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RETIRING

When You’re Forced to Cash Out in a Bear Market

You can’t leave money in your I.R.A. forever, as dictated by I.R.S. rules. This can put retired investors in a tough spot.

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Financial planners warn investors against trying to time the market. It is notoriously difficult to guess exactly when sentiment on Wall Street will reverse course — even professionals are likely to get it wrong.

Yet that is essentially what countless retirees are forced to do these days — play chicken with a volatile market roiled by 40-year-high inflation, the war in Ukraine, associated supply shocks and increasingly downbeat consumer sentiment.

For retirees mandated by Internal Revenue Service rules to take required minimum distributions from tax-deferred retirement vehicles like individual retirement accounts or 401(k)s, the prospect of having to pull funds out during a bearish market is unpalatable enough to prompt some to tighten their belts until the market rebounds — or until Congress intervenes.

Planners report a surge of new clients who are struggling to reconcile retirement spending expectations with a suddenly diminished nest egg.

“We have a lot of new clients coming in that have to take R.M.D.s,” said Peter Gallagher, managing director of Unified Retirement Planning Group. In reviewing their accounts, he discovered that some were wholly invested in riskier asset classes like stocks, which exposed them to the market’s swoon, rather than in safer categories like bonds. “They didn’t have the idea that they were taking as much risk as they had,” he said.

Sometimes, there is not much to do but break the bad news. “We had some people that were 100 percent in technology stocks, and we had to tell them, ‘Look, you’re down 40 percent from the high,’” Mr. Gallagher said. “It’s a really rough conversation, because we do have to sell.”

The ABC’s of R.M.D.

As defined-benefit pensions have been replaced by defined-contribution plans like 401(k)s, tax deferral is an incentive for workers to save. Many retirees depend on distributions from their retirement accounts for everyday income, a need that has grown more acute as the prices of gas, groceries and other necessities continue to climb. R.M.D. rules for account owners as well as inheritors are intended to prevent retirement accounts from becoming tax shelters for inherited wealth.

The last significant changes to those rules were made by the SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019, which raised the age by which account owners have to start taking distributions to 72 from 70½ and accelerated the timeline by which people who inherit I.R.A.s or similar accounts must make withdrawals.

People with these accounts must begin making withdrawals by April 1 in the year after they turn 72, and continue making them by the end of each subsequent calendar year. (Roth I.R.A.s, which are funded with after-tax dollars, don’t require R.M.D.s.)

The amount an account owner has to withdraw varies from year to year, based on their account balance as well as their anticipated life span, and the distributions are taxed as ordinary income. People with multiple accounts have some flexibility in that the total amount of their distribution can be withdrawn from one or more accounts, but the penalty for noncompliance is steep: R.M.D.s that are not withdrawn by the required dates are taxed at a rate of 50 percent.

Cil Frazier, a retired TV marketing professional who lives in a suburb of Birmingham, Ala., said she will have to begin taking her R.M.D.s by next April, which she is reluctant to do.

Ms. Frazier, 71 and a widow, said Social Security plus a small amount of pension income were enough to pay her mortgage and most everyday

expenses for the time being, but she worries about inflation driving up her cost of living.

"I'm paying more money for things I just normally buy. I'm shopping more carefully," she said, adding that she is bracing for higher energy bills as temperatures climb in the Southeast. "I'm setting the thermostat on the air-conditioner higher."

People who help retired Americans navigate their finances are alarmed by the vulnerability that this cohort — especially historically marginalized populations — faces as a result of market gyrations. It's especially tricky for those without money managers, because investors have to calculate on their own how much they have to withdraw to meet R.M.D. requirements.

"It's very complex, and it's almost impossible for a layperson" to manage without assistance, said John Migliaccio, a consultant on senior financial literacy.

"It's really indicative of, I would say, the crisis level of financial literacy in the country, particularly among women and minorities," he said. "They have lower-paying jobs, they don't get paid equally, they have caregiving responsibility" — all of which add up to less financial security in retirement.

