Sequence of Returns Risk

# WHAT KIND OF MARKET WILL YOU RETIRE INTO?

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Prudential

## Facing sequence of returns risk

On the journey of investing there are potential headwinds you may face. One that should not be overlooked is the timing of poor investment returns. This risk is known as sequence of returns, which refers to the impact that the order and timing of investment returns has on an investor's portfolio.

Why is understanding this risk important? Because based on when returns occur, your retirement outcomes could change quite significantly, especially after factoring in withdrawals. Being prepared for downturns is a critical "point of protection" investors need to factor into their retirement strategy.

Let's look at a hypothetical example of two retirees and their experience:

- Elizabeth and Michael both retire with $100,000.
- Both took annual withdrawals of 4% based on initial investment, adjusted for 3% inflation annually.
- Both experienced the same 6.09% average internal rate of return over the period, but the order (sequence) in which they experienced those returns was exactly opposite.[1]

## Hypothetical scenario highlights[1]

**A** For Elizabeth, the market downturn occurred at the end of her retirement, and her ending balance was nearly two and a half times her initial investment.

**B** Michael experienced the downturn right at the beginning of his retirement and ran out of money after just 20 years!

**It's not just the average return that matters—it's also the sequence, or order, in which you experience those returns that can significantly impact your retirement results.**

| Year | Elizabeth's hypothetical positive return sequence | Hypothetical account value with withdrawals | Michael's hypothetical negative return sequence | Hypothetical account value with withdrawals |
|---|---|---|---|---|
| 1 | 9.90% | $105,504.00 | B -17.50% | $79,200.00 |
| 2 | 25.90% | $127,642.46 | -13.30% | $65,094.36 |
| 3 | 17.60% | $145,117.05 | -8.60% | $55,617.59 |
| 4 | 6.60% | $150,035.39 | 9.60% | $56,166.37 |
| 5 | 14.10% | $166,053.56 | -9.80% | $46,601.23 |
| 6 | -19.70% | $129,617.42 | 12.10% | $47,041.79 |
| 7 | -1.80% | $122,594.07 | 13.10% | $47,802.37 |
| 8 | 16.20% | $136,737.86 | 18.40% | $50,773.33 |
| 9 | 8.60% | $142,994.46 | 6.00% | $48,448.62 |
| 10 | 9.90% | $151,415.13 | -8.30% | $39,641.48 |
| 11 | -0.30% | $145,601.35 | 18.40% | $40,570.72 |
| 12 | 26.60% | $177,321.54 | 7.20% | $37,556.22 |
| 13 | 15.90% | $198,905.84 | -3.70% | $30,674.61 |
| 14 | 23.60% | $238,587.19 | -1.00% | $24,552.47 |
| 15 | 16.90% | $271,835.56 | 13.00% | $20,907.39 |
| 16 | 13.00% | $300,132.17 | 16.90% | $17,155.68 |
| 17 | -1.00% | $290,776.21 | 23.60% | $13,270.75 |
| 18 | -3.70% | $273,650.72 | 15.90% | $7,718.20 |
| 19 | 7.20% | $286,053.54 | 26.60% | $1,150.12 |
| 20 | 18.40% | $330,382.78 | -0.30% | **$0** |
| 21 | -8.30% | $296,336.20 | 9.90% | $0 |
| 22 | 6.00% | $306,228.72 | 8.60% | $0 |
| 23 | 18.40% | $353,500.14 | 16.20% | $0 |
| 24 | 13.10% | $390,880.15 | -1.80% | $0 |
| 25 | 12.10% | $429,061.60 | -19.70% | $0 |
| 26 | -9.80% | $379,459.21 | 14.10% | $0 |
| 27 | 9.60% | $406,432.80 | 6.60% | $0 |
| 28 | -8.60% | $363,358.55 | 17.60% | $0 |
| 29 | -13.30% | $307,097.33 | 25.90% | $0 |
| 30 | A -17.50% | **$245,578.63** | 9.90% | $0 |

Past performance is not indicative of future results.

[1] This is a hypothetical mathematical example and is used to demonstrate how sequence of returns works. The returns shown are based on hypothetical down- and up-market return scenarios and do not reflect any particular time periods, any specific annuity, any actual account value, any fees, charges, taxes, or the performance of any investment. Numbers sourced from PGIM, "Expect the unexpected: Be prepared for any sequence of returns." The average internal rate of return of 6.09% is based on an average balanced portfolio of 52%/48% Standard and Poor's 500® Index Price Returns/Bloomberg Barclays U.S. Aggregate Bond Index Total Return USD between 1993 – 2022. Assumes an initial withdrawal of 4% based on the initial investment of $100,000 (or $4,000). That $4,000 is then adjusted annually for 3% inflation.

## Limiting losses may help improve outcomes

Let's look at Michael's scenario again. He had a portfolio of $100,000 with 4% annual withdrawals based on the initial investment, which was adjusted for 3% inflation annually. Due to the sequence of his returns, he then ran out of money by year 20. What if Michael protected a percentage of his assets (protected percentage) with a strategy that could have helped limited his losses in all years and even experienced positive returns in some of those down markets?

