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Individual Series – Retirement Risk

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Defining Risk

In our Article ***Vol. 1, No. 1*** on risk management, we divided the retirement risks into two major categories of Systematic Risk and Unsystematic Risk and put forth the First Axiom:

The less assets we have, the less risk we can take.

In this article, I will further define the risks of retirement. There are several considerations that we need to make when putting together our retirement plan. Protecting what we need is paramount.

We need to consider the following are risks associated with retirement[1]:

- **Market Risk**: the risk of your portfolio experiencing significant losses that persist for a longer than anticipated period.
- **Issuer and Credit Risk:** the risk that the issuer of our security defaults, has substantial risk of forfeiture because of downgrade, sale, or terms.
- **Inflation and Deflation Risks**: the purchasing power of our assets may be negatively impacted over time or the value of our leveraged assets may decrease.
- **Household Shock Risk**: death of a spouse, divorce, unemployment, deteriorating health conditions are examples of household shock risk. This includes the family unit, so this could occur with adult children as well as the retiree and spouse.
- **Spending Risk:** more than the planned income is spent and principal is depleted.
- **Income Risk:** the investments no longer obtain the desired results and income is decrease below the amount planned.
- **Healthcare Risk:** unexpected and expensive changes in the cost of maintaining health and requires above budget payments.
- **Longevity Risk:** the chance that we will outlive our money.

[1] Francois Gadenne, Retirement Income Industry Association, "The Retirement Management Analyst Designation, Curriculum Book for RMA Candidates, 2013 Fifth Addition

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- **Public Policy Risk**: changes in taxes, tax preferential accumulation accounts (taxation risk) and changes in the interest rates (interest rate risk).

- **Housing Risk**: a sudden change in health may cause an immediate and acute housing issue that exceeds all budget planning.

- **Sequential Risk:** the risk that the Market takes a significant loss in the first few years of retirement and the investor becomes suddenly conservative and cannot make up the difference.

- **Psychological Risk:** the loss of self-esteem, uncertainty, lack of disciplined schedule may cause irrational behavior.

- **Legacy Risk**: the desire to leave something for our heirs and take too much out to protect the next generation

- **Dependent Care Risk**: the unexpected care for elderly parents, children or grandchildren.

Using a chart initially developed by Francois Gadenne, CFA, RMA, below is a division of these risks into Systematic and Unsystematic Risks as developed in Article Vol. 1, No. 1.

Systematic Risks		**Unsystematic Risks**	
Political	**Business**	**Behavior**	**Chance**
Inflation/Deflation	Market	Spending	Household Shock
Public Policy	Issuer/Credit	Healthcare	Healthcare
Taxes	Income	Psychological	Longevity
Investment Returns		Legacy	Housing
			Sequential
			Dependent Care

The next article will explain the risk management techniques that are used in larger pools of risk and how we can adapt them to the individual risk pool.

Edu4Retirement, Inc. is specializing in providing retirement education and advice to our clients along with appropriate investment products to assist in mitigating retirement risk. Please think of us when it comes to retirement planning. We appreciate your referrals.

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