Doing & Delivering what others don't.

Hidden danger awaits retirees!

One of the biggest risks retirees face when investing is in the first five or so years. It's called Sequencing Risk. This is when you experience relatively poor returns in the early years for a retirement that perhaps has to span 25-30 years.

It can ruin a happy secure retirement even if starting with the right amount saved. 2008 was a recent example. For those unlucky enough to have retired near this year, the amount you could then live on had to be cut drastically, or face the likelihood of the money running out and living their last years in poverty or being forced to sell one's home. This doesn't have to happen. In this article we will look at historic examples and what can be done to mitigate this risk.

It can happen no matter what you invest in including property, unless you take the right precautions. For most people holding shares of productive businesses is a part of the long term need to earn enough growing income to ensure a secure 25-30 retirement - A second lifetime of living. Shares are also the most volatile, and so we will use this asset class in our examples.

A Case study - 10 Couples retiring: Each couple saved a nest egg of $1 million, investing into the top 500 USA companies– The S&P 500 Index (a similar outcome applies investing in the Top 200 Australian businesses- ASX 200).

Rising life expectancy means 25-30 years income is required. Each withdraws $100,000 p.a. increasing by 3% p.a (countering inflation). Fees and taxes are removed as they don't alter the comparative outcome. Each couple retires one year after the other starting in 1977 (the last couple retiring in 1987).

How did each couple fare?

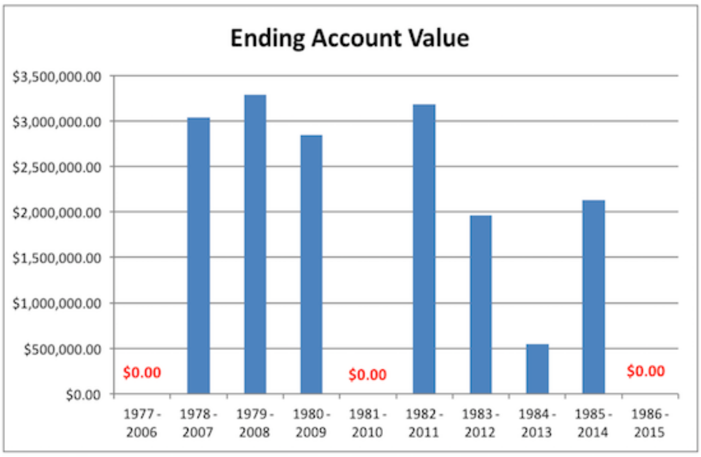
- **3 ran out of money** well before 30 years simply because they retired one year too early or too late in hindsight.
- **7 ended** well with balances from $500,000 to $3.2 million.

How not to be one of the three. The three that ran out of money retired in 1977, 1981, and 1986. Their 'average' returns were still respectable, and compared to those whom did not run out, sometimes achieved even better. So how could they have found themselves in this awful mess? The first *five to 10 years* of their investment, returns were subpar. Even though later they did well – better than others whose middle to back end of retirement experienced more mediocre returns.

Insight 1: The perfect storm for retirees is when unexpected catastrophe type losses occur combined w sub-par returns in the early years. You get so far behind; it becomes impossible to catch up. It's known "sequence of returns risk."

It’s like an ever decreasing spiral that at each income payment point, more capital is required, which deprives one of that capital in the future to build more income- forever!

The results for each couple



When analysing the declines for in the S&P there were 15 random periods of negative moments of -10.2% to -56.8% lasting from 33 to 929 days. Yet overall returns were very healthy as we can see in the next table. There is no way to predict who would have been the unlucky 3 and who weren’t. There is no pattern or warning bell. An adviser cannot confidently avoid this from happening; but there are precautions one can take.

Couple	Longevity of Retirement Nest Egg	Average Annual Return of S&P 500 for 30-Year Period	Average Annual Return of S&P 500 for First 5 Years of Retirement
1977 - 2006	$0 after 20 years	12.48%	8.13%
1979 - 2008	$3.2 million after 30 years	11.00%	17.36%

Although over the long term the S&P returned 1.48% *more* per year for 1977 to 2006 (the worst couple enjoyed this higher average overall return) than the couple from 1979 to 2008 (the best resulting account couple of all 10), the former couple ran out of funds .

It was the *first five or so years* of relatively higher investment returns (and no big losses) that the best couple enjoyed, than the worst couple who retired in 1977.

Insight 2: Be wary of chasing the highest returning investments appearing on league tables. These results are too hard to sustain. What matters is that in the first period of retirement you don’t fall below a reasonable return (not out performing it), and also not falling into catastrophic potholes. On average potholes lasting more than 3 months occur once every 6 years.

No one can predict when falls will last more than a few months. Since 1930 they struck 20 times, 9 lasting over 300 days - the longest 929 days (Year 2000). Even though the rises over time will provide an average return outperforming other forms of investment, it is the retiree’s need of constant drawdowns without periods of sub-par results in the early years, which interferes with a happy and secure future.

Insight 3: Holding most of your savings in real property won't shield you from this risk. At some point the rental income alone will not suffice and even though a large amount is not needed in any month you can't sell just a few bricks; and so the inevitable property sale will take place. At this point the whole sequential risk event begins for this portion of a nest egg all over again. Placing it all in cash creates an equivalent disaster.

Having your cake and eating it too! The reality facing retires is the need for exposure to large amounts of *liquidable growth assets* even though their volatility can be damaging. Here is how to enjoy its benefits and reduce sequential risk.

- **Keep 2 years income in a cash** type account so you can ride out most periods of low/negative returns
- **Invest in equity** funds that aim to produce a growing portion of income
- **'Dollar cost average' your nest egg** into the retirement strategic asset allocation (if not already set up in this way)
- **Diversify in ways that smooth out** returns without giving up to much upside.
- **'Downside protect**' a good portion of your equity investment. Managed funds that deploy capital protection in equities are a good start.

Finally, when retired, having the highest performers is not as important as smoothing out the inevitable 'potholes' across your portfolio. Don't try, as it increases risks you don't need. Shielding a nest egg is as crucial as posting good above inflation returns. Stellar performers often experience stellar losses. Beware.

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This and more is set out in our extensive White Paper; "The Unstoppable Global Downshift" February 2017. A copy can be obtained by visiting www.changinglifeandwealth.com

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About Grant Pearson: Grant has almost 30 years investment markets, financial advice and insurance experience in Australia and overseas holding a variety of Buy and Sell side roles at senior levels. This includes Merrill Lynch, AMP, ABN Amro, ING and AMP.

Grant built a wealth advisory network with 100 outlets in just 4 years boasting $450+ Million in FUM. Grant sits on two Investment Committees with in excess of $2 Billion in FUM, and is an ASIC registered Key Person and Responsible Manager. Grant has designed and delivered leading investment product offers and a unique Robo Advice proposition. He also heads up a **ground-breaking educational DIY investor service; http://www.changinglifeandwealth.com**

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About Longitude68.com Longitude68.com provides consulting services to fund managers and financial services providers with strategy and distribution advice and training. Clients span Australia, New Zealand and SE Asia.