FINANCIAL

At Park Place

HOW SEQUENCE OF RETURNS RISK AFFECTS RETIREMENT

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There is a lot of debate about the 4% withdrawal rate in retirement. Some believe that the markets will continue to perform adequately for retirees, allowing them a withdrawal rate of 4% a year adjusted for inflation while safely ensuring they never run out of money.

But some leading economists and financial planners argue that the 4% rule can no longer be used and that the withdrawal percentage should be considerably lower.

With interest rates at 300-year lows and the 10-year US Treasury note at 1.28%[1], the traditional conservative fixed-income, bond-heavy retirement portfolio has been abandoned in favor of seeking extra yield and growth, often taking on additional risk in the overall portfolio in the form of dividend stocks and/or high-yield bonds.

In order to illustrate the potential negative impact of sequence of returns during the important first five years immediately following retirement, we have compared some hypothetical scenarios based on stock market history.

[1] *As of 7/21/2021*

SEQUENCE OF RETURNS RISK IS ALL ABOUT TIMING

Two Scenarios with Exactly the Same Returns—In Reverse Order

- In both scenarios, the retiree is 65 years old and retires with $1 million.
- In both scenarios, the retiree withdraws 4% per year plus a 2.1% annual increase for inflation each year through age 86.
- Scenario 2 shows the actual S&P average stock market returns from the years 2000 – 2021[2]. Scenario 1 simply inverts and reverses those same returns, starting with the 2021 S&P average.

SCENARIO 1:

AGE	RETURN	WITHDRAWAL	ENDING PORTFOLIO VALUE
			$1,000,000
65	10.93%[2]	$40,000	$1,069,300
66	16.26%	$40,840	$1,202,328
67	28.88%	$41,697	$1,507,862
68	- 6.24%	$42,573	$1,371,198
69	19.42%	$43,467	$1,594,018
70	9.54%	$44,380	$1,701,707
71	- 0.73%	$45,312	$1,643,973
72	11.39%	$46,263	$1,784,957
73	29.60%	$47,235	$2,266,070
74	13.41%	$48,227	$2,521,723
75	0.00%	$49,239	$2,472,483
76	12.78%	$50,273	$2,738,192
77	23.45%	$51,329	$3,328,969
78	- 38.49%	$52,407	$1,995,241
79	3.53%	$53,508	$2,012,165
80	13.62%	$54,631	$2,231,590
81	3.00%	$55,779	$2,242,758
82	8.99%	$56,950	$2,387,432
83	26.38%	$58,146	$2,959,090
84	- 23.37%	$59,367	$2,208,183
85	- 13.04%	$60,614	$1,859,621
86	- 10.14%	$61,887	$1,609,169
TOTAL	5.09%	$1,104,133	$1,609,169

SCENARIO 2:

AGE	RETURN	WITHDRAWAL	ENDING PORTFOLIO VALUE
			$1,000,000
65	-10.14%	$40,000	$858,600
66	-13.04%	$40,840	$705,798
67	-23.37%	$41,697	$499,155
68	26.38%	$42,573	$588,259
69	8.99%	$43,467	$597,677
70	3.00%	$44,380	$571,227
71	13.62%	$45,312	$603,716
72	3.53%	$46,263	$578,763
73	-38.49%	$47,235	$308,762
74	23.45%	$48,227	$332,939
75	12.78%	$49,239	$326,249
76	0.00%	$50,273	$275,975
77	13.41%	$51,329	$261,654
78	29.60%	$52,407	$286,696
79	11.39%	$53,508	$265,843
80	-0.73%	$54,631	$209,270
81	9.54%	$55,779	$173,455
82	19.42%	$56,950	$150,190
83	-6.24%	$58,146	$82,671
84	28.88%	$59,367	$47,180
85	16.26%	$47,180	$0
86	10.93%[2]	$0	$0
TOTAL	5.09%	$1,028,811	$0

SCENARIO 1:

This hypothetical retiree was lucky—the portfolio was able to provide $1,104,133 in cumulative income withdrawals from age 65 through age 86 while still growing the account to $1,609,169 in value net of income.

Adding those two figures together, the total portfolio benefit to the client and heirs finished at $2,713,302.

SCENARIO 2:

This hypothetical retiree was unlucky because market losses occurred early in the initial years of retirement. Even though the annualized returns were the same as Scenario 1, the timing of returns prevented this portfolio from being successful.

