Stock Market Perspective: Should Percent in Stocks be 100 – Age?

That formula is often provided by publications or "experts" that provide financial guidance. It is obviously simplistic. Should someone over 100 sell stocks short and use the proceeds to buy bonds? Even if the interpretation is all bonds and no stocks, I suspect nobody over 100 cares much about portfolio composition[1].

A little more seriously, should Warren Buffett, Bill Gates, and the like be concerned about the stock percentages of their portfolios? Any formula that does not incorporate an individual's financial circumstances is not going to be of much use.

Much more seriously, the almost universal guidance is that the proportion of one's portfolio in stocks should be reduced as one approaches or is in retirement with the percentage in bonds or fixed income investments increasing correspondingly. So-called target-date funds have become popular in the past few years as all purpose options for retirement and other accounts. They are often the default choice in 401(k) plans for those who do not specify how they want the contributions invested. These funds all have a "glide path" that reduces the percentage in stocks at the target date approaches. Depending on the length of time to that date, the initial stock holdings may be quite high. Depending on their philosophies, the proportion of stocks held at the target date may be zero or it still may be as much as 50%.

Is the traditional "glide path" a good investment strategy? Probably not near the beginning or end of one's career.

The widely held belief that a high percentage in stocks is a good idea for younger investors is challenged in recent article, *What Are We Doing to Our Young Investors?,* by Rob Arnott and Lillian Wu or Research Affiliates, an investment firm noted for "smart beta" indices and funds. A follow-up article by Noah Beck of the same organization, *Retirement Planning: Millennials vs. Boomers,* also discusses the portfolios of those in or near retirement. The key observation in both articles is that it is vital to look at one's "investment portfolio" as consisting of much more than stocks, bonds, mutual funds, and the like.

When one is done with school and starts working, in most cases his or her main asset is the earning power over a career than is expected to stretch over 30 years and often quite a bit longer. That earning power behaves more like a stock than a bond. The income it generates is analogous to dividends paid by equity and can be highly variable or go to zero if one becomes unemployed. As such, it can be a risky asset. Moreover, in poor economic conditions, losing a job or not getting a raise is more likely. That is also when stocks are more likely to have fallen.

An additional risk is that a (young) person losing a job may need or want to "raid" a 401(k) plan to make up for the lost income. That creates the risk that stocks have fallen just when they are to be cashed in.

The "solution" is avoiding any investments in stocks, and hence in a target-date fund, until some financial reserves in stable investments have been accumulated. The Arnott and Wu article suggests six month's income, a "rainy day" fund, and Arnott's father advocated that all 40-year olds should have at least a year's income in liquid investments to provide flexibility and freedom from being tied to a paycheck. Once this fund has been accumulated, Arnott and Wu suggest an allocation of 1/3 each in stocks, bonds, and diversifying inflation hedges would be more appropriate and safer than the typical target-date (more than 25 years in the future) fund that has a 70% or higher allocation to stocks.

[1] The most notable exception is Irving Kahn who recently turned 109 and is still working at the Kahn Brothers Group brokerage. He is one of four extremely long-lived siblings—all have lived to at least 101—whose genetic makeup is being studied.

Moving towards the other end of the spectrum, what about those in or near retirement? Should they reduce their equity holdings and increase the fixed-income proportion of their investments? Beck says that likely is not the way to go. The reason again is that additional assets need to be considered, and they behave like fixed-income investments.

The most significant of those is Social Security. It behaves like a bond that never matures with an inflation-adjusted interest payment every month. According to the Social Security Administration, it provided about 35% of the aggregate income of the retirement age population in 2012. Pensions from traditional defined benefit plans or from 401(k) type accounts accounted for another 17% of aggregate income. They are also essentially a fixed income investment.

Investment income was about 10% of the aggregate income. Depending on the portfolio, the income may be from equities, bonds, alternatives, or a combination. Continued employment or business income accounted for about a third of the aggregate income. As discussed above, these behave like equity investments.

All told those of or near "normal" retirement age likely have already built their "glide path" when Social Security and pensions are taken into account. That means reducing equity holdings either through continued 401(k) contributions or in investment portfolios may not be appropriate, and increasing them might be suitable.

Of course, an individual's specific investments should depend on his or her financial circumstances, and nothing above is to be considered as telling anyone what they need to or should do. The main point is that when making investment decisions one needs to look beyond what is in traditional investments—mutual funds, brokerage accounts and the like—and consider additional assets such as earning power, pensions, and Social Security. This is particularly so for those at either end of the typical career timeline.