Sequence of Returns

By Dennis J. Rogers, CPA, CFP®

Most people pay great attention to the returns they make on their investments. How did each fund perform over the last year – 5 years – 10 years? How badly did they do in the big down markets? These are certainly important questions. However, as we approach the time we are about to use the money, like retirement, there is another very important concern – the sequence of the returns.

The S&P 500 has had an average return of 9.99% annually over the past 30 years. That seems comforting if you are about to retire and plan to withdraw 6% or even 8% annually, right? You will have enough for each year and some left over to cover inflation.

The problem is that you cannot predict in what sequence those returns will come. What if, in the first few years of your retirement, market performance is particularly bad and your returns are much less than 9.99% annually? Market performance will likely work out over time, but you may run out of money before it gets back. You could find yourself taking withdrawals of 13% or more from your now smaller balance. That may not be sustainable. Next month we will look at some solutions to this dilemma.

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