While the portfolio was able to provide $1,028,811 in cumulative income withdrawals, it was completely depleted in 20 years.

This is what is meant by sequence of returns risk: the timing of returns can affect portfolio income success.

[2] Through 6/18/2021

GUARANTEED INCOME STRATEGY:

Fixed Indexed Annuities

FIXED INDEXED ANNUITIES ADDRESS FIVE OUT OF SIX RETIREMENT RISKS

1. **Longevity ✓**
2. **Health ✓**
3. **Sequence of Returns ✓**
4. **Inflation ✓**
5. **Income ✓**
6. Taxes

An often-overlooked asset class for retirement is the guaranteed income provided by a fixed indexed annuity. Fixed Indexed Annuities (FIAs) and riders can address many different retirement risks, including sequence of returns.

In fact, the only asset class that can help mitigate three of the five risks in retirement—longevity, sequence of returns and income—is an annuity with guaranteed income.

A **Fixed Indexed Annuity (FIA) with an optional Guaranteed Income Rider*** provides guaranteed lifetime income that may help offset portfolio sequence of returns risk. Guaranteed income lessens the reliance on the portfolio to generate income, helping mitigate the risk of negative timing of returns and providing security to cover income needs.

Having guaranteed income gives the retiree the option to leave money in the portfolio during market downturns rather than being forced to take withdrawals for living expenses which can hasten a portfolio's decline.

**Guaranteed by an insurance carrier. Optional enhancement riders may be added to the policy for an additional charge. These are hypothetical average numbers based off of A+ rated carriers.*

HOW GUARANTEED INCOME CAN MITIGATE SEQUENCE OF RETURNS RISK

Scenario 2 Option, Adding an FIA

YEAR	RETURN	WITHDRAWAL	FIXED INDEXED ANNUITY	ENDING PORTFOLIO VALUE
			$200,000	$800,000
2000	-10.14%	$40,000	$ -	$678,880
2001	-13.04%	$29,140	$11,700	$561,214
2002	-23.37%	$29,751	$11,700	$400,306
2003	26.38%	$30,376	$11,700	$475,530
2004	8.99%	$31,014	$11,700	$487,266
2005	3.00%	$31,665	$11,700	$470,218
2006	13.62%	$32,330	$11,700	$501,930
2007	3.53%	$33,009	$11,700	$486,639
2008	-38.49%	$33,703	$11,700	$265,628
2009	23.45%	$34,410	$11,700	$293,507
2010	12.78%	$35,133	$11,700	$295,884
2011	0.00%	$35,871	$11,700	$260,013
2012	13.41%	$36,624	$11,700	$258,256
2013	29.60%	$37,393	$11,700	$297,306
2014	11.39%	$38,178	$11,700	$292,990
2015	-0.73%	$38,980	$11,700	$251,871
2016	9.54%	$39,799	$11,700	$236,100
2017	19.42%	$40,635	$11,700	$241,316
2018	-6.24%	$41,488	$11,700	$184,769
2019	28.88%	$42,359	$11,700	$195,771
2020	16.26%	$43,249	$11,700	$184,354
2021	10.93%[2]	$44,157	$11,700	$160,346
TOTAL	5.09%	$799,276	$245,700	$160,346

SCENARIO 2 OPTION:

The hypothetical 65-year-old retiree with $1 million saved who experienced market downturns early in retirement could have avoided running out of money by using a guaranteed income fixed indexed annuity (FIA).

If the retiree had allocated 20% of the portfolio into a fixed indexed annuity with guaranteed income, the FIA could generate $11,700 in guaranteed income annually and $245,700 in total as shown, assuming a 65-year-old male owns the FIA contract and income is deferred for one year.

In this scenario, the portfolio was able to provide $1,044,976 in cumulative income withdrawals while still maintaining a $160,346 portfolio balance.

NOTE: This result does not include a potential increase in the fixed indexed annuity due to interest-crediting.

[2] Through 6/18/2021

**Guaranteed by an insurance carrier. Optional enhancement riders may be added to the policy for an additional charge. These are hypothetical average numbers based off of A+ rated carriers.*

A LOOK BACK AT JAPAN'S "LOST DECADE"

- These charts illustrate the Nikkei 225 index losses during Japan's "Lost Decade" from 1991 – 2001. Per Investopedia, rising interest rates set a liquidity trap at the same time a credit crunch was unfolding.[3]
- In both of the illustrated scenarios above, the retiree is 65 years old and retires in 1990 with $1 million invested in the Nikkei 225 Index.
- In both scenarios, the retiree withdraws 4% per year plus a 2.1% annual increase for inflation.
- Scenario B includes an FIA with guaranteed income.

