



Kayne Anderson Rudnick

# Outsmarting Volatility During Retirement

## A Different Path with Lower Volatility Equities

One potential solution for creating a reliable income stream in retirement is the systematic withdrawal from an equity portfolio. But it has a catch: market volatility can severely disrupt smart planning. Big losses can get income off track—and keep it off track. Thus, in order to employ this technique effectively, it’s important to choose investments with the potential for steadier compounding.

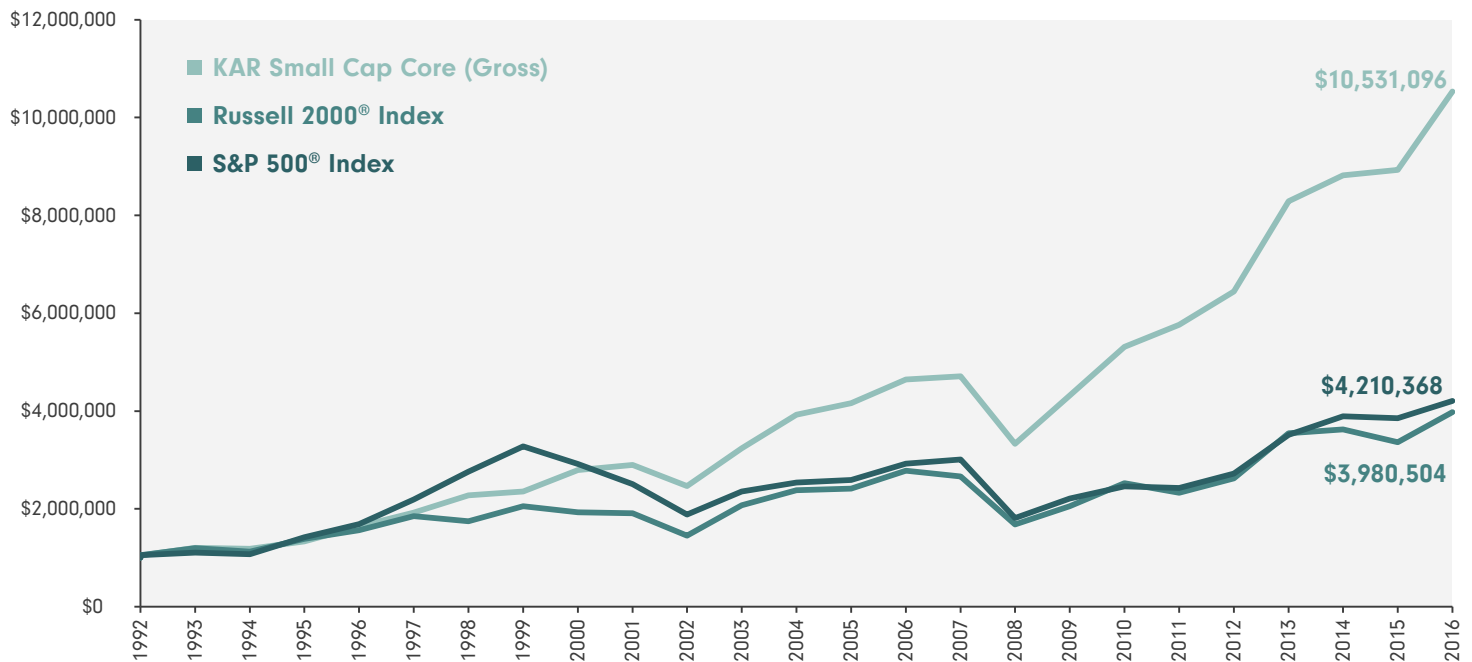
Take a real world example of a \$1,000,000 nest egg from which we’re going to withdraw 5% per year: \$50,000 to start, adjusting upward each year to neutralize a 3% inflation rate. We’ll compare what happens to our nest egg across three different vehicles, two indexed and one actively managed: the Russell 2000® Index, S&P 500® Index, and the Kayne Anderson Rudnick (KAR) Small Cap Core portfolio.

The following graphic shows the results going back to April 1992, the inception date of the KAR Small Cap Core strategy.

The retirement “playbook” is being rewritten. Historically low bond yields have complicated the quest for reliable income in retirement. Not only do we want to engineer the equivalent of a steady paycheck, we also need it to keep pace with inflation.