In today's post-pension economy, Americans have had to take a more active role in managing their money before retirement, whether they have the knowledge to do so or not.

"We've spent the last decade and a half incentivizing risk," said Scott Cole, founder and president of Cole Financial Planning and Wealth Management. "We're persuaded by headlines, by people we talk to, and we're persuaded by the fact that our current system doesn't favor savers. It favors risk."

A combination of factors — an inability to save enough for retirement, and a sense of needing to "catch up" and not move money to safer investments while stock valuations broke records — has brought many retirement savers to a day of reckoning.

"With such low returns in the fixed-income market, I think people did put more in stock than they really should have — then it started looking so good that they stayed," said Alicia Munnell, director of the Center for Retirement

Research at Boston College. “If you can avoid selling now, it’s probably a good thing. These cycles do end.”

Financial planners generally recommend that retirees allocate a certain percentage of their portfolio to cash or other stable and liquid assets to avoid having to cash out of stocks when values are dropping — but they say they also understand why clients tend to throw caution to the wind when times are good.

“After years of telling clients that interest rates would rise — and there had to be some caution utilized in fixed income as well — most advisers started sounding a bit like Chicken Little year after year,” said Joseph Heider, president of Cirrus Wealth Management. “Those investors who wanted to squeeze the last little bit of juice out of this long-running bull market both in stocks and in bonds may have been caught a little bit short with what’s happened over the last few months.”

The historically long bull market before the pandemic, and the quick turnaround after the plunge in spring of 2020, also lulled investors into complacency.

“The jolts that we’ve had to the market over the last several years — it was short-term impacts to the market, so people have been conditioned to think that we’re going to see a rebound pretty quickly,” said Kathy Carey, director of research and planning at Baird Private Wealth Management. “It feels like this downturn could last a little bit longer.”

How retired investors cope

Some retired people, like Ms. Frazier, are managing by tightening their belts. Others are dusting off their résumés. What labor market observers have called “unretirement” is bringing people in the 55- to 64-year-old bracket back into the labor market.

“A lot of older people are going back into the work force,” said Cindy Hounsell, president of the Women’s Institute for a Secure Retirement. “That’s also giving them the opportunity to catch up a little.”

Others are tapping the equity built up in their homes, said Steve Rick, chief economist at CUNA Mutual Group. “I was astounded by the increase in

home equity balances," he said. "Home equity lending is booming right now. I think a lot of people are using that as an alternative."

Through March, the annual growth on home equity lines of credit was nearly 11 percent, according to data from the trade group Credit Union National Association and its affiliates — the highest rate of increase since 2009.

"We're doing it again now — we're pulling out cash," Mr. Rick said. "People are relying on debt again."

Some are hoping lawmakers will intercede. In March, the House of Representatives passed legislation that would build on the SECURE Act and gradually raise the required minimum age for taking distributions to 75 by 2032. Similar legislation has been introduced in the Senate, but the timeline for passage is uncertain.

Ms. Hounsell said this legislation could benefit seniors, particularly since the I.R.S. calculates how much retirement savers must withdraw based on their account balance at the end of the calendar year — roughly when the market peaked in 2021.

"I think it helps people catch up, and they also don't have to take out during the worst of the market going down," she said. Especially for people who can remain employed for a little longer, she said, "it's a couple of years less they have to worry about."

Ms. Frazier fretted that her initial R.M.D. could be high enough to bump her up from her 12 percent tax bracket. "It's a huge jump of 10 percent," she said.

She plans to wait until fall to take her initial required distribution, in the hopes that either Congress steps in or market volatility eases. "I'm curious about what will change between now and then," she said. "I would not take the R.M.D. if I did not have to take it."

While congressional intervention would buy some time, forgoing access to those funds would be a double-edged sword, since delaying her distribution would mean putting off roughly $8,000 worth of dental work Ms. Frazier hopes to get done. "I'm trying to save all the teeth I can," she said.