Episode #173: Sequence of Return Risk: Is Your Retirement Safe?

Video Transcription

Hello and welcome to another episode of "Money Script Monday." My name is Luke Geller. Today, we're going to be talking about sequence of return risk and taking a look at if your retirement is safe. The reason I wanted to talk about sequence of return risk is the way I look at it is I think it's something that everyone knows is a risk, right? Everyone knows it's out there, everyone knows that it's something. But I think sometimes, that is most obvious, gets overlooked. A lot of people don't prepare themselves and their retirement portfolios for that risk.

What I want to talk about today is really what that risk is, what that entails and what it might look like or how it might affect your portfolio, and how can we protect your portfolio from that, and how we can protect ourselves from that as well. I want to kind of get into it. When I do these videos, I like to talk about and tell a story about myself or my family or a personal situation I've been in. I want to mention my dad and my step-mom. They are on the verge of retirement. In January of 2021, they are going to enter retirement and they asked me to help them out.

When they did that, which was awesome, I was more than happy to, but I also try to get in their mindset of what a scary year this was for someone that's going to be retiring. 2020 was a scary year for everyone, but I try to look at the mindset of someone that is about to retire in a month and going through the ups and downs of this year and specifically the ups and downs of the market of this year. What I want to show you is if you were to just look at the S&P 500 in 2020, and look at February 14th, which was an all-time high, 3,380. Then go to December 2nd, and we're still at an all-time high, 3,665. I've had a gain of 8.4% this year. What a great year, right?

It's been smooth sailing, but when you take a look at the surface and take a deep dive, this was a scary year for a lot of people, especially people that are it's a scary year for everyone, but for people that were getting ready to retire, were worried about their nest egg, this 2020 had plenty of ups and downs. If you look at the S&P from that perspective. February 14th, we were at an all-time high, and then just a month later, I believe this was about March 20th, we're at the low of 2,237, a loss of 34%. I was trying to think and I didn't have to think. I was getting text messages and calls from my dad asking what he should do. What's going on? Should we do, anything or what do we have to worry about? That's because they just lost 34% of their entire life savings in a month. That is a scary feeling. That is a very scary feeling to have.

Fast forward eight months down the road and we're at an all-time high and up 64%, but the path that it took to get there was a very scary one. It encapsulates what that stock market volatility and that risk is in retirement. Someone that pulled their money out of the market and took withdrawals and they started that in 2020, this is that first year of retirement, and this is a very important year. Why is it an important year? Let's take a look at a hypothetical situation. We just looked at an actual 1-year case of the S&P 500 and the ups and downs you can have.

Let's take a look at a hypothetical of someone that has a million dollars and that were to put that million dollars in one of two accounts. These two accounts are in the same rate of return over a four-year period, but the sequence in which they earn that rate of return, we're just going to flip. We're going to start in Fund A, we're going to start with a negative sequence of return. In Fund B, we're going to start with a positive sequence of return and then end with that negative sequence of return.

When you look at that, over those 4 years we're withdrawing $60,000 a year, Fund A has $720,000 left in it and Fund B has about $831,000. That's a difference of $100,000, over $110,000. Think about that. These funds earn the same amount of return, took out the same amount of money, except 1 fund has $110,000 less. That is two years of income that this person lost over a four-year period. That is a huge amount of money. What can we do to help you? What does that mean and what can we do to protect you?

The first thing, and that's what I want to talk about is I want to give you three steps that you can take. One thing that you should do is talk with a financial professional while going through these three steps because everyone should use and should utilize an expert because this is a huge decision in your life to make sure that you're protected. The first step you want to do is evaluate your specific situation. Every single person is different. Someone that's 45 and has 20 years left to save is going to be in a different situation than my parents who are a month away from retirement. There's a lot of different things that you can worry about and that you can focus on.

That 45-year old still needs to think about that sequence of return risk because everyone's going to face these same risks just at different times. Everyone can protect themselves from these risks. It's just going to depend on your situation. There might be a little bit different way to go about it. The first thing, evaluate your situation. The second thing you want to do is develop a retirement income plan. How much money do you need in retirement? Do you know how much money you need to survive? Do you know how much money you want on top of what you need to survive, to have fun, to go visit your grandkids, to go travel?

I'm talking to my dad and my step-mom, they want to go travel the country in an RV and go fishing and hiking and camping and visit their grandkids and their granddaughter and do all these things. How much money do they need to have in retirement to do that each year? How much income do they need to earn in retirement to do that each year? If they know that number then they can protect themselves and protect that number. One of the most important things to do or one of the best ways to do that is by creating multiple sources of income. And not just any income, you want to create multiple sources of protected income.

What are sources of protected income? Those are sources of income that you don't have to worry about, that sequence of return risk, that market risk because they are protected from those things. Those would be something like social security, pensions, guaranteed lifetime income from an annuity, even tax-free income from life insurance policies. Those are all sources of protected income that you can use. Everyone already has at least that one source of protected income and social security, or if you don't have social security, you're most likely going to have a pension of some sort. There’s a lot of uncertainty because of 2020 if social security will be there for you. Based on your situation, a 45-year-old, it might be, a 25-year-old, probably not. We don't know.

You want to take these steps to protect yourself and protect your retirement. You want to evaluate your situation, you want to develop a retirement income plan for that situation, how much money you need to live off of and survive, your bills for your house, etc. How much money do you want in retirement so that you can do the things you want to do? Protect that money and protect that income. Once you do those three steps what you're going to be able to do is you're not going to have to worry that in a month the S&P is going to drop 30% and you just lost 30% of your entire life savings in a month.

I want you to reevaluate yourself, reevaluate your situation and take these steps because these risks that you know, that you see every single day, but you might overlook can be extremely important in your retirement. I want to thank you for attending today, watching this video. I hope you were able to take a little piece today and take some sort of action. Make sure you get with a financial advisor and go over those three steps of how you can protect yourself. Thank you.