

Sequence of Returns Risk

Early negative or positive rates of return for an investment in withdrawal can have a lasting impact on both long-term capital values and long-term viability of income.

The examples below demonstrate the importance of the sequence of positive and negative rates of return on equivalent initial investments with the same average returns. Investment A and B have the same yearly returns, but Investment B has the order of these returns reversed. Investment A's initial returns are positive while Investment B's are negative.

Example 1: With an initial investment of £500,000 and a yearly income of £25,000, the value of the investment after 10 years is £129,771 larger for Investment A than Investment B due solely to the sequence of the positive and negative returns.

Investment	£500,000	Yearly Withdrawal	£25,000.00		
Investment A					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£500,000	20%	£25,000	£575,000	
Year 2	£575,000	10%	£25,000	£607,500	
Year 3	£607,500	12%	£25,000	£655,400	
Year 4	£655,400	8%	£25,000	£682,832	
Year 5	£682,832	6%	£25,000	£698,802	
Year 6	£698,802	5%	£25,000	£708,742	
Year 7	£708,742	5%	£25,000	£719,179	
Year 8	£719,179	-8%	£25,000	£636,645	
Year 9	£636,645	-3%	£25,000	£592,545	
Year 10	£592,545	-5%	£25,000	£537,918	
Investment B					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£500,000	-5%	£25,000	£450,000	
Year 2	£450,000	-3%	£25,000	£411,500	
Year 3	£411,500	-8%	£25,000	£353,580	
Year 4	£353,580	5%	£25,000	£346,259	
Year 5	£346,259	5%	£25,000	£338,572	
Year 6	£338,572	6%	£25,000	£333,886	
Year 7	£333,886	8%	£25,000	£335,597	
Year 8	£335,597	12%	£25,000	£350,869	
Year 9	£350,869	10%	£25,000	£360,956	
Year 10	£360,956	20%	£25,000	£408,147	
Summary					
Investment A		Investment B		Difference (A-B)	
Final Value (end of year 10)	£537,918	Final Value (end of year 10)	£408,147	Final Value	£129,771
Capital Growth	£37,918	Capital Growth	-£91,853		
Average return	5%	Average return	5%		
Total withdrawals	£250,000	Total withdrawals	£250,000		

Example 2: If you change the initial investment to £100,000 with a yearly income of £10,000, the difference is £51,909. With opposite return sequences, the difference is more than 5 years of income and Investment B would only have £5,067 left after 10 years.

Investment	£100,000	Yearly Withdrawal	£10,000.00		
Investment A					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£100,000	20%	£10,000	£110,000	
Year 2	£110,000	10%	£10,000	£111,000	
Year 3	£111,000	12%	£10,000	£114,320	
Year 4	£114,320	8%	£10,000	£113,466	
Year 5	£113,466	6%	£10,000	£110,274	
Year 6	£110,274	5%	£10,000	£105,787	
Year 7	£105,787	5%	£10,000	£101,077	
Year 8	£101,077	-8%	£10,000	£82,990	
Year 9	£82,990	-3%	£10,000	£70,501	
Year 10	£70,501	-5%	£10,000	£56,976	
Investment B					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£100,000	-5%	£10,000	£85,000	
Year 2	£85,000	-3%	£10,000	£72,450	
Year 3	£72,450	-8%	£10,000	£56,654	
Year 4	£56,654	5%	£10,000	£49,487	
Year 5	£49,487	5%	£10,000	£41,961	
Year 6	£41,961	6%	£10,000	£34,479	
Year 7	£34,479	8%	£10,000	£27,237	
Year 8	£27,237	12%	£10,000	£20,505	
Year 9	£20,505	10%	£10,000	£12,556	
Year 10	£12,556	20%	£10,000	£5,067	
Summary					
Investment A		Investment B		Difference (A-B)	
Final Value (end of year 10)	£56,976	Final Value (end of year 10)	£5,067	Final Value	£51,909
Capital Growth	-£43,024	Capital Growth	-£94,933		
Average return	5%	Average return	5%		
Total withdrawals	£100,000	Total withdrawals	£100,000		

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Sequence of Returns Risk (cont.)

