ERIC: I guess what you're saying here is if you took a percentage rather than a fixed dollar amount, assuming you have flexibility in your spending. Basically, if you were getting four percent on a million, you start taking $40,000, but if the market drops and now, you're at $900,000 you're only taking four percent of that or $36,000. Having that flexibility leads to a faster recovery rate.

In this case, you actually ended up with a good deal more money at the end of the 20 year period.

PATTI: The sidebar to this, Eric, is if you're taking that flexible spending approach, it's really important to have a really good buffer in that emergency fund so that instead of taking from the portfolio, you're making up the difference with that emergency fund.

ERIC: The takeaways here are once you go into needing cash flow, asset allocation is supremely important, as well as your spending policy. Those are the two big takeaways.

PATTI: It's especially important in this one, because if you just dial down the equity versus bond, 60 percent in equities, 40 percent in bonds, yes, you still felt that terrible period of time, but the total underwater period was only five and a half years.

Again, in this case, the ending value was almost $1.4 million. In that case, your principal actually grew, and because of that, the way this works, so did your income.

ERIC: You know what, Patti, that's a fantastic point to reiterate. What you're saying is that a 60/40 portfolio with the same requirements recovered in five and half years versus almost 14 years for the all stock portfolio. Asset allocation, the amount of risk you take in retirement, is unbelievably important to minimize drawdowns and speed up recovery rates.

PATTI: Exactly. To me, the perfect approach to this is flexible all the way around. In other words, you can start out with that $40,000 per year increasing by inflation. If you come out of the gate with a great stock market environment, and this portfolio is doing great, that's actually going to work out really well for you if you just stick to that 40 plus inflation.

If markets begin to crater, especially early in retirement, then the latter is going to be the better alternative.

ERIC: Taking the fixed percentage.

PATTI: You can flip from one to the other during this entire retirement period. You don't necessarily have to have anything cast in stone. That's where the longer term projections really help. Again, things are going to happen.

We're talking about a bear market that happened so quickly. What is the impact on your longer term financial plan? Are you still tracking well? Should we dial back on the cash flow being taken out of the portfolio?

ERIC: It's a dynamic process. We're always making decisions. The key is flexibility seems good in portfolio management as in most everything else in life.

PATTI: Exactly. It does, but I think there's something else important, Eric. Flexibility is fine and it's great, but not when it comes to your asset allocation. I think it's important for everyone listening to understand that discipline during this process is going to be really key.

Just because markets are going down and even if you're taking cash flow, it doesn't mean that you want to change your portfolio allocation to be more conservative and, frankly, maybe even more aggressive.

A lot of people think markets are down, I should ramp up my portfolio and go 80/20 on the portfolio. I don't know for sure that this thing is over. It could go back down again. We could have a double bottom that is so characteristic of many bear markets.

ERIC: The drawdown period might just be taking a breather. It might not be complete.

PATTI: It happens more often than not.

ERIC: Absolutely.

PATTI: Not a prediction, just be aware of that.

ERIC: Perspective, is what we're getting here, is really important. I know both of us when we talk to different folks on the phone or through email and so forth, there seems to be the sense that this time it's different. We have this trade wars going on, gridlock in Washington, all these things. Somehow, this is going to be unique and it's unlike any other thing.

I think the reality is, again, uncertainty is a feature of the investment landscape. It's always going to be there. The point is, looking at really significant events the dot com crash, the financial crisis, Black Monday, back when the inception of your career started drawdowns of 30 percent or more are very rare. Not that they can't happen, they're just not likely to happen.

If you go back to 1980, there's only been four events, four drawdowns of 30 percent or greater during that time period. Despite those, the market is phenomenally high and has provided a great rate of return over that period.

What about the more intermediate drawdowns, like what we just experienced? They tend to have a higher frequency, right?

