It is important to keep in mind that there are many variables involved in studies like these, but there is valid simplicity in making the argument that allowing flexibility in your spending approach can go a long way in not only assuring your original spending plan's sustenance, but it can even result in a higher payout if a disciplined approach is applied.

A few key things to keep in mind:

- In retirement, we have little control over the short term swings that affect our investment portfolio.
- While some may disagree, advisors have little control over the markets.
- Flexibility in spending should be an important consideration in retirement.
- Volatility cannot be managed by having a plan to sell at market peaks and buy at the bottoms.

Year-End Reminders

As we approach the close of 2016 here are a few important reminders for your planning.

- Charitable gifting: December 1 is the deadline for our custodian to process in-kind securities gifting.
- Tax Planning: We coordinate toward year-end with many of our client's tax accountants. Please let us know if we should be calling or meeting with your accountant for year-end tax selling or other planning strategies.

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Market Summary

Index Returns

3Q 2016	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	4.40%	6.29%	9.03%	-0.23%	0.46%	0.10%

Since Jan. 2001	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Avg. Quarterly Return	1.8%	1.4%	3.0%	2.8%	1.3%	1.2%
Best Quarter	16.8% Q2 2009	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009	4.6% Q3 2001	5.5% Q4 2008
Worst Quarter	-22.8% Q4 2008	-21.2% Q4 2008	-27.6% Q4 2008	-36.1% Q4 2008	-2.4% Q2 2004	-3.2% Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1–30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2016, all rights reserved. Bloomberg Barclays data provided by Bloomberg. Citigroup bond indices © 2016 by Citigroup.

THIRD QUARTER | 2016

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Volatility Is Back

Beware of inflexible spending plans

Year-End Reminders

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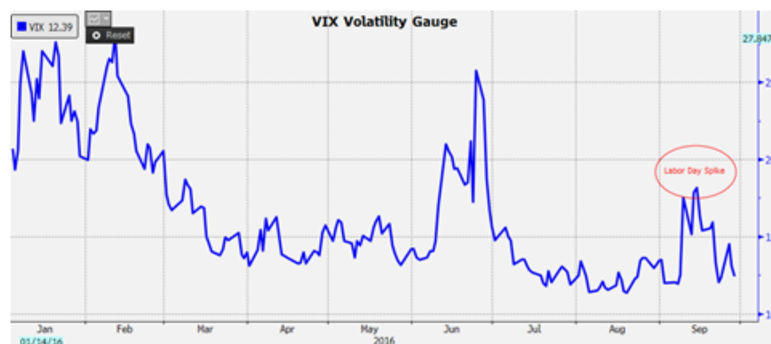
L to R: John Klobusicky, Peter LaBella, Donna Miltenberger, Jessica Mauck

Volatility Is Back

In our August newsletter, we touched on how investors were able to look back on a quiet, uneventful summer, with the VIX index—a volatility gauge—sitting at fairly low levels which we believed were not likely to be sustained through year-end—see chart below. This calm period has allowed investors to peak at their statements, feel good about the market and their investment plans, and perhaps move on to getting away from the "urgent", and thinking more about the "important".



As the chart shows, we did in fact get a bump in volatility around labor day, as a few Federal Reserve governors began talking up the possibility of an interest rate increase in September. Market complacency and low volatility seldom settle in for a long stay, and as markets look for validation amidst global growth concerns that the earnings recession is ending, we would expect more bumps in the road as we head into the fourth quarter. We do believe that the markets are looking through to 2017 and discounting an earnings recovery that will ultimately lead the market higher.

Risks over the near term include the Deutsche Bank situation, which if not dealt with quickly by the German government, could reverberate throughout the Eurozone banking system. However, we make the distinction between liquidity and solvency and, unlike Bear Sterns and Lehman Brothers, Deutsche Bank has significant liquidity on its balance sheet—over $200 billion euros. Systemic issues arise when there is a lack of liquidity in a major institution that cascades into the system, freezing up the wheels of the financial system. We do not see that as the case with Deutsche Bank. Capital concerns are very real, and Deutsche Bank with a market capitalization of barely $15 billion, coupled with a fine levied by the United States of $14 billion, is facing a capital crisis. While we still have concerns over capital levels and asset quality of European banks, the Deutsche bank situation is more isolated and not, we believe, systemic. It is likely that the German government will step in to help recapitalize the bank. Even so, this will be difficult for Angela Merkel amidst a charged political environment where her opponents are very much against bailing out any institutions.

The other new block in our wall of worry is the dire financial straits of the Chicago School District. If the teachers union and the District cannot come to terms on pension contributions that are already baked into the budget, we could see some disruption in the municipal bond market, as these issues are not isolated and are more common amongst cities dealing with underfunded pensions.

Beware of inflexible spending plans

As we leave the calm markets that we experienced this summer and enter what we believe will be period of heightened volatility going into year-end, we thought it appropriate to address a topic that few advisors approach: The inflexibility of our spending rate assumptions in retirement. Throughout our working lives, many of us have dealt with adversity that has called for sometimes painful adjustments to our everyday budgets, whether from job loss, sickness, or funding college tuition. These forks in the road were hopefully temporary, but called for a necessary discipline that kept us on track in managing our everyday budget and meeting our longer term financial goals.

Many advisors will run retirement plan estimates based on an inflexible spending approach. In other words, if a 4% spending rate is chosen at the outset of retirement that is the amount utilized in up or down market conditions, with no flexibility planned for a market decline or recession. This can be foolishly inflexible and does not reflect the volatile world in which we live. And just as we make adjustments to our spending during our working years in times of adversity, it is even more important that we consider these spending changes in later years when living off our investment portfolio, especially when our human capital-ability to earn-has been largely depleted and we are left to depend soley on financial assets to sustain our remaining years.

Below is a recent study from Vanguard, where they used lower expected returns—given the current high levels of the market, and estimated with an 85% probability of success that the spending rate will be sustained for the period shown. The key point here is that these estimates shown an INFLEXIBLE spending rate that is utilized in good and bad market scenarios.

Projected Withdrawal Rates, Inflexible Spending Moderate Portfolio (50% stocks, 50 bonds%), 85% Success Rate	
20 Years	5.6%
30 Years	4.3%
35 Years	3.9%
40 Years	3.7%

Source: Vanguard.

The second table below shows an adjustment to the spending rate if the investor is willing to be flexible with their spending plan. In this study, if the portfolio shrinks during the year due to a market decline, then the retiree cuts spending accordingly, but only up to 2.5% of the previous spending amount. For example, if the investor withdrew $40,000 in the previous year, when the markets sold off, then he/she would spend $39,000 the following year. Conversely, in the study, spending could be increased in bull markets by a maximum of 5% a year. The results of being flexible are significant, as shown below. Note that for the 30 year period, adding flexibility to your spending plan would result in a spending rate increase over time of 5.3%, or a 1% increase vs. the inflexible approach.

Projected Withdrawal Rates, Flexible Spending Moderate Portfolio (50% stocks, 50 bonds%), 85% Success Rate	
20 Years	6.7%
30 Years	5.3%
35 Years	5.0%
40 Years	4.7%

Source: Vanguard.