Janney

DON'T OVERLOOK THIS HIDDEN RETIREMENT RISK

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After working so hard to save for retirement, it's important to be aware of potential risks that arise when you stop earning and start withdrawing. This article explores some solutions you may consider to help protect your retirement income from sequence of returns risks.

During your working years as you save and invest, it's the average annual return you're making on your money over time—not the individual year-to-year returns—that matters most.

When you're saving and accumulating assets, the risks associated with a few years of negative returns are relatively negligible. Periodic market downturns can simply be viewed as opportunities to purchase more shares at lower prices. But when you transition to spending rather than accumulating (withdrawing assets), a few years of negative returns early on, combined with annual withdrawals, can serve to speed up the depletion of your assets.

As soon as you're no longer earning an income and flip the switch from saving for retirement to generating income from your retirement savings, however, the order of your returns takes on a newfound significance. In fact, your sequence of returns can make the difference between a portfolio that runs out of money in a little over a decade, or one that lasts an entire lifetime.

WHAT IS SEQUENCE OF RETURNS RISK?

Sequence of returns risk is the risk that market declines in the early years of retirement, paired with ongoing portfolio withdrawals, may reduce the number of years your assets last to fund your retirement.

Consider two $1 million portfolios that both earn an average 6% annual return over a 10-year period:

	Scenario A	Scenario B
Year 1	16%	-13%
Year 2	15%	-8%
Year 3	8%	-5%
Year 4	20%	7%
Year 5	4%	16%
Year 6	16%	4%
Year 7	7%	20%
Year 8	-5%	8%
Year 9	-8%	15%
Year 10	-13%	16%
Average Return	6%	6%

Even though the order (or sequence) of annual returns is reversed, both portfolios end up earning a 6% average annual return and are worth the exact same $1,790,848 at the end of a decade.

THE CRITICAL FIRST FEW YEARS

On the other hand, let's look at the difference the first few years of returns can make to two hypothetical $1 million retirement portfolios. In both cases, the new retiree plans on taking a 5% annual withdrawal each year beginning at age 65. And in both cases, the average annual return (6%) is identical—the order of returns is simply reversed between the two scenarios. In Scenario A, the individual experiences more positive returns earlier in retirement; whereas in Scenario B, he or she experiences more negative returns early on.

PLANNING FOR THE UNKNOWN

Since nobody can accurately time the market, the key question that arises is: what steps can you take to minimize the potential impact of sequence of returns risk on your retirement savings?

The preferred approach used to be a gradual transition from stocks to bonds as retirement drew nearer. But not only was that approach based on a retirement that was only expected to last 10–15 years, it was prevalent during a time when investors could expect 5–6% average annual returns on high-quality corporate bonds.[1]

	Scenario A			Scenario B		
Age	5% Annual Withdrawals	Annual Return	Year End Value	5% Annual Withdrawals	Annual Return	Year End Value
65			$1,000,000			$1,000,000
66	$50,000	5%	$1,000,000	$50,000	-25%	$700,000
67	$50,000	28%	$1,230,000	$50,000	-14%	$552,000
68	$50,000	22%	$1,450,600	$50,000	-10%	$446,800
69	$50,000	-5%	$1,328,070	$50,000	16%	$468,288
70	$50,000	20%	$1,543,684	$50,000	21%	$516,628
71	$50,000	19%	$1,786,984	$50,000	5%	$492,460
72	$50,000	23%	$2,147,990	$50,000	-16%	$363,666
73	$50,000	9%	$2,291,309	$50,000	8%	$342,760
74	$50,000	16%	$2,607,919	$50,000	14%	$340,746
75	$50,000	23%	$3,157,740	$50,000	24%	$372,525
76	$50,000	22%	$3,802,443	$50,000	14%	$374,679
77	$50,000	-26%	$2,763,808	$50,000	5%	$343,412
78	$50,000	-15%	$2,299,237	$50,000	-15%	$241,901
79	$50,000	5%	$2,364,199	$50,000	-26%	$129,006
80	$50,000	14%	$2,645,186	$50,000	22%	$107,388
81	$50,000	24%	$3,230,031	$50,000	23%	$82,087
82	$50,000	14%	$3,632,235	$50,000	16%	$45,221
83	$50,000	8%	$3,872,814	$50,000	9%	$0
84	$50,000	-16%	$3,203,164	$50,000	23%	$0
85	$50,000	5%	$3,313,322	$50,000	19%	$0
86	$50,000	21%	$3,959,120	$50,000	20%	$0
87	$50,000	16%	$4,542,579	$50,000	-5%	$0
88	$50,000	-10%	$4,038,321	$50,000	22%	$0
89	$50,000	-14%	$3,422,956	$50,000	28%	$0
90	$50,000	-25%	**$2,517,217**	$50,000	5%	**$0**

Source: "Sequence of Returns," Baird & Co.

