SEQUENCE OF RETURNS RISK

How Can it Affect Your Retirement?

WEALTH GUARDIANS

WHAT IS SEQUENCE OF RETURNS?

Sequence of returns refers to the order of gains and losses a portfolio experiences. While this sequence is less consequential before retirement, it becomes significantly important during retirement. A negative sequence of returns early in retirement can substantially risk the longevity of your portfolio.

Beginning to withdraw funds from your investment portfolio when the market is in a downturn can accelerate the depletion of your assets. Simply put, sequence of return risks can have a profound impact on your retirement; because it's not how much your investments go up or down, it's when the ups and downs occur.

HOW DOES SEQUENCE OF RETURNS WORK?

During the 'accumulation phase' before retirement, the sequence of returns your portfolio experiences is less critical than during the 'distribution phase,' when you withdraw money each year for retirement. For clarity, compare Table 1 and Table 2.

Table 1 presents a sequence of S&P 500 returns on a $1 million portfolio. In contrast, the portfolio on the right reflects an inverted sequence of returns, effectively reversing the order of returns.

Table 1: The Accumulation Phase

Age	Return	End of Year
		$1,000,000
40	-8.89%	$911,100
41	-12.98%	$792,839
42	-24.26%	$600,496
43	26.18%	$757,706
44	9.36%	$828,628
45	3.37%	$856,552
46	13.58%	$972,872
47	3.55%	$1,007,409
48	-39.63%	$608,173
49	26.50%	$769,339
50	11.55%	$858,197
51	0.48%	$862,317
52	11.06%	$957,689
53	31.39%	$1,258,308
54	13.00%	$1,421,888
55	-1.03%	$1,407,242
56	9.27%	$1,537,693
57	19.43%	$1,836,467
58	-7.07%	$1,706,629
59	28.66%	$2,195,749

Age	Inverted Return	End of Year
		$1,000,000
40	28.66%	$1,286,600
41	-7.07%	$1,195,637
42	19.43%	$1,427,950
43	9.27%	$1,560,321
44	-1.03%	$1,544,249
45	13.00%	$1,745,002
46	31.39%	$2,292,758
47	11.06%	$2,546,337
48	0.48%	$2,558,559
49	11.55%	$2,854,073
50	26.50%	$3,610,402
51	-39.63%	$2,179,600
52	3.55%	$2,256,976
53	13.58%	$2,563,473
54	3.37%	$2,649,862
55	9.36%	$2,897,889
56	26.18%	$3,656,556
57	-24.26%	$2,769,476
58	-12.98%	$2,409,998
59	-8.89%	$2,195,749

Table 2: The Distribution Phase

Table 2 shows the same comparison of inverted returns, but with $50,000 of annual distributions pulled in the beginning of each year.

Age	Return	Income	End of Year	Age	Return	Income	End of Year
			$1,000,000				$1,000,000
60	-8.89%	-$50,000	$865,545	60	28.66%	-$50,000	$1,222,270
61	-12.98%	-$50,000	$709,687	61	-7.07%	-$50,000	$1,089,391
62	-24.26%	-$50,000	$499,647	62	19.43%	-$50,000	$1,241,344
63	26.18%	-$50,000	$567,365	63	9.27%	-$50,000	$1,301,782
64	9.36%	-$50,000	$565,790	64	-1.03%	-$50,000	$1,238,888
65	3.37%	-$50,000	$533,172	65	13.00%	-$50,000	$1,343,444
66	13.58%	-$50,000	$548,787	66	31.39%	-$50,000	$1,699,456
67	3.55%	-$50,000	$516,494	67	11.06%	-$50,000	$1,831,886
68	-39.63%	-$50,000	$281,622	68	0.48%	-$50,000	$1,790,439
69	26.50%	-$50,000	$293,002	69	11.55%	-$50,000	$1,941,459
70	11.55%	-$50,000	$271,069	70	26.50%	-$50,000	$2,392,696
71	0.48%	-$50,000	$222,130	71	-39.63%	-$50,000	$1,414,286
72	11.06%	-$50,000	$191,168	72	3.55%	-$50,000	$1,412,718
73	31.39%	-$50,000	$185,480	73	13.58%	-$50,000	$1,547,775
74	13.00%	-$50,000	$153,093	74	3.37%	-$50,000	$1,548,250
75	-1.03%	-$50,000	$102,031	75	9.36%	-$50,000	$1,638,486
76	9.27%	-$50,000	$56,854	76	26.18%	-$50,000	$2,004,352
77	19.43%	-$50,000	$8,186	77	-24.26%	-$50,000	$1,480,226
78	-7.07%	$0	$0	78	-12.98%	-$50,000	$1,244,583
79	28.66%	$0	$0	79	-8.89%	-$50,000	$1,088,384

In conclusion, the two tables highlight the critical importance of investment strategy phases. During the accumulation years, the uninterrupted growth of a portfolio demonstrates resilience against the sequence of returns. However, as retirement approaches, the situation changes: the stark contrast in portfolio balances—when income withdrawals are made—underscores the necessity of evolving our investment mindset. Engaging with a financial professional who specializes in distribution planning for retirement is not just prudent; it's essential. While we cannot predict market returns or their timing, thorough planning can help manage risk and potentially contribute to a more secure financial future in retirement.

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SOURCES

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