

SEQUENCE OF RETURNS MATTER

Investment returns are variable and, unfortunately, unpredictable. When planning for income, the sequence of positive and negative annual returns can have a significant impact on how long a portfolio will last — particularly if the portfolio is in the distribution stage and a set amount is being withdrawn from the portfolio every year. Low or negative returns in the first few years of retirement can significantly add to the possibility of portfolio ruin.

Let's take a look at a hypothetical example over two 15-year income scenarios and consider how the sequence of annual returns could impact the value over time — and learn about a strategy using whole life insurance that may help manage risk and preserve the portfolio's value.

In the illustrations that follow, both Jane and Jim started with a balance of \$500,000. Beginning at age 66, each took out \$20,000 per year adjusted for inflation as part of their retirement income plan. No other actions were taken to manage income withdrawals. Each scenario yielded the same average annual rate of return on the underlying investment for the 15-year period, but the only difference is the sequence of the annual returns. The outcomes are dramatically different.

CLEARLY DIFFERENT OUTCOMES

Jane's portfolio is worth \$500,000. At age 66, she began taking out \$20,000 per year (adjusted by 2.5 percent for inflation). For this example, let's assume she has invested in an index fund that mirrors the performance of the S&P 500 from the time period of 2000 through 2015.

Over the 15-year period, her portfolio had a 3.77 percent average annual rate of return. Her ending portfolio balance would be \$74,300.

JANE'S PORTFOLIO WITH EARLY NEGATIVE RETURNS

Beginning Balance \$500,000

Age	Return	Annual Withdrawal	Growth	Ending Value
66	-10.14%	\$20,000	\$(48,672)	\$431,328
67	-13.04%	\$20,500	\$(53,572)	\$357,256
68	-23.37%	\$21,012	\$(78,580)	\$257,664
69	26.38%	\$21,537	\$62,290	\$298,417
70	8.99%	\$22,075	\$24,843	\$301,185
71	3.00%	\$22,627	\$8,357	\$286,915
72	13.62%	\$23,193	\$35,919	\$299,641
73	3.53%	\$23,773	\$9,738	\$285,606
74	-38.49%	\$24,367	\$(100,551)	\$160,688
75	23.45%	\$24,976	\$31,825	\$167,537
76	12.78%	\$25,600	\$18,140	\$160,076
77	0.00%	\$26,240		\$133,836
78	13.41%	\$26,896	\$14,341	\$121,281
79	29.60%	\$27,568	\$27,739	\$121,452
80	11.39%	\$28,257	\$10,615	\$103,810
81	-0.73%	\$28,963	\$(546)	\$74,300

Ending Balance \$74,300

The examples shown are hypothetical in nature and used for illustration purposes only.

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Jim's portfolio is also worth \$500,000. Let's assume he invested in the same index fund with the same average annual rate of return on the underlying investment, but we reverse the order of the hypothetical rates of return. His ending portfolio balance would be \$344,290.

In this example, there is a difference of approximately \$270,000! The bad outcome for Jane illustrates the impact of negative returns in the early years in conjunction with a set distribution pattern from a portfolio.

JIM'S PORTFOLIO WITH LATE NEGATIVE RETURNS

Beginning Balance \$500,000

Age	Return	Annual Withdrawal	Growth	Ending Value
66	-0.73%	\$20,000	\$(3,504)	\$476,496
67	11.39%	\$20,500	\$51,938	\$507,934
68	29.60%	\$21,012	\$144,129	\$631,051
69	13.41%	\$21,537	\$81,736	\$691,250
70	0.00%	\$22,075		\$669,175
71	12.78%	\$22,627	\$82,629	\$729,176
72	23.45%	\$23,193	\$165,553	\$871,537
73	-38.49%	\$23,773	\$(326,304)	\$521,459
74	3.53%	\$24,367	\$17,547	\$514,640
75	13.62%	\$24,976	\$66,692	\$556,356
76	3.00%	\$25,600	\$15,923	\$546,679
77	8.99%	\$26,240	\$46,787	\$567,226
78	26.38%	\$26,896	\$142,539	\$682,869
79	-23.37%	\$27,568	\$(153,144)	\$502,157
80	-13.04%	\$28,257	\$(61,797)	\$412,104
81	-10.14%	\$28,963	\$(38,850)	\$344,290

Ending Balance \$344,290