### A STEADIER SEQUENCE OF RETURNS

April 1992–December 2016



Certainly, what jumps out is the fact that even after withdrawing an inflation-adjusted 5% per year—a total of **\$1,822,963**—the KAR portfolio ended up at \$10.5 million, more than double what the passive vehicles returned.

Source: FactSet Research Systems. Withdrawals taken in December of each calendar year. Returns for the Kayne Anderson Rudnick composite are preliminary and gross of fees. For further details on the composite, please see the disclosure statement in this presentation. Returns shown for 1992 represent nine months of performance only from April 1, 1992 (inception date of the strategy).

There's more here than meets the eye, however. The KAR portfolio was much better at avoiding losses during this stretch. In fact, the Russell 2000 Index experienced eight annual losses, while KAR only had two. The consequence of that is harder to see in a long bull market with big gains in the early years. It's easier to see in cases when we get "unlucky" and face tough markets at the start of our decumulation phase.

The data in the following table takes the real world "unlucky" case of starting retirement at the onset of a prolonged bear market. Any investment that offers a more consistent return pattern, including smaller drawdowns, is better able to sustain a healthy retirement. In the long run, it matters a lot, as even with a sharp market rebound in 2003 after our unlucky start, the S&P 500 runs out of money. The Russell 2000 Index produced okay results after a tough start. Due to playing defense well in the early choppy markets, the KAR portfolio generated the needed income and left a much larger nest egg to boot.

## Starting Retirement Behind the 8-Ball

	5% Initial Draw + 3% Inflation (\$)	KAR Small Cap Core (Gross) (\$)	Return (%)	Russell 2000® Index (\$)	Return (%)	S&P 500® Index (\$)	Return (%)
2000	50,000	\$1,163,752	21.38	\$919,790	(3.02)	\$858,956	(9.10)
2001	51,500	\$1,183,935	6.16	\$891,157	2.49	\$705,362	(11.89)
2002	53,045	\$980,088	(12.74)	\$655,571	(20.48)	\$496,429	(22.10)
2003	54,636	\$1,262,036	34.34	\$910,717	47.25	\$584,190	28.68
2004	56,275	\$1,500,701	23.37	\$1,021,370	18.33	\$591,487	10.88
2005	57,964	\$1,559,521	7.78	\$1,009,918	4.55	\$562,577	4.91
2006	59,703	\$1,709,308	13.43	\$1,135,709	18.37	\$591,729	15.79
2007	61,494	\$1,701,831	3.16	\$1,056,431	(1.57)	\$562,745	5.49
2008	63,339	\$1,168,168	(27.64)	\$636,155	(33.79)	\$291,203	(37.00)
2009	65,239	\$1,477,805	32.09	\$743,771	27.17	\$303,030	26.46
2010	67,196	\$1,780,086	25.00	\$876,313	26.85	\$281,480	15.06
2011	69,212	\$1,891,392	10.14	\$770,510	(4.18)	\$218,213	2.11
2012	71,288	\$2,073,970	13.42	\$825,199	16.35	\$181,846	16.00
2013	73,427	\$2,624,823	30.10	\$1,072,134	38.82	\$167,316	32.39
2014	75,629	\$2,746,273	7.51	\$1,048,979	4.89	\$114,590	13.69
2015	77,898	\$2,733,440	2.37	\$924,777	(4.41)	\$38,277	1.38
2016	\$80,235	\$3,175,565	19.11	\$1,041,593	21.31	\$(37,380)	11.96
<b>Total Withdrawn</b>	<b>\$1,088,079</b>						
<b>Average Annual Return</b>			<b>11.10</b>		<b>7.41</b>		<b>4.51</b>

Withdrawals taken in December of each calendar year.

Starting value of \$1,000,000 at 1/1/2000; Source KAR and FactSet Research Systems

## Key Takeaways

- With global bond yields at rock-bottom levels, we need to employ our equity portfolios more than ever to help fund retirement income.
- Because equities are volatile, however, we have to be vigilant in choosing defensive or risk-mitigating strategies. In the case of KAR, an emphasis on profitable, high-quality companies has put them in good stead during tough times.
- Even comparing two equity strategies with the same returns, the one with better downside protection during falling markets is better positioned to help safely generate income in retirement.

