Breaking Ground in Retirement Strategies

KERRY H PECHTER OCT 16, 2009 10:10 AM

Jim Otar doesn't much care what you think. As the Canadian financial adviser likes to say in his eastern-Balkan accent, “You can't please everyone. I'm 58 years old. I'm deep in the ‘Green Zone.’ People can think what they like.”

But if you're interested in retirement income, you probably will care what Otar thinks. Since he switched from engineering to finance in 1994, his articles, books, and Retirement Optimizer planning tool have become increasingly mainstream.

Or perhaps the mainstream has become increasingly Otarian.

“In the beginning, it was very lonely,” he told me. “[William] Bernstein's Retirement Calculator from Hell triggered my first questions in 1996. I said, 'That is what I'm trying to tell everyone: You cannot have an assumed growth rate.' That's when I started developing my ideas, which became my first book, *High Expectations and False Dreams*, in 2000.”

Since then, Otar, who still practices as an adviser, has become better-known. His 2002 articles in *Financial Planning* magazine won a CFP Board award. His website and his $29.95 Retirement Optimizer planning tool (now $99.95) have a cult following in Canada. He contributed to Harold Evensky and Deena Katz's' 2006 book *Retirement Income Redesigned*.

This month, he published "Unveiling the Retirement Myth: Advanced Retirement Planning Based on Market History", a 525-page tome that details his zone system for building a portfolio of investments and, if necessary, income annuities. He offered an early edition for free online in August, but the number of requests for downloads overwhelmed the server.

Otar's fans -- including quite a few members of the Bogleheads discussion group -- often note his mechanical engineer's approach to retirement income planning. That includes a skepticism of straight-line projections, a scrupulous accounting of all sources of friction, and a belief in establishing margins of safety that can withstand Black Swan events.

Few people in the US retirement income profession claim to know much about Otar, but at least one vouched for him enthusiastically. “I have copies of Jim Otar's earlier books, and in my opinion he has done excellent work in the field,” says Bill Bengen, an El Cajon adviser who also contributed to Evensky and Katz's book.

“Aft-casting”

Otar's system assigns near-retirement clients to one of three zones.

Those in the Green Zone can draw down their savings at a sustainable rate and still cover their living expenses. Those in the Red Zone will go broke early unless they buy annuities. Those in the Gray Zone fall somewhere in between.

Whichever zone a client happens to fall in, Otar can determine how much savings should be allocated to stocks, to bonds, or, if the client's savings can't produce enough income any other way, a ladder of income annuities.

Personably written and replete with charts and graphs, the book details Otar's financial philosophy. For instance, he rejects Monte Carlo analysis in favor of “aft-casting.”

“Forecasting says ‘I'm assuming an 8% return and 3% inflation.’ In aft-casting, each portfolio value is calculated for each year since 1900. I take all lines and put them on the same chart. It's actually market history,” he said.

“I try to take the dividends out because right now the rate is about half what it once was. Then there are management fees. You have to include that as well. So I take the indexes and inflation rates from the past and I apply an adjustment for current dividends and portfolio costs. Then I have an outcome I call an aft-cast.” His calculations also include a factor he calls the “time value of fluctuations,” which acknowledges that the course of finance -- like the course of true love and other aspects of life -- never travels as the crow flies.

“The time value of fluctuations is the friction created by variations in the growth rate,” he told RIJ. “And that happens every day. Inflation goes up and down, for instance. Those variations in the growth rate create havoc for your projections.

“You cannot use straight-line assumptions. You have to add an additional factor to the calculations to make up for the losses, which is about 50%. You need 50% more assets than the average calculations. So if you need $1.5 million instead of $1 million. Basically, that's what time value of fluctuations is.

“To use an analogy, if you're driving from Phoenix to Tucson there's no fluctuations, because the highway is flat and straight. But if you drive from Flagstaff to Sedona, you'll use three times as much gas per mile, because you're going up and down hills.”

Istanbul to Toronto

Otar was born near Istanbul, Turkey, the son of an accountant who raised a few sheep, fruit trees, and vegetables. In the forward to his new book he describes his first experiment with finance: growing cabbage as a cash crop. An early frost wiped out his entire investment in seedlings and manure.

He immigrated to Canada at age 20, and earned undergraduate and graduate degrees in mechanical engineering at the University of Toronto. “In 1982, I went into a marine equipment business, and worked in it until 1994, when I went into the financial business. I started looking after my own investments. Then my friends and family wanted advice. I ended up getting my CFP in 2000. I also used to do technical analysis, and got my most recent designation, Chartered Market Technician. I did ‘cross over.’ I did ‘bottom out.’ We just followed the signals. Every technician has different signals.”

But he's not one of those far-out cycle theorists who believe that pi rules the universe.

“My advice is, keep it simple. You can't please everyone. So you have to make happy the people who believe in you. That's all. Don't make things too complicated," he says.

“More than 50% of everything is luck. Actually, two types of luck. The first piece of luck has to do with the timing of retirement with respect to market behavior. If you don't retire in a bullish trend, your portfolio life can go down by half.

“The second part, which is less important, is the timing of retirement with respect to inflation. Inflation comes in waves, and if you're in a bad wave, your purchasing power will drain away. The easiest way to minimize the luck factor is to buy insurance. We buy life annuities. If you ladder them, you can reduce the interest rate risk and the market risk.”

Speaking of market risk, Otar, like many others, doubts the sustainability of the equities rally that started in March 2009. “The more the politicians say that the depression is over, the louder their chorus gets, the more I plug up my ears. I don't think the recovery is sustainable. If you keep printing money you might avoid a depression. But we won't be going back to a bull market soon.”

Otar's plans for the coming year include trying to scale his Retirement Optimizer into a tool that millions of Baby Boomers can use to convert their life savings to lifetime income.

“We're talking to a big insurance company here in Canada,” he said. “I hope it works out.”