Dollar Cost Ravaging: Sequence of Returns Risk

There is a time for everything — especially selling your investments.

Both hypothetical portfolios began with $1 million and the retiree made annual withdrawals of $65,000 increasing by 3% each year for inflation. Both portfolios had the same average annual returns of 5.69%, but the order in which those returns occurred was opposite. The green portfolio lasted longer because it had positive returns in the early years and negative returns in the later years. However, the purple portfolio was depleted because it experienced its negative returns early, despite having positive returns later.

Investors should be sensitive to taking withdrawals during volatile markets, especially in the early years of retirement.

1 Assumptions:
Both portfolios are based on a hypothetical portfolio of 60% equity (represented by the S&P 500 Total Return Index), 30% bonds (represented by the total return of 10-year U.S. Treasury Bonds), and 10% cash (represented by U.S. Treasury Bills) using the 2000–2014 annual returns of those indices. The sequence of weighted portfolio returns for the green portfolio was: 11.33%, 6.57%, 10.43%, 6.08%, 11.44%, 12.24%, -15.74%, 6.82%, 10.42%, 4.06%, 7.91%, 17.23%, -8.48%, -5.07%, 0.16%. The sequence of weighted portfolio returns for purple portfolio was: 0.16%, -5.07%, -8.48%, 17.23%, 7.91%, 4.06%, 10.42%, 6.82%, -15.74%, 12.24%, 11.44%, 6.08%, 10.43%, 16.57%, 11.33%.
Source: BNY Mellon Investment Management.

The examples presented are for illustrative purposes only. Past performance is no guarantee of future results. Please see side 2 for definition of index.

Why Should You Care?
Dollar Cost Ravaging2 is the opposite of Dollar Cost Averaging. Dollar Cost Averaging works to the investor’s benefit during the saving period. Market declines are an opportunity to purchase more shares for a consistent investment dollar amount. During retirement, when assets are being sold, the opposite occurs in market declines, meaning that more shares are liquidated to achieve a consistent income, and future compounding is hampered.

You should be strategic when taking money out of retirement savings, otherwise market declines may mean running out of money too soon.

What’s the Good News?
- Investment withdrawals during a steady up market usually also work to the investor’s benefit — just like Dollar Cost Averaging.
- While no one knows what investment markets will do over time, there are several strategies your advisor can employ to potentially mitigate the negative impact of Dollar Cost Ravaging, also called Sequence of Returns Risk.
- Diversifying your portfolio may reduce some of your market risk, allowing you to plan where to make withdrawals.
Avoid ravaging
Beware of taking withdrawals during a down market. Delay or reduce distributing your savings from investments that are declining or during prolonged market volatility.

Don't set it and forget it
To make your money last, you may need to reduce the percentage you originally planned to distribute — perhaps for your entire retirement.

Watch out for the "4% Rule"
Often individuals think they can safely withdraw at least 4% from their investment accounts and have enough money for life. With retirement lasting 20–30 years, it may be risky to stick to an arbitrary distribution amount — even only 4%.

Use insurance wisely
Insurance and guaranteed products may reduce reliance on your investment portfolio and mitigate sequence of returns risk.

This information is general in nature and not intended to constitute tax or estate-planning advice. Please consult your tax or estate-planning advisor for more detailed information on these issues and advice on your specific situation.

The Standard & Poor's 500 (S&P 500) Composite Stock Price Index is a widely accepted, unmanaged index of U.S. stock market performance. Investors cannot invest directly in any index.

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