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How To Retire Even If The Market Crashes

High Unemployment, Volatile Stock Market Take a Toll on Americans' Retirement.

By Tony Christensen, Forbes.com

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A cautious optimism is creeping back into the market, but there are still some predicting another dip or at least a prolonged recovery. What we do know for sure is that history suggests there *will* be another downturn; whether it's six months or six years from now, no one can say. The big question is: Will you be prepared for it or will you once again suffer large losses in your possibly already-diminished retirement savings?

The high rate of unemployment, a volatile stock market and sagging home values have taken a huge bite out of many Americans' retirement savings. According to the Center for Economic and Policy Research, baby boomers age 46 to 54 have watched their net worth drop an average 45% over the past five years.

Even more troubling, boomers between the ages of 55 to 64--those nearing and already in retirement--have seen their net worth cut nearly in half (49%).

If you are among those who've watched their retirement shrink up like a cashmere sweater in the dryer, you're faced with some hard choices: delay retirement (sometimes indefinitely), drastically reduce your living expenses, buy more lotto tickets or come up with a better strategy.

I'd pick the better strategy.

If you want to rebuild your retirement in a way that helps grow your wealth while still taking steps to help protect it from future downturns, I have a simple strategy for you. Group your money into three buckets: rainy day, preretirement and post-retirement. I'm not recommending three accounts; you can have any number of accounts in any of these buckets. This is instead a strategy for dividing up your money based on when you'll need it.

Rainy Day Bucket

Having a few twenties in a coffee can isn't a reliable way to prepare for financial troubles. Even major celebrities, or at least many of the ones I work with, have rainy day funds to help protect them from unforeseen needs. Conventional wisdom has told us that three to six months' worth of living expenses is enough for an emergency, but instead, I recommend keeping *two years* of living expenses on hand. (After you regain consciousness, I'll explain.)

As we've seen in the past two years, three to six months' of savings just isn't enough when there is a prolonged downturn. Many Americans who have lost their jobs or suffered pay cuts have been forced to live off savings and sell their investments at low prices.

If they didn't have a properly funded rainy day bucket, they may have had to cut into their retirement bucket earlier than the IRS allows, which often means paying stiff early-withdrawal penalties (withdrawals prior to 59 1/2 may result in a 10% penalty) and potential tax liabilities in addition to the frustration of selling at lower prices.

You need to do everything you can to avoid taking money out of your retirement accounts for living expenses. Two years worth of liquid living expenses--such as what's in your checking and savings account, short-term CDs, money market accounts, etc.--that you can access easily should see you through most hardships.

If you don't currently have two years of living expenses put away, create a budget and see where you can save to help build up a rainy day bucket.

Preretirement Bucket

Aside from emergencies, there are other big things that life throws your way between your 30s and when you turn 59 1/2, like putting kids through college, buying a vacation home and caring for aging parents.

Keep your rainy day fund intact for emergencies and plan a pre-retirement growth strategy as well. This isn't for living expenses--it's a moderate growth investment strategy that also maintains liquidity just in case. You don't plan on taking this out, but you could if you had to.

I believe preretirement funds should remain liquid but still look for potential growth. I recommend including a mix of stocks, bonds and alternative investments to help make sure it's not all dependent on where the stock market goes. But keep in mind, alternative investments are not suitable for all investors.

Post-Retirement Bucket

Now that you've properly planned for any emergencies and contingencies, your retirement savings should be able to remain intact. You shouldn't even think about touching it until you're older than 59 1/2. This bucket includes things like your 401(k) and annuities as well as traditional and Roth IRAs, just to name a few.

Of the three buckets I believe the post-retirement bucket should be the most aggressive, and the longer you have until retirement, the more aggressive you can afford to be. But don't just take risk for the fun of it. Take steps to reduce your overall risk exposure by looking for positive alpha (which means the investment performed better than would be expected, given its risk) as well as investments that have the ability to produce compounding returns. It is important to make sure you are rewarded for the risk you do take.

Lastly, I suggest reviewing your strategy each year to make sure all three buckets remain properly funded. For example, if you drain your rainy day fund you'll need to rebalance your strategy. Developing this kind of plan can get complicated, and it's difficult to stay on top of it, so it's best to enlist the help of a qualified professional. Your family's financial future is worth it, right?

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