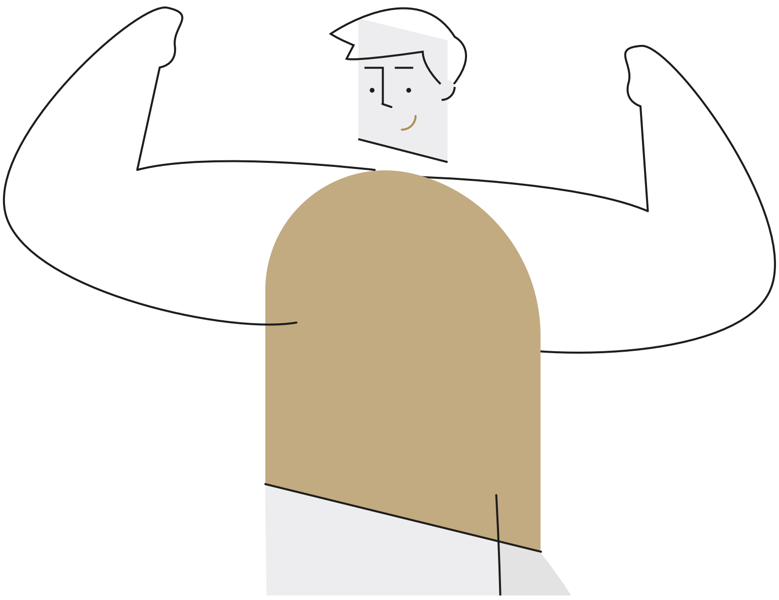
Will this work?

When asked the worst time in modern history to retire, most people think of the Great Depression. As bad as things were then, the worst time to retire in modern history was actually 1972. Not only did you have the bear market of '73-'74, when the markets fell 50 percent, but it was followed by more than a decade of extreme inflation. Guardrails worked in this period and every other period we've seen. While there's certainly no guarantee it'll work in every future scenario, based on everything we know and can control, guardrails are our best strategy.



What about the '4% Rule' or assumed rates of return?

The '4% Rule' is a rule of thumb which considers how much you could draw from a 60/40 portfolio, without running out of money. So, if you've $1,000,000, you'd start drawing $40,000 per year and continue this, adjusted for inflation, indefinitely. With that strategy, whether the markets do rocket or plummet, you're still taking out the same amount.

Being able to take a predictable, pay cheque-equivalent stream of income from a portfolio is appealing. But research shows retirees who are willing to be even a little bit flexible about their withdrawals, can generally take a higher starting amount—and in turn higher lifetime withdrawals—than those who are wedded to a fixed, real withdrawal system.

Using guardrails allows us to take out more when times are good, in exchange for being willing to tighten our belts when times are bad.

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30 Year Starting Safe Withdrawal Rate by Asset Allocation, 90% Success Rate (Rolling 30-Year Periods from 1927-2021)

	Starting Safe Withdrawal Rate %		Lifetime Withdrawal Rate %	
Equity Weighting %	Fixed Annual Withdrawals	Guardrails	Fixed Annual Withdrawals	Guardrails
100	3.5	5.2	3.5	6.3
90	3.6	5.3	3.6	5.9
80	3.7	5.5	3.7	5.6
70	3.7	5.5	3.7	5.3
60	3.8	5.4	3.8	5.0
50	3.8	5.3	3.8	4.8
40	3.8	5.2	3.8	4.5
30	3.8	5.0	3.8	4.3
20	3.7	4.7	3.7	4.1
10	3.5	4.5	3.5	3.9
0	3.3	4.3	3.3	3.7

Source: Morningstar, State of Retirement Income 2022

One of the reasons most firms and individuals use a fixed withdrawal rate is that it's very easy to implement. Just do the maths once, set up the monthly distribution, and you're on autopilot for the rest of your life (or until you run out of money).

On the other hand, for guardrails to work, we need to constantly monitor and adjust your portfolio, including maintaining a 'war chest' of cash and bonds, strategically rebalancing for income, and adjusting course when you hit a guardrail. That's all part of the service our team offers you.

