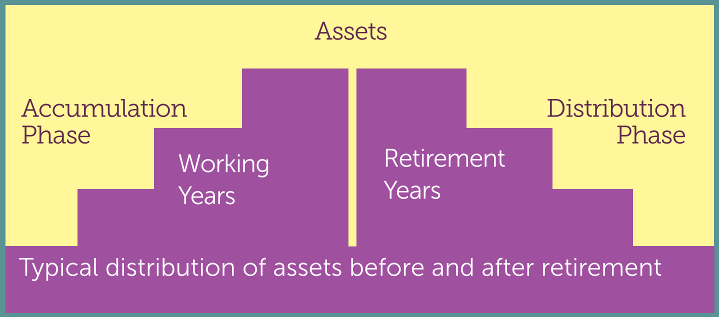
Financial Wellness & Education

Investing

Understanding Sequence of Returns

Foresters Financial

Sequence of Returns



This chart illustrates the accumulation of assets as you approach retirement and the subsequent sale or distribution of those assets during retirement.

Why the Sequence of Returns is important

The Sequence of Returns can pose a real risk to retirees

You have saved your entire life. You have made it to retirement, but will you have enough money to last the rest of your life? Achieving this goal can be a difficult task because of something called "Sequence of Returns" risk.

Sequence of Returns risk involves the order in which investment returns occur and the impact of those returns on a retiree's portfolio.

During your working years or "Accumulation Phase," the Sequence of Returns may potentially have less of an impact on a buy and hold investor. However, in your retirement years or "Distribution Phase" when you begin taking systematic withdrawals, existing market conditions and Sequence of Returns can have an enormous impact on how long your money will last.

Sequence of Returns has taken on a greater importance as individuals live longer and now spend on average more than 20 years in retirement[1]

Working Years – "Accumulaton Phase"

During your working years, the Sequence of Returns has less of an impact on retirement income because you are accumulating assets and there are no withdrawals, as you can see in the four scenarios below.

Scenario 1. This account value grew over time from $100K to more than $1 million while earning an annualized return of 9.71 percent; due to a long time horizon, and ability to ride out the market's ups and downs, this account grew significantly.

Scenario 2. If we were to take that average return from Scenario 1, 9.71 percent, and apply it to each year during your working years, the end result would be exactly the same. In other words, while more volatile, Scenario 1 yielded the same return you would have experienced with a steady return year after year. The point here is that while you are accumulating, the average annual rate of return matters more than the sequence of those returns.

Scenario 3. In Scenario 3, we see the account reach its highest value of the previous scenarios due to having all the positive returns up front. However, there is a period of decline and lost opportunity when a period of prolonged negative returns occurs right before retirement, which can seriously impact someone about to retire. You'll notice however that the end result is the same as Scenario 1, 2 and 4, again because there were no withdrawals from the account.