Returns for the Kayne Anderson Rudnick composite are preliminary and gross of fees. For further details on the composite, please see the disclosure statement in this presentation. Past performance is no guarantee of future results. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The S&P 500® Index is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The indexes are calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Past performance is not indicative of future results.

## DISCLOSURE

Kayne Anderson Rudnick Investment Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Kayne Anderson Rudnick Investment Management, LLC has been independently verified for the period from January 1, 1999 through December 31, 2014.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. The Small Cap Core Composite has been examined for the period from January 1, 1999 through December 31, 2014. The verification and performance examination reports are available upon request.

Kayne Anderson Rudnick Investment Management, LLC, a wholly owned subsidiary of Virtus Investment Partners, Ltd., is a registered investment advisor under the Investment Advisers Act of 1940. Registration of an Investment Advisor does not imply any level of skill or training. Kayne Anderson Rudnick Investment Management, LLC manages a variety of equity and fixed-income strategies focusing exclusively on securities the firm defines as high quality.

The composite includes all discretionary institutional and pooled Small Cap Core Portfolios. Small Cap Core Portfolios are invested in equity securities with market capitalizations consistent with the Russell 2000® Index, that have market control, rising free cash flow, shareholder-oriented management, strong consistent profit growth, and low-debt balance sheets. For comparison purposes, the composite is measured against the Russell 2000® Index. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total-return basis with dividends reinvested. Benchmark returns are not covered by the report of the independent verifiers. The composite was created in April 1992. A list of composite descriptions and policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Prior to January 1, 2011, the composite minimum was \$250,000. Prior to December 31, 2010, only non-taxable portfolios are included in the composite. As of January 1, 2011, the composite was redefined to include both taxable and tax-exempt accounts. As of January 1, 2011, the composite was redefined to include both institutional and mutual fund [or pooled] accounts. Previously, only institutional accounts were included. Prior to January 1, 2011, accounts that experienced a significant cash flow, defined as aggregate flows that exceeded 25% of the account's beginning of period market value, were temporarily removed from the composite.

The standard management fee schedule currently in effect is as follows: 1.00% for the first \$25 million; 0.80% on the next \$25 million; 0.70% on the balance. Actual management fees charged may vary depending on applicable fee schedules and portfolio size, among other things. Additional information may be found in Part 2A of Form ADV, which is available on request. The performance information is supplied for reference. Past performance is no guarantee of future results. Results will vary among accounts. The U.S. dollar is the currency used to express performance. Returns are presented net of transaction fees and include the reinvestment of all income. Gross returns will be reduced by investment management fees and other expenses that may be incurred in the management of the account. Model net returns have been calculated by deducting 1/4th of the highest tier of the standard management fee schedule in effect for the respective period from the gross composite returns on a quarterly basis.

Internal dispersion is calculated using the asset-weighted standard deviation of annual gross returns for accounts in the composite for the entire year. For those years when less than five accounts were included for the full year, no dispersion measure is presented. The three-year annualized ex-post standard deviation measures the variability of the composite (using gross returns) and the benchmark for the 36-month period ended at the following dates:

3-Yr Annualized Standard Deviation (%)		
December 31	Composite	Benchmark
2011	20.61	25.34
2012	15.26	20.48
2013	11.81	16.68
2014	9.79	13.31
2015	11.29	14.16

Year	Total Firm Assets (\$ Millions)	Total Composite Assets (\$ Millions)	Accounts at Year End	Gross Annual Return (%)	Net Annual Return (%)	Russell 2000® Index Annual Return (%)	Internal Dispersion
2006	6,523	175	47	13.43	12.30	18.37	0.33
2007	5,392	138	41	3.16	2.14	(1.57)	0.48
2008	3,445	69	31	(27.64)	(28.40)	(33.79)	0.54
2009	4,010	75	23	32.09	30.80	27.17	0.55
2010	4,729	63	22	25.00	23.79	26.85	0.76
2011	5,232	362	88	10.14	9.08	(4.18)	0.67
2012	6,545	541	102	13.42	12.29	16.35	0.33
2013	7,841	1,018	121	30.10	28.84	38.82	1.41
2014	7,989	965	145	7.51	6.43	4.89	0.24
2015	8,095	1,048	157	2.37	1.31	(4.41)	0.23

The Russell 2000® Index is a trademark/service mark of Frank Russell Company. Russell® is a trademark of Frank Russell Company.