Sequencing Risk

Sequencing risk is the risk that the order and timing of investment returns on a portfolio are unfavourable. In other words, sequencing risk is the risk of a negative return at the worst possible time. For many, the worst possible time is for those who are just retiring and commencing an income stream from superannuation. This is because their retirement asset base is the largest with no employment income to provide any buffer.

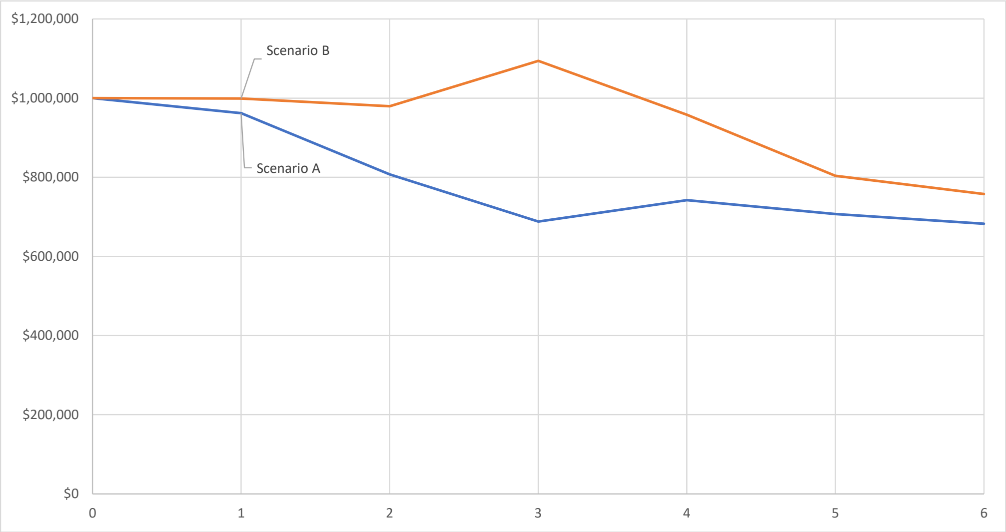
What is Sequencing Risk?

Assuming no contributions or withdrawals, did you know that reversing a sequence of investment returns on a $1 million investment portfolio will produce the same end result after six years? The portfolio is worth $1,232,303 after the six-year period under both scenarios indicated below.

No withdrawals	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Scenario A	4%	-9%	-6%	21%	6%	8%
Scenario B (reverse)	8%	6%	21%	-6%	-9%	4%

However, if an investor is required to draw upon the investment portfolio, the results are different. Specifically, negative investment returns early in the sequence (i.e. retirement) will have a disproportionate benefit on the portfolio balance. This is shown in the example to follow, whereby we assume identical returns from the previous example, however now assume a $75,000 per annum withdrawal.

Withdrawing $75,000 p.a. (beginning of period)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Scenario A	4%	-9%	-6%	21%	6%	8%
Scenario B (reverse)	8%	6%	21%	-6%	-9%	4%



After the six-year period, the portfolio is worth approximately $75,000 lower under scenario A when compared with scenario B. As the example shows, if a retiree sees a greater proportion of negative investment returns during the early years of retirement, this can have a significant effect on the income they can draw upon throughout the retirement timeframe.

As we have experienced during the last 17 or so months since the beginning of 2020, markets exhibit both positive and negative outcomes. The order in which the up and down fluctuations occur can have a big impact on financial wellbeing.

Conclusion

While investors understand that fluctuations in markets can affect the value of their retirement savings, another risk known as ‘sequencing risk’ can have a bearing on long-term retirement outcomes.

The importance of managing sequencing risk should not be underestimated in these volatile and uncertain times. Employing an appropriate investment plan is warranted. This is where the assistance of an experienced adviser can help to navigate and act upon changing market conditions.