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Preserving wealth, enriching legacy

The Retirement Threat Most People Overlook

And How You Can Protect Yourself

by Mike Marion

How important is it that your money lasts for the duration of your retirement? Most people would answer that it is the essential consideration. Yet, few people are aware of one of the most severe threats to their retirement wealth.

The Problem

Sequence-of-returns risk involves the order in which investment returns occur. In the accumulation (saving) stage, the investor can recover from a few bad years with a few good years later on. The situation is quite different during the period in which one is no longer working and saving, relying solely on investments for income.

If the first couple years of retirement happen to land within a declining market, the retiree may have no choice but to sell into losses. This depletes the principal they are depending on to grow within their retirement accounts. It is quite possible that the portfolio may never recover. This would result in either the retiree running out of money or having their lifestyle reduced from what they had planned on.

The bad news is that there is nothing an investor/retiree can do to control the timing of the market's ups and downs. The good news is that retirement income planning tools exist that can mitigate this threat.

A Solution

To address the sequence-of-returns risk, a retiree should have a pool of money apart from their investments from which to draw income. A cash-value life insurance policy is an example of such a source. This allows the retiree to withdraw income from the insurance policy instead of selling investment assets in a down market. The retiree can leave his regular retirement funds untouched so he can recover as the market moves back up.

Consider the difference between the hypothetical scenarios of Client A and Client B. Both clients retire with $1 million in the same year. Although they experience the same market returns, the balance of their portfolios after 20 years is vastly different. Client A withdraws $70,000 each year, including years with down markets. Client B also withdraws $70,000 per year, except for five years when the market was down, during which he leaves the $70,000 invested and instead withdraws it from the cash value of his life insurance policy.

At age 85, Client A has a balance of $382,644, while client B has $4,004,003 — over ten times as much! (see Exhibit A)

In this example, the normal benefits of life insurance will also still be in place. The insured's loved ones will be protected with the policy's death benefit and the insured will own an asset with special tax treatment.

For an individual who is still in their working years and is concerned about what might happen in the event the market declines during or just prior to retirement age, cash value life insurance could be an important retirement income planning solution.

Exhibit A:

		Client A				Client B			
Age	Hypothetical S&P 500 Return	Beginning of Year Balance	Annual Withdrawal	Post Withdrawal Balance	End of Year Balance	Beginning of Year Balance	Annual Withdrawal	Post Withdrawal Balance	End of Year Balance
65	-14.66%	$1,000,000	$ (70,000)	$ 930,000	$ 793,662	$1,000,000	$ (70,000)	$ 930,000	$ 793,662
66	-26.47%	$ 793,662	$ (70,000)	$ 723,662	$ 532,109	$ 793,662	0	$ 793,662	$ 583,580
67	37.20%	$ 532,109	$ (70,000)	$ 462,109	$ 634,013	$ 583,580	0	$ 583,580	$ 800,671
68	23.84%	$ 634,013	$ (70,000)	$ 564,013	$ 698,474	$ 800,671	$ (70,000)	$ 730,671	$ 904,863
69	-7.16%	$ 698,474	$ (70,000)	$ 628,474	$ 583,475	$ 904,863	$ (70,000)	$ 834,863	$ 775,087
70	6.56%	$ 583,475	$ (70,000)	$ 513,475	$ 547,159	$ 775,087	0	$ 775,087	$ 825,933
71	18.44%	$ 479,791	$ (70,000)	$ 409,791	$ 485,356	$ 825,933	$ (70,000)	$ 755,933	$ 895,327
72	32.50%	$ 485,357	$ (70,000)	$ 415,357	$ 550,348	$ 895,327	$ (70,000)	$ 825,327	$1,093,558
73	-4.92%	$ 550,348	$ (70,000)	$ 480,348	$ 456,715	$1,093,558	$ (70,000)	$1,023,558	$ 973,199
74	21.55%	$ 456,714	$ (70,000)	$ 386,714	$ 470,051	$ 973,199	0	$ 973,199	$1,182,923
75	22.56%	$ 470,051	$ (70,000)	$ 400,051	$ 490,303	$1,182,923	$ (70,000)	$1,112,923	$1,363,999
76	6.27%	$ 490,303	$ (70,000)	$ 420,303	$ 446,656	$1,363,999	$ (70,000)	$1,293,999	$1,375,133
77	31.73%	$ 446,656	$ (70,000)	$ 376,656	$ 496,169	$1,375,133	$ (70,000)	$1,305,133	$1,719,251
78	18.67%	$ 496,169	$ (70,000)	$ 426,169	$ 505,735	$1,719,251	$ (70,000)	$1,649,251	$1,957,166
79	5.25%	$ 505,735	$ (70,000)	$ 435,735	$ 458,611	$1,957,166	$ (70,000)	$1,887,166	$1,986,243
80	16.61%	$ 458,611	$ (70,000)	$ 388,611	$ 453,159	$1,986,243	$ (70,000)	$1,916,243	$2,234,531
81	31.69%	$ 453,159	$ (70,000)	$ 383,159	$ 504,582	$2,234,531	$ (70,000)	$2,164,531	$2,850,470
82	-3.11%	$ 504,582	$ (70,000)	$ 434,582	$ 421,066	$2,850,470	$ (70,000)	$2,780,470	$2,693,998
83	30.47%	$ 421,066	$ (70,000)	$ 351,066	$ 458,036	$2,693,998	0	$2,693,998	$3,514,859
84	7.62%	$ 458,036	$ (70,000)	$ 388,036	$ 417,604	$3,514,859	$ (70,000)	$3,444,859	$3,707,357
85	10.08%	$ 417,605	$ (70,000)	$ 347,605	$ 382,644	$3,707,357	$ (70,000)	$3,637,357	$4,004,003

Retiring in Down Market:
$1,000,000 at start
$70,000 annual withdrawal
62% erosion over 20 years
Balance in 20 years: $382,663

Zero withdrawal in 5 Down Years:
$1,000,000 at start
$70,000 annual withdrawal
400% growth over 20 years
Balance in 20 years: $4,004,003

The results presented here are hypothetical and your results will be different. These are based on the S & P returns from 1993-2013. Past performance is not a guarantee of future results. Clients cannot invest directly in the S & P 500.
Assumptions are not adjusted for income tax on growth - i.e, assumes 0% income tax rate

The numbers shown above do not consider the additional financial investment required to fund the hypothetical cash value life insurance policy. The above analysis of portfolio A & B is intended solely to illustrate the sequence-of-return risk that is present if additional assets are not available in the 5 down years shown above.