

## How Conservative Investing Threatens Retirement

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Just as the Great Depression left a generation with a poverty mentality that still persists, the two bear markets of the last 10 years risk shaped an entire generation's attitude to investing.

That's a key finding from a survey of affluent Americans commissioned by Merrill Lynch and released earlier this year, and it raises important implications for how financial advisors should deal with conservatively-minded investors.



Events over the past decade have made it fashionable for affluent investors to adopt a conservative approach to investing. That stance is the single biggest factor preventing investors of all stripes from achieving their retirement goals –and that's particularly the case for younger investors.

### **A perspective on conservative investing**

Categorizing yourself as conservative when it comes to investing is nothing new – for understandable reasons, this has historically been true for seniors and retirees. Bear markets such as 1973-1975, 1980-1982 and the tech meltdown of 2000-2002 broadened the appeal of conservative investing to include many in their 40s and 50s – and this certainly happened in the first half of the last decade.

Throughout those downturns, though, there was generally a consistent pattern where investors became more conservative with age.

The 2008 global meltdown turned this pattern upside down. Today six in 10 affluent investors under 35 consider themselves conservative –significantly higher than older investors aged 35 to 65. What's striking is that of those who call themselves conservative investors, 90% don't understand the extent to which this approach will lead to lower returns in stronger markets and can stand in the way of their retirement goals.

These are some of the findings from a Merrill Lynch survey of Americans with over \$250,000 in investment conducted in December of last year:



- Overall, 47% of affluent Americans described themselves as “conservative investors.”
- 41% of affluent investors aged 35 to 64 fell into this category, compared to 59% of those 18 to 34, whose average age is 31.
- Two-thirds of conservative investors believed that a mix of low and moderate risk investments will shield them from losses during market downturns.
- However, only 25% believed that this mix will result in sacrificing opportunity during stronger markets and just 10% hold the view that this approach may impede achieving their retirement goals.

### **Extrapolating from the recent past**

There are a number of reasons for this conservative approach among investors under 35:

- Due to the “lost decade,” most have never experienced strong markets – they are extrapolating future returns from those experienced in the recent past.
- Many lack a good understanding of the strong historical outperformance of stocks compared to bonds, cash and gold.
- Even if they are aware of this outperformance, recent events have led to a pervasive sense among many that the market is stacked against average investors – and that the rules of the game have shifted and historical patterns no longer apply.
- Most important, many conservative investors don’t have a good understanding of the returns required to achieve their retirement goals. While they see the immediate benefits of a low-risk approach in reducing possible losses, most don’t have a clue about the implications that a low-risk stance has on how much they’ll have to save, how long they’ll have to work before retirement and how much they’ll have to scale back their lifestyle after retirement.

Perhaps these conservative investors will become more aggressive and return to stocks after an extended period of strong market returns. Meanwhile, however, many of these investors have just missed one of the strongest two year periods on record. If it takes a further extended period of outperformance to bring these investors back to stocks, not only will they miss further positive performance, but they risk coming back into the market just in time for one of the corrections that typically follow periods of strong returns.

There’s really only one solution: Investors must better understand the ramifications of a conservative stance when it comes to investment returns. Whether done with an advisor or conducted on their own through one of the online sites, most 30 and 40 year olds will be shocked at what happens when their long term investment returns are 4% or 5% rather than 6% or 7%. If you’re in your 30s or 40s, even a 1% return differential makes a very big difference.

The investment industry as a whole and financial advisors in particular have a responsibility to help investors understand the tradeoffs they’re making by adopting a



conservative stance to investing, as do the academic community and commentators on personal finance in the media. Just to be clear, there's nothing wrong with investors making a conscious decision that sleeping soundly today is more important than having to work longer or scale back current spending to increase savings. Where this becomes problematic is when investors avoid risk without a good understanding of the implications and tradeoffs they're making.

One final note. If you're talking to the children of clients who might not share their parents' trust of financial advisors, consider using an online site like Intuit's Mint.com. It may help address some of the scepticism that advice to invest in stocks is driven more by the investment industry's interests than by theirs.

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*[Dan Richards](#) conducts programs to help advisors gain and retain clients and is an award winning faculty member in the MBA program at the University of Toronto. To see more of his written and video commentaries, go to [www.clientinsights.ca](http://www.clientinsights.ca). Use A555A for the rep and dealer code to register for website access.*

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