The examples below illustrate the importance of sequence of returns with the same 5% return across all years except for a loss of -15% in one year. In example 3, this loss occurs in year 10 for Investment A, while Investment B incurs this loss in year 1.

Example 3: With an initial investment of £500,000 and a yearly income of £25,000, Investment A is worth £55,133 more than Investment B, the equivalent of over 2 years of income.

Investment	£500,000	Yearly Withdrawal	£25,000.00		
Investment A					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£500,000	5%	£25,000	£500,000	
Year 2	£500,000	5%	£25,000	£500,000	
Year 3	£500,000	5%	£25,000	£500,000	
Year 4	£500,000	5%	£25,000	£500,000	
Year 5	£500,000	5%	£25,000	£500,000	
Year 6	£500,000	5%	£25,000	£500,000	
Year 7	£500,000	5%	£25,000	£500,000	
Year 8	£500,000	5%	£25,000	£500,000	
Year 9	£500,000	5%	£25,000	£500,000	
Year 10	£500,000	-15%	£25,000	£400,000	
Investment B					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£500,000	-15%	£25,000	£400,000	
Year 2	£400,000	5%	£25,000	£395,000	
Year 3	£395,000	5%	£25,000	£389,750	
Year 4	£389,750	5%	£25,000	£384,238	
Year 5	£384,238	5%	£25,000	£378,449	
Year 6	£378,449	5%	£25,000	£372,372	
Year 7	£372,372	5%	£25,000	£365,990	
Year 8	£365,990	5%	£25,000	£359,290	
Year 9	£359,290	5%	£25,000	£352,254	
Year 10	£352,254	5%	£25,000	£344,867	
Summary					
Investment A		Investment B		Difference (A-B)	
Final Value (end of year 10)	£400,000	Final Value (end of year 10)	£344,867	Final Value	£55,133
Capital Growth	-£100,000	Capital Growth	-£155,133		
Average return	3%	Average return	3%		
Total withdrawals	£250,000	Total withdrawals	£250,000		

Example 4: If the initial investment amount is £100,000 with a yearly income of £10,000, Investment A is worth £22,053 more than Investment B and Investment B is left with only £6,084 after 10 years..

Investment	£100,000	Yearly Withdrawal	£10,000.00		
Investment A					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£100,000	5%	£10,000	£95,000	
Year 2	£95,000	5%	£10,000	£89,750	
Year 3	£89,750	5%	£10,000	£84,238	
Year 4	£84,238	5%	£10,000	£78,449	
Year 5	£78,449	5%	£10,000	£72,372	
Year 6	£72,372	5%	£10,000	£65,990	
Year 7	£65,990	5%	£10,000	£59,290	
Year 8	£59,290	5%	£10,000	£52,254	
Year 9	£52,254	5%	£10,000	£44,867	
Year 10	£44,867	-15%	£10,000	£28,137	
Investment B					
Period	Initial Value	Return	Withdrawals	Final Value	
Year 1	£100,000	-15%	£10,000	£75,000	
Year 2	£75,000	5%	£10,000	£68,750	
Year 3	£68,750	5%	£10,000	£62,188	
Year 4	£62,188	5%	£10,000	£55,297	
Year 5	£55,297	5%	£10,000	£48,062	
Year 6	£48,062	5%	£10,000	£40,465	
Year 7	£40,465	5%	£10,000	£32,488	
Year 8	£32,488	5%	£10,000	£24,112	
Year 9	£24,112	5%	£10,000	£15,318	
Year 10	£15,318	5%	£10,000	£6,084	
Summary					
Investment A		Investment B		Difference (A-B)	
Final Value (end of year 10)	£28,137	Final Value (end of year 10)	£6,084	Final Value	£22,053
Capital Growth	-£71,863	Capital Growth	-£93,916		
Average return	3%	Average return	3%		
Total withdrawals	£100,000	Total withdrawals	£100,000		

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