In the first instance, even after 25 years of regular withdrawals, the retirement account is actually worth 2.5 times more than its initial value at retirement. In the second case, however, the negative returns early on (combined with annual withdrawals) eroded the account's entire value within just 17 years. Without thoughtful retirement income planning along with careful consideration of strategies to help limit downside risk, your retirement goals could be in unexpected jeopardy.

Today, however, you need to plan for a retirement which might last 30 years or longer. You can't afford to forego growth and become too conservative. Instead, consider trying to balance income and price appreciation—enabling the part of your portfolio intended to generate future income (7–10+ years down the road) to keep growing, while the rest of your retirement savings can pursue more conservative income strategies. That way, even if the market experiences a downturn, your longer-term growth assets may have time to recover before you need them to generate income.

For the more immediate income portion of your portfolio, you may want to consider adding an annuity with living benefits to provide an additional stream of guaranteed lifetime income. Depending on your individual needs and preferences, there are several types of annuities you may consider.

- **Income annuities** provide predictable guaranteed lifetime income payments in exchange for a single, up-front lump sum payment. They generate the maximum amount of initial income, but offer no liquidity or growth potential.
- **Fixed indexed annuities** give you 100% downside protection combined with some limited upside growth potential tied to the performance of a particular market index (e.g., S&P 500®) over a specific time period.
- **Registered index-linked annuities** offer greater growth potential than fixed indexed annuities in exchange for taking on some limited downside exposure (e.g., a 10% buffer), but carry lower potential risks than variable annuities.
- **Variable annuities** offer the most upside growth opportunity in exchange for greater downside risk potential of any annuity solution. But they too can provide guaranteed retirement income (regardless of how the underlying investments perform) through optional living benefit riders.

You may also want to explore other income strategies with your Financial Advisor including bond ladders, a dividend stock portfolio, and/or Treasury Inflation-Protected Securities (TIPS) which can provide you with a valuable hedge against inflation and interest rate risks. This 'total return' approach could potentially provide better diversification, more tax flexibility, and the ability to generate a sustainable lifetime income stream.

DO YOU HAVE A FINANCIAL PLAN?

Want to ensure you're able to retire on your own terms? It starts by putting a thoughtful plan in place well before you retire. We're here to work with you to explore various strategies to help yield gains, design an optimal income strategy based on your personal needs and preferences, and ultimately help minimize the potential for sequence of returns risk to derail your long-term retirement goals.

WORKING WITH JANNEY

Depending on your financial needs and personal preferences, you may opt to engage in a brokerage relationship, an advisory relationship or a combination of both. Each time you open an account, we will make recommendations on which type of relationship is in your best interest based on the information you provide when you complete or update your client profile.

When you engage in an advisory relationship, you will pay an asset-based fee which encompasses, among other things, a defined investment strategy, ongoing monitoring, and performance reporting. Your Financial Advisor will serve in a fiduciary capacity for your advisory accounts. For more information about Janney, please see Janney's Relationship Summary (Form CRS) on www.janney.com/crs which details all material facts about the scope and terms of our relationship with you and any potential conflicts of interest.

By establishing a relationship with us, we can build a tailored financial plan and make recommendations about solutions that are aligned with your best interest and unique needs, goals, and preferences.

Contact us today to discuss how we can put a plan in place designed to help you reach your financial goals.

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1. Moody's Daily Corporate Bond Yield Averages (1970-2020), October 2022

The examples provided are all hypothetical and do not take into account any specific situations. The hypothetical examples are provided to help illustrate the concepts discussed throughout and do not consider the effect of fees, expenses, or other costs that will affect investing outcomes. Any actual performance results will differ from the hypothetical situations illustrated here. Please consult a professional to help you evaluate your situation before implementing any of the strategies discussed here.

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