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Briefly Noted

Actions to Take During the Five Years Prior to Retirement

Transitioning to retirement from a working career is challenge for many people. To help, The New York Times interviewed financial advisers, economists and retirees to create what they described as a "five-year countdown to retirement." We'll share their suggestions along with a few comments of our own.

- **Five Years Out:** Review your current finances. In doing so, project both withdrawals from retirement savings (4.5% or less during the first year) and guaranteed streams of income (Social Security, pensions, annuities, etc.). At the same time, create a budget of what you think you will spend in retirement. If you are facing a potential shortfall, you still have time to increase your savings rate.
- **Four Years Out:** Begin to plan for the later years of retirement. Look at potential retirement communities you might want to move into. If long-term care is a concern, weigh the costs versus the likelihood of using a long-term care policy. Review your estate documents. AAII's "Investing at Level3" withdrawal strategy calls for allocating one-year of portfolio withdrawals into safe assets during each of the last four years leading up to retirement.
- **Three Years Out:** Consider adjusting your lifestyle to practice for your retirement years by engaging in similar activities that you plan to be involved with. Consider your living arrangements too. Regardless of whether you plan to move or stay in your house over the long term, any necessary work is best done while you are still salaried. This can be a good time to refinance a mortgage or open a line of credit that can be tapped in the event of an emergency.
- **Two Years Out:** Making Roth IRA conversions now can lower your taxable income once in retirement. Roth IRA conversions are taxable in the year they occur and withdrawals are tax free as long as the converted dollars stay in the account for at least five years. Rerun your retirement spending and income numbers again to ensure you are on track. Then practice living off of your projected cash flows.
- **One Year Out:** Look into health insurance options; apply for Medicare if age 65. Review your allocation to ensure you can withstand a significant drop in stock prices.

Source: "Countdown to Retirement: A Five-Year Plan;" Peter Finch; The New York Times, July 6, 2018.

Sector Classification Change Could Alter Some ETFs

A shift in sector and industry classifications will impact exchange-traded funds (ETFs) and mutual funds that target the affected industries and sectors. The change could also result in the renaming of some funds in addition to the potential changes to holdings and the weightings of various stocks within those fund's portfolios.

Both S&P Dow Jones Indices and MSCI Inc. categorize companies into various sectors and industries based on the Global Industry Classification Standard (GICS). GICS is used to create various indexes upon which ETFs are based and can be used by mutual funds in constructing sector and industry funds. GICS is also used for assessing portfolio allocations. However, it is not the only industry classification system.

The most notable change in the GICS structure is the renaming and expansion of the telecom services sector. This sector will be renamed to communications services sector. Added to it will be advertising, broadcasting, cable and satellite, entertainment, video gaming and internet media companies. As of July 2, 2018, companies scheduled to be included in this shift include, but are not limited to, CBS Corp. (CBS), Comcast Corp. (CMCSA), Electronic Arts Inc. (EA), Netflix Inc. (NFLX) and Walt Disney Co. (DIS).

Providers of telecom services will be classified in the telecom services industry group, which will remain part of the renamed communications services sector.

Several online retailers and marketplace companies currently in the information technology sector will be reclassified into the consumer discretionary sector. Affected companies include, but are not limited to, Alibaba Group Holding Ltd. (BABA) and eBay Inc. (EBAY).

The changes will be effective as of the close of trading on September 28, 2018. Nothing will need to be done by investors, though any change has the potential to cause tax implications. Investors in mutual funds and ETFs tracking broad market indexes such as the S&P 500 index will not be affected.

Investors holding sector and industry ETFs and mutual funds should review their funds' prospectus, fact sheets and portfolios following the reclassifications for any changes.

Source: "S&P Dow Jones Indices and MSCI Announce Revisions to the Global Industry Classification Standard (GICS) Structure in 2018"; November 15, 2017.

