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How a Cash Stash Can Help Retirees Keep Peace of Mind, if Not Portfolio

By Neal Templin   March 6, 2021 8:00 am ET

Dreamstime

When the market crashed last spring amid coronavirus fears, retiree Tim McDermott didn't fret.

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The 58-year-old, who retired in November 2019 after running a derivatives exchange, keeps more than 40% of his assets in cash and near-cash investments.

"We could probably go 10 years without selling any stock," says McDermott, who lives in suburban Chicago. "I feel pretty comfortable when I go to sleep."

McDermott is among retirees who carry cash to protect themselves from market gyrations. "I want people to live the lives they've always dreamed of," says Sheila Padden, McDermott's financial advisor.

“It’s hard to do that if you’re worrying about the market all the time.”

While market downturns can be unnerving for any investor, they can be devastating for retirees who have begun spending down investments and must sell depleted shares of stock. If the market rebounds, those shares are no longer there. A string of bad years early in retirement, called sequence-of-return risk, can devastate a portfolio.

“Once you turn off the earnings spigot, and go into drawdown mode, now you’re really vulnerable to what happens in the market,” says Milo Benningfield, a San Francisco financial advisor. “The cash reserve becomes even more important.”

Building a cash cushion can be as simple as setting aside cash in a bank account. Yields are low but its purpose is to give you peace of mind, not earn a lot of interest. When stocks get pounded, you simply stop drawing money from your investment portfolio and live off your savings for a while.

Benningfield’s firm has a separate brokerage account—where it doesn’t charge management fees—to maintain a cash reserve in a money-market fund for its clients. The 59-year-old advisor plans to use a cash reserve when he retires someday.

Many market experts and academics don’t like cash bucket strategies. Larry Swedroe, chief research officer at Buckingham Wealth Partners, calls them market timing. Instead of a cash cushion, Swedroe says risk-averse investors should have portfolios with less equity. Swedroe, 69, says he has only roughly 30% of his personal investments in stock.

“Sequence-of-return risk is there,” Swedroe says. “But how you deal with it is you make sure you have a sufficient amount of safe bonds to dampen stock losses.”

Jamie Hopkins, a finance professor at Creighton University, says that holding lots of cash drags down returns. “I don’t like the bucketing approach,” he says.

Advisors say such criticism misses the biggest benefit of cash buckets: They stop clients from panicking and selling stock during market downturns. After crashing last year during the first weeks of the pandemic, stocks have since climbed to new highs.

“If last year is proof of anything, it is that staying in the market is so valuable,” says John Bovard, a Cincinnati-area financial advisor.

A cash bucket isn’t the only way retirees can minimize sequence-of-return risk. If you own a home, you can take out a reverse mortgage and only draw it down when the market drops. If you have a paid-up whole life insurance policy, you can take loans against the policy for the same purpose.

Research on both approaches shows that if retirees can avoid selling stocks during downturns, their portfolios can sustain higher withdrawal rates and last longer.

But whole life policies make the most financial sense if you’re at least 10 years from retirement so there’s time for cash value to build. And taking out a reverse mortgage often means paying thousands of dollars in up-front fees.

Paul Winter, a Salt Lake City financial advisor, is aware of research advocating that retirees borrow against their house during market downturns, but he prefers the cash-bucket approach. “I have a problem with recommending an increase in leverage to retirees as a response to a crash,” he says.

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> — Milo Benningfield, a San Francisco financial advisor

You don’t need a financial advisor to put a cash bucket strategy in place. For starters, figure out how long you want the bucket to last. Most advisors want clients to have enough cash to go two to five years without selling stock—enough to ride out most bear markets.

Clients with lots of Social Security and employer pension income will need less cash. Ones who depend heavily on withdrawals from their portfolio will need more cash.

How much cash also depends on how you react to market downturns. “Once I have a portfolio that is invested in a way that the client is able to meet all their needs, I recommend that they keep whatever level of cash helps them sleep at night,” says financial advisor Marienela Collado of Plantation, Fla. “I have some who are comfortable with $50,000 in the case the roof leaks or the car breaks, but I have others who need $1 million just for comfort.”

Don’t take risks to get higher yields when it comes to stashing your cash. Daniel Roe, a financial advisor in Columbus, Ohio, notes that the market for auction-rate securities, a near-cash product, froze up during the 2007-09 financial crisis.

“I’ve learned over time not to go too far out on a limb and this is supposed to be the safest of all assets the clients hold,” Roe says.

If you want more yield than cash, stick to other safe, liquid assets. In addition to a small amount of cash, adviser Mark Fonville keeps roughly 40% of clients’ portfolios in high-quality, short-term bonds that won’t suffer big losses if interest rates rise.

Cash buckets come in handy for all sorts of emergencies.

Last year, financial advisor Elyse Foster of Boulder, Colo., had one client who had had expensive repairs on his home and was glad to have the cash. She had another client who owned a lot of commercial real estate in Colorado who was forced to make concessions due to the pandemic and needed the cash.

“Clients said they were able to sleep at night through the volatility and uncertainty knowing they had the buffer to get them through,” she says.

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By Steve Goldstein   Updated March 4, 2021 3:49 pm ET / Original March 4, 2021 7:30 am ET

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