

Retirement Income Planning – Sequence of Returns

What is sequence of returns risk?

Sequence of returns risk is an investment risk that may affect investors, such as retirees, who are (or are close to) actively drawing income from their investment portfolio(s). It can be referred to as the risk of running into a period of negative returns at a time in which you are regularly withdrawing money from your portfolio.

One aim of retirement income planning is to approximate the appropriate amount of money that may be withdrawn from a portfolio each year while trying to ensure that an individual does not outlive their assets. In theory, a retirement portfolio would have a sustained ability to cover all living expenses after accounting for other income sources, such as Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) payments, Old Age Security (OAS) payments, and privately-funded pension payments (where available), adjusting for factors such as inflation. To this end, it may be worth exploring alternate projections with your TD Waterhouse advisor, which account for periods of negative return activity during periods of regular withdrawals, such as retirement.

Effects of withdrawals in periods of downwards markets

Using actual rate of return data from the S&P/TSX Composite Index (TSX) from 1988 to 2008, as illustrated in the table to the right, you can see how having a period of negative returns at the time of withdrawal can have harmful effects during the distribution phase of retirement. The graph on the reverse side illustrates two portfolios with beginning value of \$500,000 with withdrawals of \$35,000 per year adjusted annually for inflation at 2%. The solid green line uses actual rates of return (including dividends) tied to the TSX for the period 1988 to 2008 (TSX actual) while the dashed green line inverted (flipped) rates of return (e.g., starting with 2008 and working backwards). As you can see, the rates of return during the initial years have a dramatic effect on the outcome of the portfolio over the next 20-25 years.

Sequence of returns can be one of the most important determinants in the longevity of a portfolio when regular withdrawals are occurring. If high returns are experienced during a period of regular withdrawals, a portfolio may benefit from capital appreciation and as a result may have the ability to withstand the impact of future negative performance. Alternatively, if a withdrawal period experiences prolonged or considerable downward returns, the outcome may be very different.

Actual annual returns (including dividends) of S&P/TSX Composite Index and inverted rates of return (1988-2008)

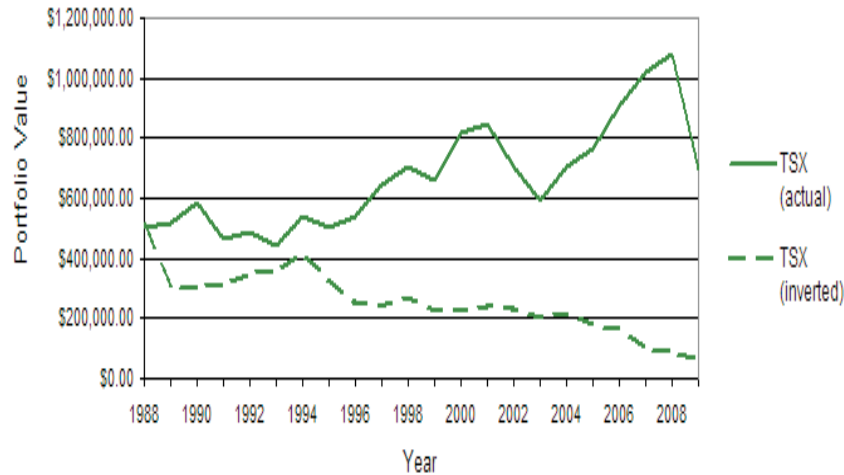
Year	TSX Actual	TSX Inverted
1988	11.08	-33.00
1989	21.37	9.83
1990	-14.80	17.26
1991	12.02	24.13
1992	-1.43	14.48
1993	32.55	26.72
1994	-0.18	-12.44
1995	14.53	-12.57
1996	28.35	7.41
1997	14.98	31.71
1998	-1.58	-1.58
1999	31.71	14.98
2000	7.41	28.35
2001	-12.57	14.53
2002	-12.44	-0.18
2003	26.72	32.55
2004	14.48	-1.43
2005	24.13	12.02
2006	17.26	-14.80
2007	9.83	21.37
2008	-33.00	11.08

Source: Report on Canadian Economic Statistics 1924-2010, produced by the Canadian Institute of Actuaries



Is there an optimal withdrawal amount in retirement?

Every individual views retirement differently and will have varying levels of assets (resources to draw upon) to support this phase of their life. Those fortunate enough to have “stable” income resources available to them in retirement may have the ability of being more flexible with their investment portfolio and withdrawal rate, as their daily living expenses may be covered by income sources such as a pension, annuity, or other income. Alternatively, individuals who depend largely on their investment portfolio to fund their retirement may be more impacted by the performance of capital markets. While there is generally no magic retirement withdrawal rate that will ensure that you do not outlive your assets, it is important to closely monitor your position on a regular basis.



For illustrative purposes only. The following graph displays a \$500,000 investment portfolio with \$35,000 annual withdrawals using the rate of return assumptions from the table on the reverse side. Source: Report on Canadian Economic Statistics 1924-2010, produced by the Canadian Institute of Actuaries

Ways to potentially address the effects of sequence of returns risk

- Delay retirement/postpone distributions from invested savings during depressed markets
- Reduce withdrawal rate during depressed markets
- Create a low risk pool of assets that can provide you with up to 5 years of income
- Consider the use of guaranteed income products to fund a portion of your income need

Call your TD Waterhouse advisor today to find out more about how we may help with your retirement planning.



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