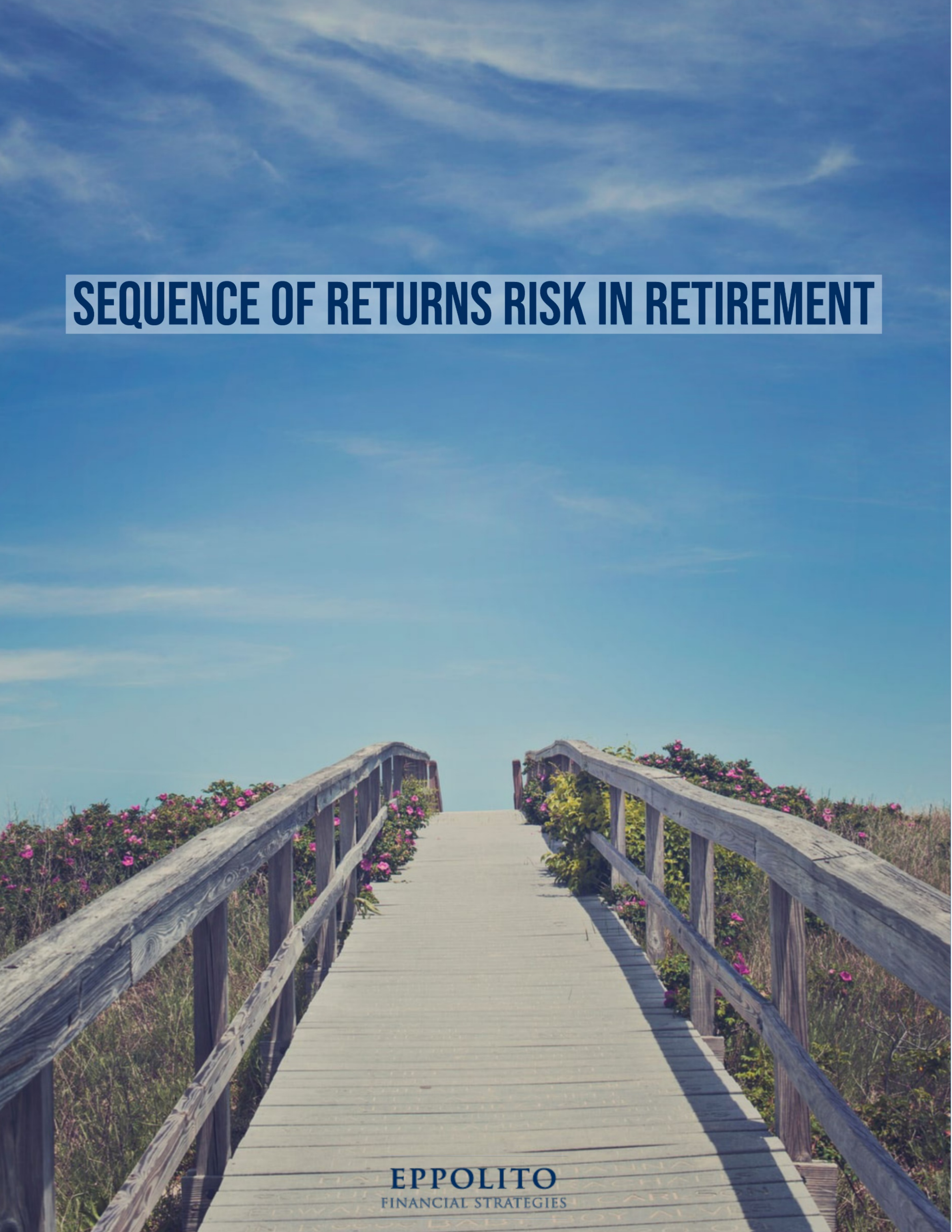
SEQUENCE OF RETURNS RISK IN RETIREMENT

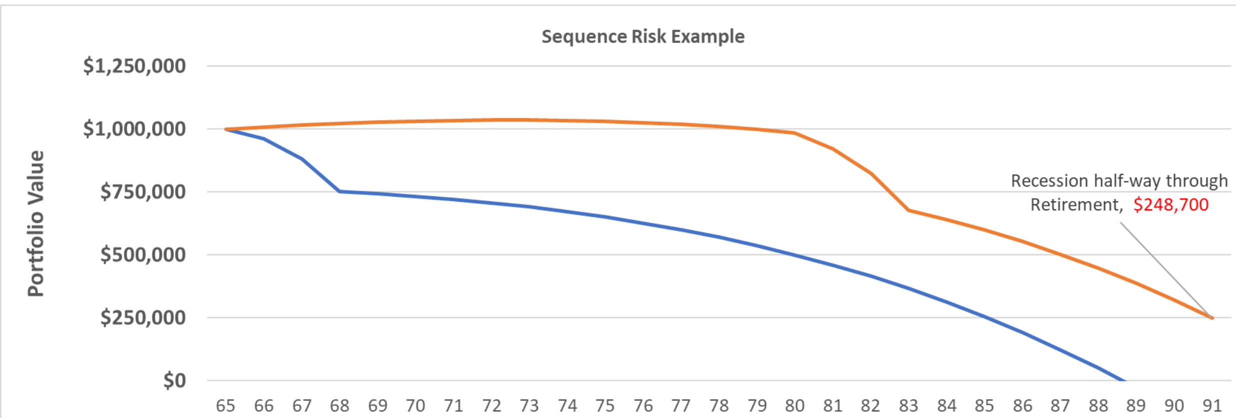


EPPOLITO
FINANCIAL STRATEGIES

What is Sequence Risk and What Can I Do About It?

"Sequence Risk" or "Sequence of Returns Risk" is the danger that poor market returns early on in retirement may threaten a portfolio's ability to last a lifetime. Simply put, retiring on the eve of a deep market downturn can increase the chances of running out of money early.

Here's a simple example to explain the concept.
Let's assume a person retires at 65 with $1 million in financial assets, then spends $40,000 annually* from the portfolio for life.



1. In **Scenario 1** (the blue line on the chart below) the market suffers from an
2. economic downturn for the <u>first three years</u> of retirement, and growth of 5% annually for all other years.
3. In **Scenario 2** (the orange line on the chart) there are also 3 years of negative growth, *but they occur later in retirement* – <u>in years 15, 16 and 17</u>.

* For the sake of illustration, this example focuses solely on the portfolio's rate of return. Inflation on spending is assumed at 3% annually.

The Crux of the Issue
While both scenarios assume the same compound annual growth rates and a market downturn of similar depth, the portfolio is worth $700,000 less at age 91 in **Scenario 1,** when the markets are down in the early years of retirement versus, **Scenario 2**, when the market downturns occur later on.

Why is the Difference So Large?
It's because, in **Scenario 1**, you'll be taking the <u>same amount of money</u> off of a <u>smaller pool of investment assets</u>. Also, as your investment portfolio falls in value, you'll have

less money on which to earn potential investment returns in the future. It benefits us, therefore, to delay shrinkage to the extent possible.

Controlling what is Controllable – Tailoring Which Funds to Tap
Consider the following example.

