Chapter 5

PROTECTION HAS A PRICE

"A man [or woman] cannot have his cake and eat his cake."

– Thomas, Duke of Norfolk

Years ago, a friend told me an interesting story about a client who came in with a specific request. The well-intended client expressed frustration with the market. He said, "Is there an investment that offers significant growth potential, next-day liquidity, principal protection, and guaranteed income for life?"

My friend responded, "Do you want it to have tax advantages too?"

The client said, "Yes! That'd be great!"

My friend smiled. "I wish that were possible, but that doesn't exist."

There is no such thing as a perfect investment.

For the Kedrec Reservoir™ strategy to work, you must have a reservoir of assets that have principal protection so you can draw income without accentuating losses. That means you are funding assets that either offer liquidity and principal protection, like your savings account, or you are funding assets that offer reasonable growth potential and principal protection, like CDs.

Giving up some liquidity is, in many people's minds, a big ask. It's often new and can feel uncomfortable. As previously stated, no investment can offer you everything you could want or need.

We believe it is mission critical to have a way to protect at least a portion of your assets when the market goes down or stays flat. Remember, bonds are not considered principal guaranteed if you end up selling them before they mature. Also, they are only as good as the issuer.

Relying on your ability to get every trade right is statistically improbable. I would argue having a reasonable portion of your assets protected may be one of the most important characteristics of your portfolio. But, it comes at a price.

Protection requires patience and discipline.

Do you need 100% access to all of your funds in retirement at any given time? Probably not. The only situation I can think of is the need to spend everything you have for a life-saving emergency. If that were to happen, then you wouldn't have anything left in retirement, which would be a problem unto itself.

What you likely need is access to some funds now and access to some funds later. There's a good chance you'll need income for at least twenty years, if not longer. This is where patience and discipline come in.

Let me explain with a few examples. Arguably, I think that one of the "best" features of a qualified account (like your 401(k) or IRA) is the fact that if you take income out too early, you get hit with a 10% early withdrawal penalty. That helps people keep their retirement savings in those accounts, so they have it when they retire.

The same could be said about investments and products that qualify for the Kedrec Reservoir™ (e.g., Treasuries, CDs, fixed annuities, fixed-index annuities, and cash value life insurance policies). No one likes giving up liquidity. But is it worth it to know that a portion of your portfolio can't lose money when markets crash? I would argue yes. Does it help you stay disciplined in your retirement spending so that you can potentially have income now and have income later? I would argue yes as well.

Every decision we make in life is nothing more than a trade. We give up something to gain something. When we get married, we give up being single and available to anyone to being intimately available and dedicated to an individual person while hoping the "trade" is beneficial for all parties involved.

When we have kids, we give up many freedoms, including a good night's sleep, and hope that in the end, the experience will be worth it. Most parents say having kids was the best thing they ever did. Was it hard? Yes. Did it require patience and discipline? Yes.

The trade we must make to protect ourselves from down markets is using various financial vehicles that may require us to give up full liquidity for a period of time. There's no way around it.

If you can't live with the idea of having any part of your portfolio lacking liquidity for a certain amount of time, then you may want to save yourself some time and stop reading this book. We are going to discuss a series of strategies that can work together for your benefit. Everything in life is a trade. You've got to give something in order to gain something in return. Many people are looking for the perfect investment. It just doesn't exist.

If you are looking for that perfect investment, there's nothing I can do or say to help you. In addition, and based on my research, I cannot endorse the idea of keeping all of your assets at risk. Markets have a history of crashing every 7–8 years. In my opinion, it's only a matter of time until you will be forced to accentuate your losses by drawing income during a market crash. I wish you the best.

For the rest of us who are willing to accept the fact that by giving up some liquidity in our portfolio we will be more prepared to keep our income coming in without having to accentuate losses when the market crashes. I look forward to seeing you in the next chapter.

Key Chapter Takeaways

- There is no such thing as a perfect investment.
- Protection requires patience and discipline.
- Every decision we make in life is a trade. Often, we need to give up something in order to gain what we desire.