Student Loan Debt Reduces Retirement Savings

Having a student loan reduces the amount college graduates set aside for retirement at age 30. College graduates who had a student loan at age 25 went on to have retirement plan [e.g., 401(k)] balances ranging between $9,000 (25th percentile) and $9,300 (75th percentile) at age 30. Savings for those in the 50th percentile were $9,100.

Graduates with no debt at age 25 were much further ahead on saving for retirement. Their average retirement plan balances at age 30 were $18,200.

The mere existence of a student loan has a negative effect on savings. Graduates with smaller outstanding loan balances had similar amounts as those with high loan balances. The study's authors observe, "For graduates … assets are about 50 percent lower for those with student loans compared to those with no loans. The difference is both large and statistically significant. These results suggest that among college graduates, the presence of a student loan does impact retirement saving."

Student loans affect the amount saved, but not participation in retirement savings plans. Between 61% and 62% of graduates with outstanding student debt at age 25 participated in a retirement plan at age 30. This is essentially even with the participation rates of the graduates who had no outstanding student debt.

It's unclear what role other factors play. Demographic information included in the study show graduates with student debt earning less ($43,984 versus $47,931 for those without debt at age 30). These graduates also appear to have grown up in comparatively less affluent households. Parental income when these college graduates were age 18 was $66,593 for graduates with student debt versus $83,017 for those with no debt.

In all cases, having a college degree was associated with larger retirement savings relative to non-graduates. Retirement plan assets for non-graduates with no student debt was $5,400; savings were less for those with debt. Retirement plan participation rates were lower as well.

The statistics were gathered from the NLSY97 dataset. The NLSY97 is a survey conducted by the Bureau of Labor Statistics of approximately 9,000 youths who were 12 to 16 years old in 1997. Participants continue to be interviewed on an annual basis.

"Do Young Adults With Student Debt Save Less for Retirement?;" Matthew Rutledge, Geoffrey Sanzenbacher and Francis Vitagliano; Center for Retirement Research at Boston College; June 2018, Number 18-13.

Protracted CEO Successions Linked to Higher Stock Returns

Shares of companies without a named replacement for a departing chief executive officer (CEO) tend to outperform. This outperformance occurs despite the uncertainty about who the new leader will be.

A protracted succession occurs when a new CEO is not immediately named following the resignation of the incumbent CEO. During such periods, incumbent CEOs ran their companies for nearly six months, on average. Approximately three out of the 10 CEO turnovers occurring among S&P 1500 companies between 2005 through 2014 were protracted.

The annualized abnormal return for these 537 stocks was approximately 10% annualized. An abnormal return is the difference between the actual return and the expected return for a security. The return was calculated by adding a stock at the start of the month following a departure announcement and holding it until the end of the month in which a new CEO was announced. Notably, when a portfolio was constructed of buying ("going long") stocks with protracted successions and short-selling stocks with prompt successions (where the new CEO was quickly announced), the abnormal returns were still 8.5%.

As to why this would be the case, the authors of the study offer two possible explanations. The first is an under-reaction to "the (expected) probability of announcing the new CEO's identity." The second is "tournament competition." Executives within the company "engage in a stronger competition" for the newly opened position when there is a protracted succession.

There is a link between the under-reaction and the tournament competition. Up to 29 weeks beyond the incumbent CEO's departure announcement, weekly stock returns increased along with the probability of a new CEO being named. This pattern was most pronounced among those firms where competition among executives is above that of the industry median level.

It's possible another factor has a role. Protracted successions most often occur in "less profitable and worse valued firms." These companies are less likely to pay a dividend. To the extent investors view resignation of the incumbent CEO as a positive change, the stock's price performance could improve. The study's authors did not discuss this possibility, though they did find that companies with proacted successions "obtain positive long-run abnormal performance."

Source: "Lame-Duck CEOs;" Marc Gabarro, Sebastian Gryglewicz and Shuo Xia; SSRN, June 8, 2018.