When You Retire Could Make a Huge Difference

Tony Kendzior | 24 JAN 2020

There is a risk associated with **when** you retire that's sometimes the fault of your parents. It's something over which you had absolutely no control. Specifically, when you were born.

Let's assume you're now well into middle age, have a job that pays well but the idea of retirement is increasingly on your mind. You will need to keep busy so what other venue is there for your marketable skills. What will you do?

What follows is about the risk mentioned above. It's called the Sequence of Returns Risk. While it helps to know about it in advance, there is not a lot you can do to minimize it. More on that later.

If you accept that you have a finite life, luck has a lot to do with how your life will play out. And it's going to take at least some good luck to avoid this risk.

My presumption is that you've been finding ways to accumulate funds somewhere, with the expectation those monies will be used to help fund your retirement. You are now in what we call the "accumulation" phase of life. At some point, you'll shift into the "distribution" phase. The risk I'm talking about here will impact you regardless of which phase you find yourself. It's not a given but it does happen.

How will the markets in which you are invested perform? How fast will you extract money from those reserves to pay your retirement bills? How long do you expect to live? Yes, it's a little complicated but please, bear with me. You'll find two charts a little further down that will help you understand.

I mentioned that while you're happy doing what you do now to earn a living, an early retirement might make for a good transition to full retirement, say at age 67. That's when you should plan to start taking your Social Security retirement benefits. Your debt is under control, the kids are more or less grown and making their own way in life. So maybe just keep the status quo for two more years and then when you reach age 57, do something else.

Here's a chart that shows what I call Scenario #1. This is where you put your $500k into the S&P500 and let it grow. In this scenario, you have two selves, one born in 1943 and the other in 1953. I each case you're 57 and have left your job but have marketable skills. It's not long before you're generating an acceptable income, so you don't need to extract money from your retirement reserves. Just sit back and let your account grow.

Sequence of Returns Risk Example

Scenario #1: Allow money to grow and take no withdrawals

Initial starting amount:	$500,000				Annual % of withdrawals:		0%

Ten Years: 2000 thru 2009				Ten Years: 2010 thru 2019			
Year	Age of Client A	S&P 500 % Return	Year End Value	Year	Age of Client B	S&P 500 % Return	Year End Value
2000	57	-10.14%	$449,300	2010	57	12.78%	$563,900
2001	58	-13.04%	$390,711	2011	58	0.00%	$563,900
2002	59	-23.37%	$299,402	2012	59	13.41%	$639,519
2003	60	26.38%	$378,384	2013	60	29.60%	$828,817
2004	61	8.99%	$412,401	2014	61	11.39%	$923,219
2005	62	3.00%	$424,773	2015	62	-0.73%	$916,479
2006	63	13.62%	$482,627	2016	63	9.54%	$1,003,911
2007	64	3.53%	$499,664	2017	64	19.42%	$1,198,871
2008	65	-38.49%	$307,343	2018	65	-6.24%	$1,124,062
2009	66	23.45%	$379,415	2019	66	28.88%	$1,448,690
		Average Rate of Return	-2.72%			Average Rate of Return	11.22%

You've chosen to invest in the S&P500 as it generally represents the US stock market and the economy as a whole. It reflects the value of the largest 500 companies that comprise the US economy. Since you're healthy, and with people living longer and longer, it's no stretch to think you just might live to age 90. This gives you a long-term perspective which suggests your money has to keep growing for a long time. Why not put it into an index fund or ETF that mirrors the S&P500?

Here's where your date of birth comes into play. In Scenario #1, you have two selves, one born in 1943 and the other self born in 1953. In a couple of years, you'll turn 57. Yes, I know it's already 2020 but please, indulge me here. For both selves, at the end of ten years you are now 66. In those ten years, the market had some down years and some up years. For your 1943 self, the timing was bad and by the end of 2009, your $500k had shrunk to $379,415. Bummer.

On the other hand, for your 1953 self, that same $500k would be worth $1,448,690 ten years later at the end of 2019. The difference is over $1,000,000, all because you were born ten years later. So, let's look at Scenario #2.

Scenario #2: With a 4% annual year end withdrawal as income

Initial starting amount:	$500,000			Annual % of withdrawals:	4.00%

Ten Years: 2000 thru 2009				Ten Years: 2010 thru 2019		
Starting amount in the S&P 500				Annual % of withdrawals		

Year	Age of Client A	S&P 500 % Return	Year End Value	Year	Age of Client B	S&P 500 % Return	Year End Value
2000	57	-10.14%	$431,328	2010	57	12.78%	$541,344
2001	58	-13.04%	$360,080	2011	58	0.00%	$519,690
2002	59	-23.37%	$264,892	2012	59	13.41%	$565,805
2003	60	26.38%	$321,379	2013	60	29.60%	$703,953
2004	61	8.99%	$336,261	2014	61	11.39%	$752,767
2005	62	3.00%	$332,494	2015	62	-0.73%	$717,381
2006	63	13.62%	$362,669	2016	63	9.54%	$754,387
2007	64	3.53%	$360,452	2017	64	19.42%	$864,853
2008	65	-38.49%	$212,846	2018	65	-6.24%	$778,451
2009	66	23.45%	$252,248	2019	66	28.88%	$963,137
	Average Rate of Return		-6.61%		**Average Rate of Return**		6.78%

This also compares your two selves. In each case you are 66 at the end of ten years. The difference is that both selves chose to start taking distributions from the $500k and the subsequent values. The idea was to start extracting 4% a year, thinking at the time it would result in your never running out of money. There's a little issue with the IRS in the first couple of years but not too bad.

Yes, I know the 4% Rule has been discredited and is either dead or dying, but this is all to make a point. That same $500k shrinks to $252,248 if you're looking at your 1943 self compared to $963,137 for the 1953 self. The raw numbers reflect the distribution of 4% annually, so a shrinking income happened to the 1943 self. 4% of $500k is a lot more monthly income than 4% of $252,248 going forward.

For your 1953 self where you turned 57 in 2010, there were some negative years between 2010 and the end of 2019, but it doesn't take a rocket scientist to know that $963,137 will generate a lot more monthly income going forward than $252,248. If you have any expectation of reaching age 90, you can easily see in this example you'd have been better off being born in 1953.

There's a lot you can do to preserve your wealth and make sure you have money to spend if you do manage to live to age 90 or beyond. But there isn't a damn thing you can do now to change the year you were born.

I have some suggestions for things you can do to try and mitigate this risk, but that's beyond the scope of this blog post. You know how to reach me if you are so inclined.