

Hope for the best ...
but plan for the worst.



How sequence of returns risk can affect your retirement nest egg.

If you're planning to rely on stock market investments for retirement income, you're hoping for the best. That's because a simple run of bad luck early in retirement can turn your financial life upside down.

To see how, let's look at two hypothetical investors, Bob and Ted. Both are retired and have \$500,000 invested in a stock market index fund for 20 years. The beginning and ending values of the index are the same. But the order of annual returns is flipped. In other words, the return Bob receives in year one is what Ted receives in year 20.

If no withdrawals are taken, Bob and Ted realize the same gain on their investment. The sequence of returns in individual years has no effect on the final result.

Bob			
Year	Return	Index Value	Account Value
0		1463	\$500,000
1	29%	1886	\$644,390
2	-6%	1768	\$604,198
3	19%	2112	\$721,533
4	10%	2313	\$790,331
5	-1%	2296	\$784,589
6	11%	2558	\$873,959
7	30%	3315	\$1,132,661
8	13%	3760	\$1,284,502
9	0%	3760	\$1,284,461
10	13%	4240	\$1,448,650
11	23%	5235	\$1,788,420
12	-38%	3220	\$1,100,132
13	4%	3334	\$1,138,962
14	14%	3788	\$1,294,082
15	3%	3901	\$1,332,918
16	9%	4252	\$1,452,793
17	26%	5374	\$1,836,046
18	-23%	4118	\$1,407,036
19	-13%	3581	\$1,223,521
20	-10%	3231	\$1,103,816
20-Year Return		121%	

Ted			
Year	Return	Index Value	Account Value
0		1463	\$500,000
1	-10%	1320	\$451,082
2	-13%	1148	\$392,249
3	-23%	880	\$300,596
4	26%	1112	\$379,894
5	9%	1212	\$414,060
6	3%	1248	\$426,486
7	14%	1418	\$484,571
8	4%	1468	\$501,674
9	-38%	903	\$308,601
10	23%	1115	\$380,981
11	13%	1258	\$429,680
12	0%	1258	\$429,667
13	13%	1426	\$487,266
14	30%	1848	\$631,503
15	11%	2059	\$703,436
16	-1%	2044	\$698,325
17	10%	2239	\$764,910
18	19%	2674	\$913,455
19	-6%	2507	\$856,481
20	29%	3231	\$1,103,816
20-Year Return		121%	

But Bob and Ted are using their investment for retirement income. So let's see what happens when they withdraw money each year.

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The luck of the draw. When you retire can make all the difference.

Now, let's assume Bob and Ted each withdraw \$25,000 per year for retirement income.

For Bob, the index value increases 44% in the first three years. Twenty years later, his portfolio is still worth over \$550,000 and he's sitting pretty.

But Ted doesn't fare so well. He retires, starts withdrawing money, and the market sheds 40% in years 1-3. Even though it rebounds, Ted runs out of money in year 19.

Bob					Ted				
Year	Withdrawal	Return	Index Value	Account Value	Year	Withdrawal	Return	Index Value	Account Value
0			1463	\$500,000	0			1463	\$500,000
1	\$25,000	29%	1886	\$612,171	1	\$25,000	-10%	1320	\$428,528
2	\$25,000	-6%	1768	\$550,547	2	\$25,000	-13%	1148	\$350,897
3	\$25,000	19%	2112	\$627,609	3	\$25,000	-23%	880	\$249,748
4	\$25,000	10%	2313	\$660,067	4	\$25,000	26%	1112	\$284,037
5	\$25,000	-1%	2296	\$630,453	5	\$25,000	9%	1212	\$282,334
6	\$25,000	11%	2558	\$674,418	6	\$25,000	3%	1248	\$265,056
7	\$25,000	30%	3315	\$841,654	7	\$25,000	14%	1418	\$272,751
8	\$25,000	13%	3760	\$926,132	8	\$25,000	4%	1468	\$256,495
9	\$25,000	0%	3760	\$901,103	9	\$25,000	-38%	903	\$142,402
10	\$25,000	13%	4240	\$988,093	10	\$25,000	23%	1115	\$144,938
11	\$25,000	23%	5235	\$1,188,979	11	\$25,000	13%	1258	\$135,269
12	\$25,000	-38%	3220	\$716,012	12	\$25,000	0%	1258	\$110,266
13	\$25,000	4%	3334	\$715,402	13	\$25,000	13%	1426	\$96,696
14	\$25,000	14%	3788	\$784,431	14	\$25,000	30%	1848	\$92,919
15	\$25,000	3%	3901	\$782,222	15	\$25,000	11%	2059	\$75,656
16	\$25,000	9%	4252	\$825,322	16	\$25,000	-1%	2044	\$50,288
17	\$25,000	26%	5374	\$1,011,450	17	\$25,000	10%	2239	\$27,699
18	\$25,000	-23%	4118	\$755,956	18	\$25,000	19%	2674	\$3,223
19	\$25,000	-13%	3581	\$635,620	19	\$3,223	-6%	2507	\$0
20	\$25,000	-10%	3231	\$550,879	20	\$0	29%	3231	\$0
Years 1-3 Return				44%	Years 1-3 Return				-40%
20-Year Return				121%	20-Year Return				121%

When you take regular withdrawals from a stock market investment, you're exposed to what's known as **sequence of returns risk**. You might call it "the luck of the draw." Poor market performance in the early years of retirement can dramatically reduce the value of your nest egg over time, leaving you with less than you hoped for.

Because you can't predict what the market will do, it's important to plan for the worst. Talk to your financial professional about how you can guard against "the luck of the draw" by diversifying your retirement portfolio and including sources of guaranteed income, like annuities.

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