2535 Townsgate Rd., #213
Thousand Oaks, CA 91361
TEllis@GoldenOakWM.com
CA Insurance Lic. # 0D96275
P: (805) 379-9374
F: (805) 379-1585

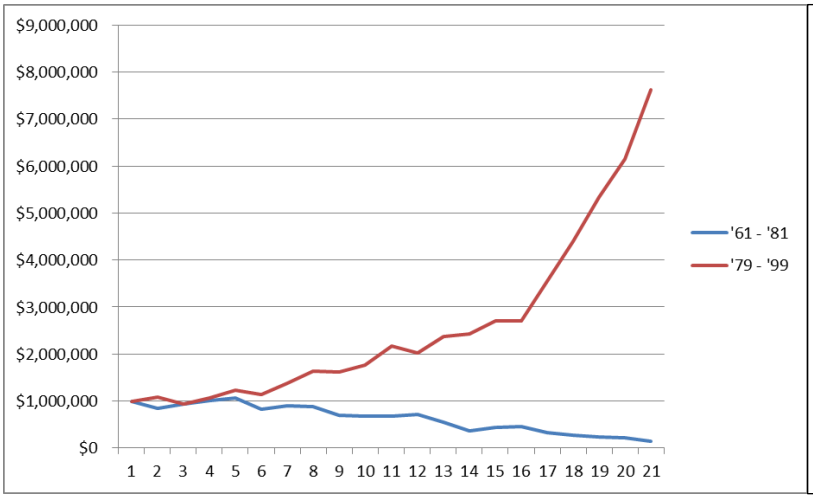
"Average Returns" – The Great Retirement Deception

The Dilemma

The biggest retirement question most retirees ponder is whether they have enough saved to ensure they will not run out of money as they spend down their retirement assets. The answer to this question is never as simple as retirees hope due to the unknown future of investment returns. Despite the Financial Industry's claim that you should expect average returns over the long-run, the fact that the commonly accepted "safe withdrawal rate" has declined over the past decade indicates that once accepted rules of retirement are changing. While industry "experts" once declared that a retiree should feel safe withdrawing 6% annually from their investment accounts, that number shifted down to 5% and then to 4% as reality overcame the wishful thinking of many investors' financial plans; plans they often paid handsomely to have a financial advisor draft and track. The reason for this, in my opinion, is that the bulk of the investment "expert" community does not fully appreciate the devastating role volatility can wreak on investments once those investments reach the distribution phase; nor do they appreciate the reality that there have been, and will continue to be, periods of lower than "expected" returns.

Two Retirees Doing the Same Thing with Vastly Different Results

Let's look at two 20-year time periods to illustrate my point. For the first, let's assume that you retired at the end of 1961 with a nest egg of $1,000,000 and take $50,000 each year from your portfolio to fund your retirement. By the end of 1981, your nest egg, invested in the Dow Jones Industrial Average, has shrunk to $146,255, less than 3 years' worth of distributions. However, if you were born 2 decades later and didn't retire until the end of 1979, and took out $50,000 each year, that $1,000,000 nest egg would be worth $7,629,982 by the end of 1999. $146,255 vs. $7,629,982 – what an enormous difference! And yet, both investors did the exact same thing – they both had $1,000,000 invested in the DJIA, took out $50,000 per year, and trusted that the market would provide them with long-term average returns. The difference between these retirees had nothing to do with any decisions they made; it had everything to do with how the market performed during their different retirement years.



Graph depicts the effects on $1,000,000 from the annual returns of the two time-periods with annual withdrawals of $50,000.

The massive uptick in the '79 – '99 value reflect the very large returns received during the Tech Run-Up of the late 1990's, but as you can see, even the 1980's & early 1990's were already handily beating the '61 – '81 time-period.

GOLDEN OAK
WEALTH MANAGEMENT

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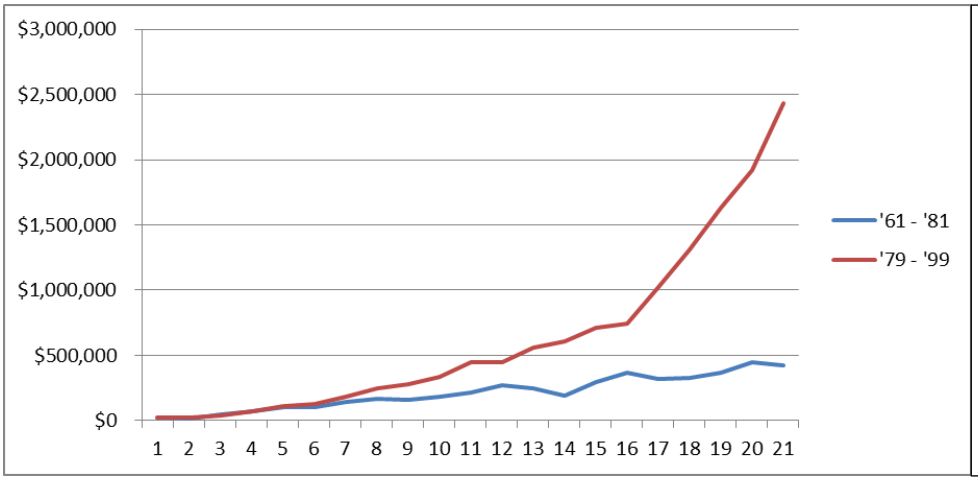
F: (805) 379-1585

Two Savers Doing the Same Thing with Vastly Different Results

Flipping the issue a bit and looking at the same 20-year periods as **savings** periods rather than **withdrawal** periods makes the same point. A saver who invested $20,000 each year from 1962 – 1981 would see their nest egg grow to only $420,202. That means they invested $400,000 over 20 years and have only $20,202 in gains to show for it. The saver who invested $20,000 each year from 1980 – 1999 saw their nest egg grow to $2,431,246. Again, both did the exact same thing yet their results are so vastly different. The '62-'81 investor can only draw down $21,010 each year in retirement at a 5% withdrawal rate, while the '80-'99 investor can draw down $121,562 at that same 5% withdrawal rate.



Graph depicts the growth of a savers portfolio over the two time-periods investing $20,000 each year for 20 years.

Both savers invested a total of $400,000 over 20 years.

What Gives?

The reality in both of these cases is that the performance of the market was far from "average". The '61-'81 period was well below average while the '79-'99 was well above average. The lesson here is that no one will ever actually receive the market's "average" return. An average, by definition, means there are higher and lower *actual* numbers. You and I will receive those *actual* returns, not some "long-term average of the market" peddled by the investment experts.

So how do you plan for retirement knowing that no one can predict the next 20-years of market performance, let alone the next single year? That is a question for another article, but let's keep in mind this article's lesson as we navigate the unknown future of investment returns; NEVER PLAN ON "AVERAGE RETURNS"!

Disclaimer – The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. An investor cannot invest directly in an index. Past performance does not guarantee future results.