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The 'war chest'

Whilst we can't predict when or where the next bad market will hit, we can say with total confidence that it will hit during your retirement, likely several times. In fact, Murphy's law says that the moment you quit your job, the markets will go down... a lot.

As such, we need to be prepared with a five-year war chest of cash, bonds, and other safe, stable investments. This way, when (not if) the markets go down, we have five years to ride it out before needing to sell anything at a loss.

Let's say you retired in 2007, just before the 2008-2009 financial crisis hit. While you watched the value of your investments get cut in half, our war chest would've provided five years of protection. In other words, 2008, 2009, 2010, 2011, and 2012 would've all been covered. So, even though a five-year buffer didn't get us totally back to all-time market highs, it did give us five years of safety through the worst of the decline.

What this looks like behind the scenes is that every year, if the markets are up, we'll top up your war chest.

When markets are down, we'll use your war chest until the markets are up again.

What if you want to make changes to your guardrails?

If you want a variation – just let us know and we'll run the numbers and explain the potential impact.

Why use guardrails?

Based on our experience, guardrails are the most useful, easy-to-explain tool for us to help keep you on track and fund your ideal future.

Why does implementing guardrails have such an incredible impact on you?

Guardrails make it virtually impossible to run out of money.

If anything, this strategy is more likely to err on the side of paying you an income you don't need, rather than leaving you high and dry.

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Other situations where guardrails work

A market downturn isn't the only event that can threaten to derail your carefully laid financial plans. Lots of things could happen in your life that might disrupt your finances, both expected and unexpected. These include:

- divorce
- illness
- death in the family
- bankruptcy

Whatever happens to blow through a lower guardrail, we have powerful systems in place to handle 80 percent to 90 percent of the scenarios that come up.

With guardrails, you'll always have a clear explanation of what we're doing. Whatever the situation, we'll be able to meet it together as a team.

The #1 key to guardrail success

Your behaviour.

For your guardrail strategies to really work and take you through the tighter times, you must be willing to take a reduced income. And just because you agreed to your strategy once, doesn't mean you'll always act consistently with the theoretical agreement you made several years ago.

That's why, with every progress meeting, we'll reiterate the guardrail plan. We may have to talk about what you might change in your lifestyle to accommodate that reduction, so that when you have to move to that reduced income, you know exactly what that looks like, and exactly what to expect.

You'll also need the discipline to 'stay the course' when your emotions are telling you to take a different path. We'll talk to you a lot about this aspect of your behaviour, which is typically the hardest part of the equation.

Next steps

It should be clear by now, that guardrails are the best way to keep you on track with your financial goals during your spending phase of life, regardless of your current concerns or what's going on in the news.

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How does this look in practice?

Retirement Income Guardrails Report

for Mr Flourishing-Future (USD)

This strategy is designed to give you the highest possible monthly income, without jeopardising your portfolio when the markets decline. It relies upon five key principles:

1. War chest of cash and bonds
2. Strategic rebalancing
3. Careful diversification
4. Tax efficiency
5. Discipline

Mr Flourishing-Future	Available
Portfolio Value	$2,000,000
Dynamic Distribution Rate	5.00%
Upper Guardrail	$2,400,000
Lower Guardrail	$1,600,000

Starting Monthly Income	$8,333
Upper Income	$9,166
Lower Income	$7,500

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How does this look in practice?

Retirement Income Guardrails Report

for Mr Flourishing-Future (GBP)

This strategy is designed to give you the highest possible monthly income, without jeopardising your portfolio when the markets decline. It relies upon five key principles:

1. War chest of cash and bonds
2. Strategic rebalancing
3. Careful diversification
4. Tax efficiency
5. Discipline

Mr Flourishing-Future	Available
Portfolio Value	£10,000,000
Dynamic Distribution Rate	5.00%
Upper Guardrail	£12,000,000
Lower Guardrail	£8,000,000

Starting Monthly Income	£41,600
Upper Income	£45,833
Lower Income	£37,500

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