A client needs $40,000 annually off of financial assets to cover expenses in retirement and takes $3,333/month off of their assets. During "normal times," the $3,333 is taken *proportionally* from stocks and bonds, based on target allocations. During "good times," we may look to sell more against the stock – should stocks grow to become too large a percentage of the overall portfolio. During the "bad times," we may look to take the $3,333 primarily from bonds and cash to potentially reduce the negative effects of the downturn on the stock portion of our portfolio. Many studies have shown this is the opposite of what many investors do.

Preparing for the Worst
We believe performing a stress test on retirement income planning greatly increases the chances for success. We model several "bad case" scenarios to help our clients to understand a range of potential outcomes. These stress tests may help clients determine the right time for retirement, a proper annual budget etc.

It Can Be a Long Arduous Journey
Downturns are inevitable and none of them are any fun. Living through the down portion of economic cycles can be psychologically difficult for many families.

Although past performance cannot guarantee future results, we believe that proper diversification, intelligent asset allocation and a smart withdrawal strategy are among the most important components for long-term financial success.

We don't know what's going to happen – no one does, but we believe we know what to do to put the probabilities of success in your favor.

We are happy to offer a free review of your financial situation and goals. Please let us know if this would be of interest to you.

Please see **Important Disclosures** Below.

Sincerely,

Eppolito Financial Strategies

Important Disclosures

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Past performance is not indicative of future results and there is no assurance that any investment strategy will be successful. The examples throughout this material are for illustrative purposes only. Actual investor results will vary. Investment yields will fluctuate with market conditions. Investing involves risk and you may incur a profit or loss regardless of the strategy selected. Diversification and asset allocation do not ensure a profit or protect against a loss.

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