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8/23/2012

Using a Bond Ladder to Protect your Retirement Plan

A hallmark principle of successful retirement planning is to have three to five years of predictable cash flow to live on during the first several years of retirement. If you retire at the beginning of a down market, you will not have to sell stocks that are down to live. The concept is to create a bond ladder that each rung of the ladder represents one year of budget needs. If the market is positive, sell stocks that are up and live on that money. The bond that comes due that year is reinvested as a new higher rung on the ladder to become due in a later year. If the market is negative, use the bond that year for your budget and keep the stocks invested in the market allowing them to get back into positive territory.

Assume two clients invest $1 million and achieve an average rate of return over a 10-year period of 5.1%. Their portfolios realize this average by generating the returns listed in the chart below. You'll notice that they both experience the same returns but in the opposite order. Client 1 experiences a bear market in the first three years, while client 2 experiences negative returns in the final three years. However, the value of both portfolios at the end of the 10 years is the same.

	Initial Down Market	**Initial Up Market**
Year 1	-20%	24%
Year 2	-8%	18%
Year 3	-6%	14%
Year 4	4%	12%
Year 5	6%	8%
Year 6	8%	6%
Year 7	12%	4%
Year 8	14%	-6%
Year 9	18%	-8%
Year 10	24%	-20%
Value at end	$1,525,347	$1,525,347

In the next example, the retiree needs to withdraw $50,000 each year to live on. The sequence of returns you experience in the market while making withdrawals can have a significant impact on the value of your portfolio. Let's assume the same portfolio, average rate of return, and sequence of returns over a 10-year period. However, this time, let's assume both clients withdraw $50,000 a year. You'll notice that the outcome is very different. Client 1, who takes withdrawals during three years of down markets at the beginning of the 10-year period, would end up with far less than Client 2, who experiences down markets only at the end of the period. The bond ladder for Client 1 would mitigate this risk of early down markets.

	Initial Down Market	**Initial Up Market**
Year 1	-20%	24%
Year 2	-8%	18%
Year 3	-6%	14%
Year 4	4%	12%
Year 5	6%	8%
Year 6	8%	6%
Year 7	12%	4%
Year 8	14%	-6%
Year 9	18%	-8%
Year 10	24%	-20%
Value at end	$630,178	$1,074,455

Another point to consider is establishing the cash pool to purchase the bond ladder in the three to five years approaching retirement. Many of my clients wait until actual retirement to create the bond ladder. This should be in place before retirement. I hope this helps you understand this important retirement principle.

I hope this helps you with your retirement planning, estate planning, tax planning, and financial planning journey. Let me know if I can be of assistance. I welcome the opportunity to be a part of your team.

John B. Cornetet