Portfolio Distributions

July 2026

"Change the way you look at things and the things you look at will change."
- Wayne W. Dyer

One of the most frequent comments we get from pre-retirees or new retirees, regardless of age, is that it feels strange, discombobulating, or just downright scary that they are not adding to their investment portfolio but are instead starting to take distributions. Look, we get it! We've gone through this with many clients more times than we can count over the last twenty plus years. But the reality is that this change, going from portfolio accumulation to distribution, is the pinnacle of a lifetime of working for a comfortable retirement. In fact, if/when your portfolio is at the point where you can stop working and rely on your investment portfolio, in whole or in part, for your income need, then that is a great accomplishment!

The nervousness, which is completely understandable, is due to the fact that you are not only changing how you fund your standard of living, but you're also making a change of perception as to how you see your investment portfolio: it becomes a tool for distributions rather than accumulation. Sure, there is always a need to have long-term growth (a form of accumulation), but your standard of living in the short-term is, or should be in our opinion, dependent upon a distribution paradigm rather than just a growth mindset. This change of perception takes time; in our experience it takes most people six to twelve months to "get used to" this new paradigm of taking distributions rather than adding to the portfolio. But sooner or later almost everyone calls us to say that the fear has subsided, they've gotten comfortable with the distribution perception, and that they have no idea where they found the time to work before!

Although this is a timeless discussion, whereby the primary goal of almost every investor is to get to the place where they do not *have* to work any longer, it's also apropos in a long running bull market. Why? Because even though it is fun and profitable to have as much money as possible exposed to stocks when the stock market seemingly goes up 15% every year, it's a dangerous time to get greedy and forget the primary long-term goal(s) of your portfolio. So even if you are within ten to fifteen years of retiring, but much more so if you are within zero to ten years of retiring, it's appropriate to build a bond portion of your portfolio; we believe stocks are great in every portfolio for long-term growth, but caution against letting the volatility of the stock market dictate your standard of living much less your mood.

Further, if you're over-exposed to stocks when taking distributions, you may run into a problem with sequence of returns. Simply put, if you take money out of an account when the stock market has dropped, it hurts more than normal. For instance, if you have $1,000,000 ($1M) in stock but it drops to $900k due to a market correction, and you take out $50,000 (5% of the $1M), then you need a 17.6% increase to get back to the $1M; without the distribution you would have only had to get an 11.1% increase to get back to the $1M. Another way to look at the sequence of returns problem is that if you need $50,000 either way, it's only 5% of $1M, but it's 5.55% of $900k; seems like a small difference, but if these small differences persist they can become real, large problems in retirement.

As for the current bull market, please know that we are by no means pessimists; we try to be realists, and given a choice of optimism over pessimism when discussing an unknown future we think the former is simply more enjoyable than the latter. We also believe the upward momentum in the stock markets will continue to lift those indexes higher in the short-term. But we can never ignore the many varied risks in any one particular year. Currently, those risks include inflation running above the Federal Reserve's comfort zone (even new Fed chair Kevin Warsh has reversed course and indicated the next most likely move by the Fed is an increase in rates rather than a decrease), the war with Iran (with implications well beyond just the price of oil), a potential bankruptcy-like issue with Medicare and Medicaid in seven years, a five year stock market average annual return (about 15%) well above its long term average (still just 10-11%), and historically high price/earnings valuations (which are not necessarily indicative of short term direction but seemingly very determinative for long term averages).

Switching gears a bit, let's talk about taking distributions from a qualified account such as an IRA or 401K. First, distributions from these accounts will be seen as income for tax purposes unless there's after-tax contributions. Additionally, you will eventually need to take annual required mandatory distributions ("RMD") from these accounts so the government can finally tax this money; most investors will be required to start these distributions at age 73 (age 75 if you were born in 1960 or later).

As for timing, your RMD can be satisfied at any point during the year, although in some cases you can actually postpone your first years' distribution until the following year. For our part, we prefer to have most if not all RMDs completed by mid-December, just in case, since the penalty for being late can be pretty steep. Another newer feature for RMDs is the ability to make qualified charitable distributions ("QCD") whereby money that's sent directly to a qualified 501(c)3 charity may count as part or all of your RMD yet not be taxable. Last but not least, remember that a RMD is only just that, a required minimum, and you can always take out more than the requirement (you just have to pay the appropriate tax).

As always, please remember to consult your tax professional before making any changes, including distributions, that may affect your taxes. And be careful not to let the tail wag the dog; i.e., don't let your perception of things dictate what makes most sense financially overall. Remember, investment accounts are just a means to a hopefully long-lasting and comfortable retirement!

As always, thanks so much for your friendship, your trust, and your referrals.

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