

# SEQUENCE RISK

Why it should concern you, and how to eliminate it from your retirement strategy

## TIMING IS EVERYTHING

Sequence-of-returns risk, or sequence risk, is the risk associated with the timing of distributions from investment accounts used for retirement income. Negative market returns early in retirement can adversely impact how long retirement savings will last.

## A TALE OF TWO RETIREMENTS

To illustrate how even the most diligent individual can fall victim to sequence risk, consider the example of Big Brother Bill and Little Sister Jill. Jill followed in the footsteps of her big brother, and at the beginning of retirement both had amassed \$1M in total retirement assets through the same financial strategies. Both planned to withdraw at the same rate, with the same adjustment for inflation each year.



### BILL & JILL

Total Retirement Assets:  
**\$1,000,000**

Investments:  
**Broad market index fund**

Withdrawals:  
**4% per year**

Inflation:  
**Steps up by 3% each year  
to adjust for inflation**



DIST. STARTS  
**1996**

DIST. STARTS  
**1999**

### HYPOTHETICAL EXAMPLE

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Year-End Value  
in 2017:  
**\$1,894,503**

Avg. 1 Year Return:  
**8.90%**

Total Withdrawals:  
**\$1,221,478\***

Total Change in  
Account Value:  
**89.45%**

As you can see, Bill and Jill's retirements both started out the same. The difference? Bill is three years older than Jill, and began his retirement in 1996, three years before she did in 1999.

### THE RESULTS

Jill is three years behind Bill in distributions, but the differences in their retirement accounts by 2017 is staggering.

Year-End Value  
in 2017:  
**\$257,123**

Avg. 1 Year Return:  
**6.05%**

Total Withdrawals:  
**\$ 1,004,680\*\***

Total Change in  
Account Value:  
**-74.29%**

\*Distributions starting in 1996

\*\*Distributions starting in 1999

## WHAT HAPPENED?

Bill retired in 1996, and experienced four years of positive returns before weathering two bear markets, from 2000-2002 and from 2008-2009. Jill, however, retired in 1999 and only had one year of positive returns before the first bear market started in 2000. Jill fell victim to sequence risk. Simply put, Bill had more time for his savings to grow before the negative returns hit – in fact, when he came out of the first bear market, he still started 2003 with 17% more than he started with, while Jill entered the year with just 59% of her initial \$1M. The only thing Jill did wrong was retire at the wrong time.

## INCOME ALLOCATION AS A POTENTIAL SOLUTION

What if Jill had used a different strategy? Sequence risk hit Jill hard merely by her retiring a few years after Bill. But what if Jill had allocated just a portion of her retirement savings to create her income and left the rest in financial products tied to the stock market during the same period of time? As you can see from the hypothetical results to the right, a \$600,000 portfolio would have grown by 117% in the same scenario if no withdrawals were taken from this account, with her retirement income coming from a different source that was protected from the effects of sequence risk and market volatility. Her income needs could have been met AND her investment account would have become surplus money to help her enjoy retirement even more. This is the concept of Income Allocation.

**How else could we have generated \$40K in yearly retirement income for Jill?** One option is through the use of a fixed index annuity. These long-term retirement income vehicles offer tax-deferred growth potential and a death benefit for beneficiaries during the accumulation phase. Product features, benefits, and rates can vary. There are options based on when income is needed, or how early she started planning for retirement income. The following options could be considered:

1. If income is needed immediately, utilizing a single premium immediate annuity with an initial deposit around \$675,000, an annual income of approximately \$40,000 could be generated for Jill using a life and 10-year certain payout, given today's rates.
2. If she had five years of deferral, she could use around \$525,000 to generate approximately \$40,000 annually that will last for the rest of her lifetime using a fixed index annuity.
3. Or if she had even more time to defer the payments – say 10 years – she could purchase a product with only around \$400,000 that could guarantee her approximately \$40,000 annually for as long as she lives, again utilizing a fixed index annuity.

The bottom line: by implementing an Income Allocation solution fueled in part by a fixed index annuity, the lifetime income Jill needs to have a measure of financial confidence in retirement can be generated, while still growing her other assets that aren't needed to generate her income. While asset allocation is an investment strategy, using Income Allocation as a retirement strategy puts you in more control of your retirement income by mitigating sequence risk and not leaving your retirement success dependent on the timing of financial markets.

These are hypothetical examples for illustrative purposes only. The hypothetical returns are not indicative of actual market performance. Actual market returns will vary. This is not intended to project the performance of any specific investment, index, or insurance product. It is not possible to invest directly in an index. If this were an actual product, the returns may be reduced by certain fees and expenses. Fixed index annuities are designed to meet long-term needs for retirement income. Early withdrawals may result in loss of principal and credited interest due to surrender charges. Distributions may be subject to ordinary income tax and, if taken prior to age 59 ½, an additional 10% federal tax. Riders will likely incur additional charges and are subject to availability, restrictions, and limitations. Guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.



### HYPOTHETICAL EXAMPLE

Total Investment Assets:  
**\$600,000**

Investments:  
**Broad market index fund**

Year-End Value in 2017:  
**\$1,304,770**

Avg. 1 Year Return:  
**6.05%**

Total Withdrawals:  
**\$0**

Total Change in Account Value:  
**117.46%**

(Based on Option 3)