PATTI: Absolutely. Let's just really make sure that that's clear, the point that you just made is really clear. We're talking 40 years. 40 years is a long term. We're talking about 1 year out of 10. The hype, the headlines. If it bleeds, it leads when it comes to newspapers.

ERIC: [laughs]

PATTI: They've got to really hype it up, and make it awful, and tell people to stay tuned because you have to hear about what's happening next.

ERIC: You always have so many wonderful little sayings that I have to compartmentalize them. I think I've heard at least three or four in the short conversation we had that I got to remember to put in the memory bank for the next time.

PATTI: Yeah, 30 years will do it to anybody.

ERIC: [laughs] What do you say we package this up with a bow here and take us down the runway? What are some observations on recovery periods? What are some of the things people should be aware of? Let's wrap it up with some key takeaways about what those in our audience should be thinking about as it relates to the drawdown and recovery.

PATTI: It's real clear. If you've got 100 percent of your money in the stock portfolio, it's going to take longer to recover, because it's got to go deeper down. To do that round trip takes a lot more effort.

ERIC: If you're down 50 percent, it takes 100 percent to get back to even.

PATTI: Exactly. If you're taking cash flow out of the portfolio, it's even more so. Very, very important. Each person listening today is in a different season of life. Keep that all into consideration. As it relates to cash flow, Eric, as we both pointed out, a flexible approach is going to be the most important thing.

All equities, drawdowns of 30 percent or greater they do happen. More frequent are the 5 to 10s. If you have any money in the market, you got to plan on losing 5 to 10 percent at least once a year. On average, that's what happened, but as long as you don't do anything, you haven't experienced a loss.

ERIC: I would say history is never a predictor of future. There's never a guarantee of what will happen in future drawdowns, but when you observe historically when we've had a 30 percent drawdown or greater, an all equity portfolio, if you're not taking cash flow, usually takes three to four years to recover.

In a lot of instances, drawdowns that are 20 percent or less, sometimes they're recovered in a couple of months, maybe upwards of a year. That's been historical experience. Again, going through what we just went through, just keep that in mind, that yes, it's temporary, but usually within if it's a fairly minor drawdown a couple of months to a year is the typical time it's taken to recover.

PATTI: The one thing that I really want to emphasize as we close this program today is this is not even taking into consideration that many people listening today are working and probably contributing to your 401(k)s and IRAs. That will accelerate your recovery period. You are buying low. Every paycheck that you make those contributions will accelerate your recovery period.

ERIC: What are some key takeaways here that we can? Maybe we'll end with the quote of…We always like to end with the sage quote from somebody far wiser than both of us.

PATTI: To me, and Eric, I think you'll agree, the key here is lack of diversification will magnify your drawdown. It will extend your recovery period. The theme here is diversification. Don't make it harder than it already is. Your stock to bond ratio is really critical to manage the risk versus return that you get on your money.

Second point, taking cash flow can dramatically affect your recovery period and the total period that you go through this. Flexibility is the mantra. Rigid spending policies make you more vulnerable to that sequence of return risk.

The third thing is if you are saving money, if you are continuing to work, consider periods like the fourth quarter of 2018 to be a blessing because you bought stocks. You added money into your whether it's the United States or even worse, the international market, at a deep, deep discount.

We don't know for sure when it's going to recover. We seem to be coming out of the gate here in January, but boy, if you can just keep that discipline, don't change the portfolio. If you have extra cash flow, add to it. That will accelerate your recovery period.

ERIC: That is a perfect way. It's a shame we can't play a little dramatic music before we end with our quote from our legendary investor, Benjamin Graham, the father of value investing.

It's so pertinent to this topic of drawdown. What he said was the essence of investment management is the management of risks, not the management of returns. You can probably speak to this.

Returns are something that nobody can really influence or affect, but the management of the risk you take is so critical. That's something that we can control.

PATTI: Absolutely. As with all of the things that we talk about in these podcast, it is so important for you to control the things that you can. Understand that there are things that nobody can