[1] socialsecurity.gov

		Scenario 1		Scenario 2		Scenario 3		Scenario 4	
Year	Age	Annual Return	Portfolio Value	Annual Return	Portfolio Value	Annual Return	Portfolio Value	Annual Return	Portfolio Value
0	40		$100,000		$100,000		$100,000		$100,000
1	41	16.61%	$116,610	9.71%	$109,707	37.58%	$137,578	-37.00%	$63,002
2	42	31.69%	$153,559	9.71%	$120,357	33.36%	$183,478	-22.10%	$49,078
3	43	-3.10%	$148,792	9.71%	$132,040	31.69%	$241,615	-11.89%	$43,245
4	44	30.47%	$194,123	9.71%	$144,857	30.47%	$315,226	-9.10%	$39,308
5	45	7.62%	$208,914	9.71%	$158,919	28.68%	$405,647	-3.10%	$38,088
6	46	10.08%	$229,970	9.71%	$174,346	28.58%	$521,575	1.32%	$38,591
7	47	1.32%	$233,007	9.71%	$191,270	26.46%	$659,608	2.11%	$39,405
8	48	37.58%	$320,565	9.71%	$209,837	22.96%	$811,055	4.91%	$41,341
9	49	22.96%	$394,168	9.71%	$230,206	21.04%	$981,714	5.49%	$43,612
10	50	33.36%	$525,675	9.71%	$252,553	16.61%	$1,144,776	7.62%	$46,935
11	51	28.58%	$675,906	9.71%	$277,068	16.00%	$1,327,981	10.08%	$51,666
12	52	21.04%	$818,127	9.71%	$303,964	15.79%	$1,537,725	10.88%	$57,288
13	53	-9.10%	$743,642	9.71%	$333,470	15.06%	$1,769,358	15.06%	$65,918
14	54	-11.89%	$655,254	9.71%	$365,841	10.88%	$1,961,901	15.79%	$76,329
15	55	-22.10%	$510,439	9.71%	$401,354	10.08%	$2,159,635	16.00%	$88,544
16	56	28.68%	$656,857	9.71%	$440,314	7.62%	$2,324,185	16.61%	$103,251
17	57	10.88%	$728,336	9.71%	$483,057	5.49%	$2,451,875	21.04%	$124,977
18	58	4.91%	$764,112	9.71%	$529,948	4.91%	$2,572,310	22.96%	$153,672
19	59	15.79%	$884,797	9.71%	$581,391	2.11%	$2,626,631	26.46%	$194,340
20	60	5.49%	$933,408	9.71%	$637,828	1.32%	$2,661,315	28.58%	$249,880
21	61	-37.00%	$588,067	9.71%	$699,743	-3.10%	$2,578,700	28.68%	$321,557
22	62	26.46%	$743,696	9.71%	$767,669	-9.10%	$2,343,925	30.47%	$419,522
23	63	15.06%	$855,722	9.71%	$842,188	-11.89%	$2,065,330	31.69%	$552,453
24	64	2.11%	$873,793	9.71%	$923,941	-22.10%	$1,608,881	33.36%	$736,769
25	65	16.00%	$1,013,630	9.71%	$1,013,630	-37.00%	$1,013,630	37.58%	$1,013,630
		9.71%	**$1,013,630**	**9.71%**	**$1,013,630**	**9.71%**	**$1,013,630**	**9.71%**	**$1,013,630**

Sequence of Returns

Retirement Years – “Distribution Phase”

During retirement years or the “Distribution Phase,” you are withdrawing assets from your retirement accounts to fund your retirement. If you experience a negative “Sequence of Returns” early in retirement, it can have a huge impact on retirement assets, as you can see in the four scenarios below.

Scenario 1. Here assets are withdrawn at the rate of $5,000 per year with a 2 percent increase in distributions per year. Market volatility causes the account value to fluctuate. However, over time, you would have been able to accumulate assets due to favorable market conditions, which results in a strong income stream for 25 years.

Scenario 2. In this Scenario, we had a consistent return year after year. However, while there were no negative returns, there were also no years that allowed the account value to grow more than 9.71 percent, resulting in a lower overall value than Scenario 1.

Scenario 3. Even though the same withdrawals are being made, positive returns occur in the early years, or in the beginning of the sequence, which generates the largest account value at the end of 25 years, despite “down market” years later on.

Scenario 4. This account, using systematic withdrawals, experiences several down market years at the start of retirement and thus, you have to sell more assets to have the same income stream, making it harder for the portfolio to bounce back from the declines. After a few years, the portfolio completely runs out of money.