If Michael allocated this "protected percentage" to an annuity, it could help reduce the impact of market volatility and provide a reliable stream of income in retirement. Annuities can offer different features, benefits, and levels of protection, and in exchange for downside protection, there may not be 100% participation in market growth.

In this example, let's assume Michael has chosen a level of downside protection of 15% where growth is limited to 14%. Let's see how his outcome could improve.[2]

## Michael's results with a level of downside protection[1,3]

**A** In year one, Michael experienced a 17.5% loss. However with a 15% level of protection he would have only realized a loss of 2.5%.

**B** In periods where there are losses similar to year five, the 15% level of protection would have covered it, so Michael's account would have experienced no loss.

**C** There are several years, similar to year eight, where Michael's growth would have been limited to 14% in exchange for the level of downside protection in the negative years.

**D** With the help of the 15% level of protection, Michael changed the path of his retirement. Instead of running out of money by year 20, he would have ended up with $156,447, even after taking over $190,000 in withdrawals over the 30-year period.

**You can't control what market you may retire into. Talk to your financial professional to see how an annuity can help you protect your life's work.**

| Year | Michael's hypothetical negative return sequence | Hypothetical account value with withdrawals | Michael's hypothetical negative return sequence with 15% level of protection[1] | Hypothetical account value with withdrawals |
|---|---|---|---|---|
| 1 | -17.50% | $79,200.00 | A -2.50% | $93,600.00 |
| 2 | -13.30% | $65,094.36 | 0.00% | $89,480.00 |
| 3 | -8.60% | $55,617.59 | 0.00% | $85,236.40 |
| 4 | 9.60% | $56,166.37 | 9.60% | $88,628.58 |
| 5 | -9.80% | $46,601.23 | 0.00% B | $84,126.54 |
| 6 | 12.10% | $47,041.79 | 12.10% | $89,107.67 |
| 7 | 13.10% | $47,802.37 | 13.10% | $95,378.88 |
| 8 | 18.40% | $50,773.33 | C 14.00% | $103,123.70 |
| 9 | 6.00% | $48,448.62 | 6.00% | $103,940.02 |
| 10 | -8.30% | $39,641.48 | 0.00% | $98,720.93 |
| 11 | 18.40% | $40,570.72 | 14.00% | $106,413.60 |
| 12 | 7.20% | $37,556.22 | 7.20% | $108,139.78 |
| 13 | -3.70% | $30,674.61 | 0.00% | $102,436.74 |
| 14 | -1.00% | $24,552.47 | 0.00% | $96,562.60 |
| 15 | 13.00% | $20,907.39 | 13.00% | $102,278.84 |
| 16 | 16.90% | $17,155.68 | 14.00% | $109,493.54 |
| 17 | 23.60% | $13,270.75 | 14.00% | $117,505.18 |
| 18 | 15.90% | $7,718.20 | 14.00% | $126,418.92 |
| 19 | 26.60% | $1,150.12 | 14.00% | $136,354.47 |
| 20 | -0.30% | $0 | 0.00% | $129,340.44 |
| 21 | 9.90% | $0 | 9.90% | $134,205.48 |
| 22 | 8.60% | $0 | 8.60% | $137,666.04 |
| 23 | 16.20% | $0 | 14.00% | $148,201.85 |
| 24 | -1.80% | $0 | 0.00% | $140,307.50 |
| 25 | -19.70% | $0 | -4.70% | $125,964.04 |
| 26 | 14.10% | $0 | 14.00% | $134,051.38 |
| 27 | 6.60% | $0 | 6.60% | $133,703.06 |
| 28 | 17.60% | $0 | 14.00% | $142,292.41 |
| 29 | 25.90% | $0 | 14.00% | $151,780.40 |
| 30 | 9.90% | $0 | 9.90% D | $156,447.20 |

Past performance is not indicative of future results.

[1] This is a hypothetical mathematical example and is used to demonstrate how sequence of returns works. The returns shown are based on hypothetical down- and up-market return scenarios and do not reflect any particular time periods, any specific annuity, any actual account value, any fees, charges, taxes, or the performance of any investment. Numbers sourced from PGIM, "Expect the unexpected: Be prepared for any sequence of returns." The average internal rate of return of 6.09% is based on an average balanced portfolio of 52%/48% Standard and Poor's 500® Index Price Returns/Bloomberg Barclays U.S. Aggregate Bond Index Total Return USD between 1993 – 2022.

[2] Includes an upside limit on growth of 14% based on downside protection option of 15%. The limit on upside growth based upon the average of the top five selling indexed variable annuities utilizing the S&P 500® Index, annual point-to-point crediting method, and no explicit fee charged, as of October 2024. Note: Features, charges, fees, levels of protection, and limits on upside growth vary by product and are subject to change.

[3] Levels of downside protection limit the amount of negative index credit applied to an account. The level of downside protection is the amount of the protected negative return. The level of downside protection availability varies by product.

It is important to note that, in the event of an extended, high-performing market, an indexed annuity product which limits upside growth potential may underperform products which do not offer levels of protection but have no upside limits.

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