SEQUENCE OF RETURN RISK: HOW IT CAN DRAMATICALLY IMPACT YOUR RETIREMENT

TARKENTON FINANCIAL
Solutions for Retirement

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Sequence of return risk is the risk that low or negative returns in the early years of retirement can dramatically impact one's whole retirement picture in the future. If you don't think it is real, imagine or talk to people who retired in 2000 or 2008. If your retirement nest egg declined 20%, 30% or 40% when you first "sailed into the sunset," your retirement picture would have been forever changed.

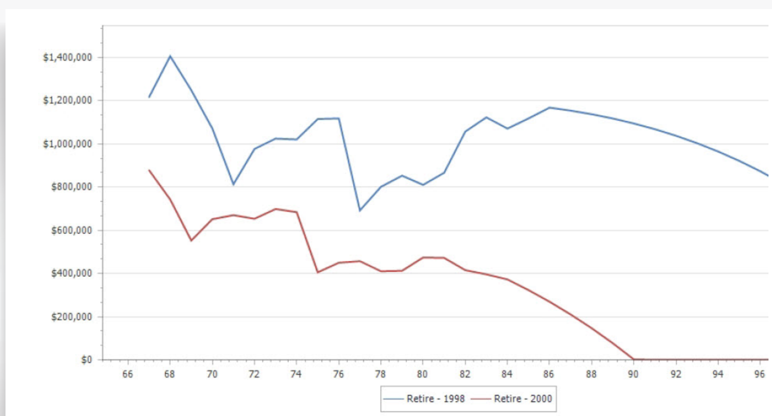
Allow me to illustrate with a story that is depicted in the chart at the bottom of the page. Let's assume there are two retirees, Jack and Jill. They have a lot in common.

- √ Both of them retire at age 66,
- √ Both of them have $1,000,000 at retirement,
- √ Both withdraw 4% per year of their account for income and index that income to inflation each year,
- √ Both of them have investment returns that exactly mirror the S&P 500, and
- √ Both of them live 30 years until age 96.

The only difference was that one retired in 1998 and the other in 2000…and yet that one small difference changes the outcomes entirely.

Jack retired in 2000, and ran out of money in 24 years, spending the last 6 years of his life broke. Jill retired in 1998 and enjoyed income for the next 30 years and still had a nest egg of more $820,000 at the time of her death.

Why the disparity? Jack did not know it when he retired, but 2000 was a lousy year to collect his gold watch. The market was down dramatically that year, and his retirement account found itself in a hole that Jack was never able to dig his way out of. By retiring in 1998 and having two years of positive returns before the 2000 slump, Jill ended up with a great retirement. **The problem is obvious: we do not have the benefit of retiring with a rearview mirror.** We have to look through the windshield at an uncertain future. We do not know in advance if it is a lucky time to retire or an unlucky time.



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How do we solve for Sequence of Return Risk?

While there are several ways to solve for sequence of return risk, I have long been an advocate of what I call Four Bucket Retirement Planning. By taking a four bucket approach, we can be prepared for the potential of poor returns early in retirement and increase our likelihood of having the retirement that we desire.

The basic approach is to have our retirement dollars allocated very carefully into four different "buckets" of money:

- √ **Liquidity Bucket (money market, savings and CDs)**
- √ **Lifetime Income Bucket (annuities or other income-producing assets)**
- √ **Long Term Growth Bucket**
- √ **Legacy Bucket**

The concept is pretty simple. We know that although investing always involves risk, when we have longer holding periods for our investments (in other words, when our long term investing really ends up being long term!), we have a statistically lower likelihood of losing money. If we buy and sell our portfolio after one year, the odds are much higher that we might lose money than if we had 10 or 15 years. The problem in retirement is that we don't always have 10 or 15 years…we need our money now.

That is where the four bucket concept comes in. We want to leave our long term money alone to grow for the long term, so we put enough money into a Liquidity Bucket (typically money markets, savings and CDs) for emergencies and enough money into the Lifetime Income Bucket (typically using annuities) for income, so that we don't need to withdraw money from our long term growth bucket when the market might happen to be down.

As the years go by and we perhaps enjoy some growth in our Long Term Growth Bucket, we might take some of that growth and add it to our Liquidity Bucket to replenish some withdrawals we might have taken, as well as add some dollars to our Lifetime Income Bucket to increase our income in light of inflation. Whatever is left in the first three buckets at our death would pour into the Legacy Bucket for our loved ones.

Please speak with the retirement advisor who provided this white paper about your personal situation and the potential for sequence of return risk. With proper planning, you can have predictable income in retirement and potential long term growth.

As I often say, there is no "dress rehearsal" for retirement, so make sure your retirement plans position you to enjoy your retirement to the fullest!

DISCLOSURE: Fixed index annuities are insurance products. Not FDIC insured. Guarantees are based solely on the financial strength and claims-paying ability of the issuing insurer. All scenarios presented are hypothetical and strategies discussed are not recommendations. Strategies may or may not be appropriate for your situation. Consult a financial and/or tax advisor about your individual situation.

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