SCENARIO A:

YEAR	RETURN	WITHDRAW	ENDING PORTFOLIO VALUE
			$1,000,000
1990	-38.72%	$40,000	$572,800
1991	-3.63%	$40,840	$511,167
1992	-26.36%	$41,697	$334,726
1993	2.91%	$42,573	$301,893
1994	13.24%	$43,467	$298,396
1995	74.00%	$44,380	$474,829
1996	-2.55%	$45,312	$417,409
1997	-21.19%	$46,263	$282,696
1998	-9.28%	$47,235	$209,227
1999	36.79%	$48,227	$237,974
2000	-27.19%	$49,239	$124,029
2001	-23.52%	$50,273	$44,583
2002	-18.63%	$44,583	$0
2003	24.45%	$0	$0
2004	7.61%	$0	$0
2005	40.24%	$0	$0
2006	6.92%	$0	$0
2007	-11.13%	$0	$0
2008	-42.12%	$0	$0
2009	19.04%	$0	$0

SCENARIO B:

YEAR	RETURN	WITHDRAWAL	FIXED INDEX ANNUITY	ENDING PORTFOLIO VALUE
			$400,000	$600,000
1990	-38.72%	$40,000	$ -	$327,680
1991	-3.63%	$17,465	$23,375	$298,320
1992	-26.36%	$17,831	$23,375	$201,851
1993	2.91%	$18,206	$23,375	$189,518
1994	13.24%	$18,588	$23,375	$196,022
1995	74.00%	$18,978	$23,375	$322,100
1996	-2.55%	$19,377	$23,375	$294,509
1997	-21.19%	$19,784	$23,375	$212,318
1998	9.28%	$20,199	$23,375	$172,415
1999	36.79%	$20,624	$23,375	$215,222
2000	-27.19%	$21,057	$23,375	$135,646
2001	-23.52%	$21,499	$23,375	$82,243
2002	-18.63%	$21,950	$23,375	$44,970
2003	24.45%	$22,411	$23,375	$33,553
2004	7.61%	$22,882	$23,375	$13,224
2005	40.24%	$10,773	$23,375	$0
2006	6.92%	$0	$23,375	$0
2007	-11.13%	$0	$23,375	$0
2008	-42.12%	$0	$23,375	$0
2009	19.04%	$0	$23,375	$0

SCENARIO A:

In Scenario A, the hypothetical retiree would have run out of money in 12 years, in 2002.

SCENARIO B:

In Scenario B, even if the hypothetical retiree had allocated 40% to a guaranteed* FIA with an income rider, the portfolio would have been depleted by 2005.

But the client would still have received $23,375 yearly for the rest of their life.

[3] *https://www.investopedia.com/articles/economics/08/japan-1990s-credit-crunch-liquidity-trap.asp*

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COULD HISTORY REPEAT ITSELF?

While history may not repeat, there is a saying that "it often rhymes." While the United States may not experience a lost decade like Japan, it is something to consider and plan for. As the U.S. is potentially in the late innings of its current bull market run, it just makes sense to hedge against multiple retirement risks in the retirement portfolio.

Japan's Nikkei 225 returns for 15 years prior[3] to the "Lost Decade"

YEAR	RETURN
1989	29.04%
1988	39.86%
1987	14.58%
1986	43.85%
1985	13.35%
1984	16.66%
1983	23.42%
1982	4.36%
1981	8.76%
1980	7.51%
1979	9.46%
1978	23.35%
1977	- 2.51%
1976	14.94%
1975	13.16%
15 YEAR AVG	16.70%

The US Current Bull Market (S&P 500)[4] since the financial crisis:

YEAR	RETURN
2021	26.89%[4]
2020	16.26%
2019	28.88%
2018	- 6.24%
2017	19.42%
2016	9.54%
2015	- 0.73%
2014	11.39%
2013	29.60%
2012	13.41%
2011	0.00%
2010	12.78%
2009	23.45%
13 YEAR AVG	13.64%

[4] *As of 05/2022*

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