		Scenario 1			Scenario 2			Scenario 3			Scenario 4		
Year	Age	Annual Return	With-drawals	Portfolio Value	Annual Return	With-drawals	Portfolio Value	Annual Return	With-drawals	Portfolio Value	Annual Return	With-drawals	Portfolio Value
25	65			$100,000			$100,000			$100,000			$100,000
26	66	16.61%	$5,000	$111,610	9.71%	$5,000	$104,707	37.58%	$5,000	$132,578	-37.00%	$5,000	$58,002
27	67	31.69%	$5,100	$141,875	9.71%	$5,100	$109,771	33.36%	$5,100	$171,710	-22.10%	$5,100	$40,083
28	68	-3.10%	$5,202	$132,269	9.71%	$5,202	$115,225	31.69%	$5,202	$220,916	-11.89%	$5,202	$30,117
29	69	30.47%	$5,306	$167,260	9.71%	$5,306	$121,104	30.47%	$5,306	$282,915	-9.10%	$5,306	$22,069
30	70	7.62%	$5,412	$174,591	9.71%	$5,412	$127,448	28.68%	$5,412	$358,655	-3.10%	$5,412	$15,972
31	71	10.08%	$5,520	$186,668	9.71%	$5,520	$134,299	28.58%	$5,520	$455,633	1.32%	$5,520	$10,662
32	72	1.32%	$5,631	$183,502	9.71%	$5,631	$141,705	26.46%	$5,631	$570,584	2.11%	$5,631	$5,257
33	73	37.58%	$5,743	$246,714	9.71%	$5,743	$149,717	22.96%	$5,743	$695,848	4.91%	$5,515	$0
34	74	22.96%	$5,858	$297,502	9.71%	$5,858	$158,392	21.04%	$5,858	$836,407	5.49%	$0	$0
35	75	33.36%	$5,975	$390,783	9.71%	$5,975	$167,792	16.61%	$5,975	$969,359	7.62%	$0	$0
36	76	28.58%	$6,095	$496,368	9.71%	$6,095	$177,985	16.00%	$6,095	$1,118,395	10.08%	$0	$0
37	77	21.04%	$6,217	$594,595	9.71%	$6,217	$189,046	15.79%	$6,217	$1,288,820	10.88%	$0	$0
38	78	-9.10%	$6,341	$534,120	9.71%	$6,341	$201,056	15.06%	$6,341	$1,476,618	15.06%	$0	$0
39	79	-11.89%	$6,468	$464,167	9.71%	$6,468	$214,105	10.88%	$6,468	$1,630,837	15.79%	$0	$0
40	80	-22.10%	$6,597	$354,986	9.71%	$6,597	$228,291	10.08%	$6,597	$1,788,606	16.00%	$0	$0
41	81	28.68%	$6,729	$450,083	9.71%	$6,729	$243,722	7.62%	$6,729	$1,918,158	16.61%	$0	$0
42	82	10.88%	$6,864	$492,198	9.71%	$6,864	$260,517	5.49%	$6,864	$2,016,676	21.04%	$0	$0
43	83	4.91%	$7,001	$509,373	9.71%	$7,001	$278,804	4.91%	$7,001	$2,108,734	22.96%	$0	$0
44	84	15.79%	$7,141	$582,683	9.71%	$7,141	$298,727	2.11%	$7,141	$2,146,124	26.46%	$0	$0
45	85	5.49%	$7,284	$607,412	9.71%	$7,284	$320,441	1.32%	$7,284	$2,167,179	28.58%	$0	$0
46	86	-37.00%	$7,430	$375,253	9.71%	$7,430	$344,118	-3.10%	$7,430	$2,092,473	28.68%	$0	$0
47	87	26.46%	$7,578	$466,983	9.71%	$7,578	$369,943	-9.10%	$7,578	$1,894,388	30.47%	$0	$0
48	88	15.06%	$7,730	$529,597	9.71%	$7,730	$398,125	-11.89%	$7,730	$1,661,495	31.69%	$0	$0
49	89	2.11%	$7,884	$532,896	9.71%	$7,884	$428,887	-22.10%	$7,884	$1,286,411	33.36%	$0	$0
50	90	16.00%	$8,042	$610,136	9.71%	$8,042	$462,478	-37.00%	$8,042	$802,425	37.58%	$0	$0
			$160,151	$610,136		$160,151	$462,478		$160,151	$802,425		$42,686	$0

Conclusion

The distribution of retirement income can dramatically affect an account’s value if assets are withdrawn early in down market years, which can adversely affect the ability of a retiree to sustain an income stream during retirement. Remember, with the average retirement lasting more than 20 years, retirees have to make sure they have enough money to fund those years.

Foresters Financial can help

We have retirement strategies and solutions that may help reduce Sequence of Returns risk and potentially provide protection for your retirement income stream, even when markets decline. So don’t go it alone — speak with your Representative today!

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