Stay Nimble With Withdrawals

Retirees beware: Excessive withdrawal rates in down years can quickly deplete your portfolio.

If you're nearing retirement or already in it, you may have decided to follow the popular 4%-plus-inflation annual withdrawal strategy[1] to help your nest egg last as long as you do. But before you commit to an inflexible plan, be sure to evaluate the hazards of *sequence-of-returns risk*—a specific type of financial risk that could deplete your portfolio in later years.

Consider two hypothetical scenarios in the chart below—Ms. Westwood's portfolio on the left and Ms. Eastwood's on the right. Both start with a $500,000 nest egg, but Ms. Westwood is retiring into a generally rising market. Though she experiences some negative returns in later years, the early momentum allows her nest egg to grow, even as she takes withdrawals from it. On the right, Ms. Eastwood experiences identical gains and losses, but in reverse order. Because Ms. Eastwood's losses come early, her regular withdrawals are helping to starve her portfolio—already weakened from losses. Gains recouped in later years come too late to reverse the damage. By Ms. Eastwood's 23rd year of retirement, her portfolio would have evaporated.

Sequence-of-Returns Risk: Two Hypothetical Withdrawal Scenarios for a $500,000 Retirement Nest Egg

Early market gains can provide a margin of safety for regular withdrawals, while early losses have the opposite impact.

Early Bull Market: Ms. Westwood's Portfolio				Early Bear Market: Ms. Eastwood's Portfolio			
Retirement Year	Market Gain/ Loss	Annual Withdrawal Amount	Portfolio Market Value	Retirement Year	Market Gain/ Loss	Annual Withdrawal Amount	Portfolio Market Value
0	n/a	n/a	$500,000	0	n/a	n/a	$500,000
1	3%	$20,000	$495,000	1	-37%	$20,000	$295,011
2	21%	$20,400	$578,756	2	-22%	$20,400	$209,412
3	12%	$20,808	$627,166	3	-12%	$20,808	$163,714
4	14%	$21,224	$691,792	4	33%	$21,224	$195,703
5	23%	$21,649	$828,980	5	-5%	$21,649	$164,420
6	16%	$22,082	$939,564	6	22%	$22,082	$177,764
7	2%	$22,523	$936,882	7	23%	$22,523	$195,336
8	-9%	$22,974	$828,611	8	6%	$22,974	$184,618
9	15%	$23,433	$929,995	9	11%	$23,433	$181,274
10	1%	$23,902	$918,373	10	5%	$23,902	$166,277
11	-9%	$24,380	$810,381	11	32%	$24,380	$194,651
12	8%	$24,867	$847,259	12	-4%	$24,867	$161,249
13	10%	$25,365	$906,621	13	19%	$25,365	$165,982
14	-3%	$25,872	$852,605	14	5%	$25,872	$149,229
15	32%	$26,390	$1,096,373	15	26%	$26,390	$162,332
16	26%	$26,917	$1,359,605	16	32%	$26,917	$186,851
17	5%	$27,456	$1,406,846	17	-3%	$27,456	$153,595
18	19%	$28,005	$1,641,430	18	10%	$28,005	$140,950
19	-4%	$28,565	$1,540,898	19	8%	$28,565	$123,124
20	32%	$29,136	$2,000,640	20	-9%	$29,136	$82,778
21	5%	$29,719	$2,069,191	21	1%	$29,719	$54,153
22	11%	$30,313	$2,264,048	22	15%	$30,313	$31,996
23	6%	$30,920	$2,375,167	23	-9%	$30,920	($0)
24	23%	$31,538	$2,879,355	24	2%	($0)	($0)
25	22%	$32,169	$3,467,584	25	16%	($0)	($0)
26	-5%	$32,812	$3,264,060	26	23%	($0)	($0)
27	33%	$33,468	$4,291,539	27	14%	($0)	($0)
28	-12%	$34,138	$3,747,316	28	12%	($0)	($0)
29	-22%	$34,820	$2,884,320	29	21%	($0)	($0)
30	-37%	$35,517	**$1,781,667**	30	3%	($0)	($0)

For illustrative purposes only. Percentage market gains and losses shown in each scenario are hypothetical and do not represent any particular asset allocation or market index strategy. Annual withdrawal amounts assume a 4% annual distribution based on a starting $500,000 retirement portfolio, plus an annual 2% inflation factor. No taxes, costs, or transaction fees were included; had they been included, the withdrawal amounts would be lower. Source: Hartford Funds.

Bottom Line: While it's impossible to predict the market's ups and downs, you can mitigate sequence-of-return risk by using a more flexible withdrawal strategy (i.e., reducing withdrawals in down years and increasing them in up years) or by withdrawing money from fixed-income investments in down years.

Your financial professional can help you tailor a withdrawal strategy to help ensure you don't outlive your portfolio.

[1] The "4% rule" is a financial rule of thumb used to determine how much a retiree should withdraw from a retirement account each year. The rule calls for withdrawing 4% of your total investment during the first year of retirement while adjusting withdrawals for inflation in subsequent years.

Important Risks: Investing involves risk, including the possible loss of principal.

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