Alpha Beta
PARTNERS

Article 5.

# “The return of sequence risk”

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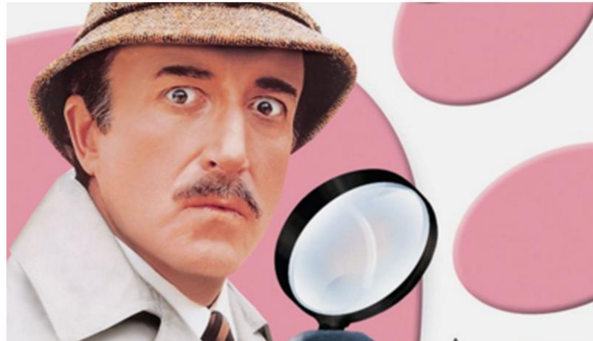
# Alpha Beta Partners

## "The return of sequence risk"



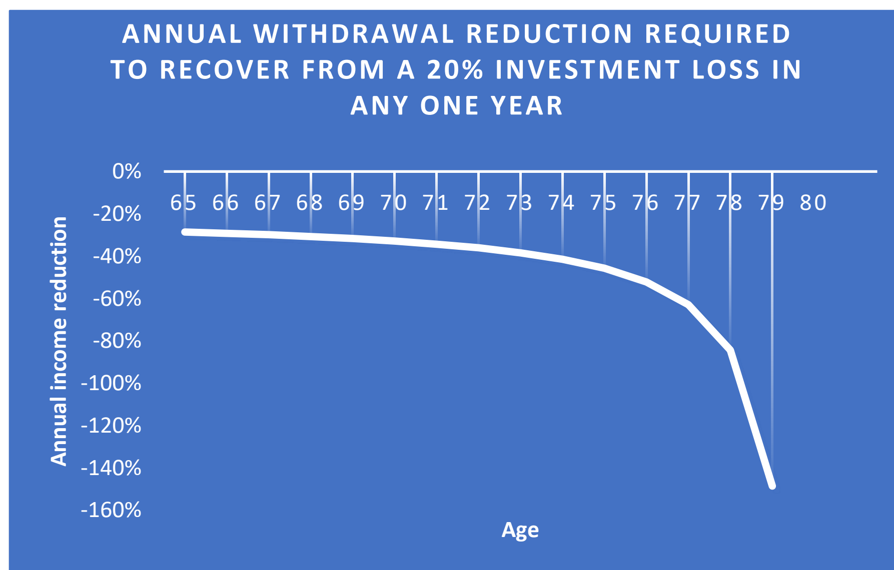
The danger of "suffering from a bad dose of sequence risk" is generally associated with the early stages of retirement when a pension pot is at its greatest value. However, sequence risk can come back and bite at the end of the decumulation journey, or indeed can make an unwelcome appearance at just about any time, rather like our friend here!

A practical solution to guard against a retiree outliving their savings is to withdraw income at a rate which leaves a pension balance in later life from which to buy a delayed annuity. There might also be a desire to leave a bequest or charitable donation.

Consider the case of a retiree with a £500,000 pension pot at age 65. The retiree invests in a portfolio with a desire to have a balance left over with which to buy a delayed annuity at age 80 of around £150,000.

For ease of explanation the investment portfolio in our example provides 0% net return each year except one year when it returns a negative 20%.

Exhibit 1 shows by how much the retiree's annual income would have to be reduced if the single 20% loss occurred in any particular year so to continue to meet the desired ending balance objective and annuity purchase.




Source: WholeMoney

The overall impact to the investor's plan is greatest if the 20% loss occurs in the first year of retirement, reducing the pension pot by £100,000, but the annual reduction of income is the least as it is spread over the remaining years in the planning horizon.

If the 20% loss occurs in the years just prior the end of the planning horizon when a capital balance of £150,000 or so remains, then annual income would have to be severely reduced.

If the loss occurs in the last year, at age 79 in this example, annual income will be wiped out completely and the desired ending balance of £150,000 will not be met.

This simplistic example shows that sequence risk is ever-present and needs to be mitigated throughout the retirement journey, and not just near the beginning as has often been the focus.

One possible solution is the AB Lifetime portfolio which was developed in partnership with leading academics at Cass Business School.

The AB Lifetime portfolio includes a systematic investment strategy which switches between equity exposure and cash depending on market trends. It is specifically designed to significantly reduce sequence risk and has shown to be successful in doing so both in back testing and since inception in May 2019.

Please contact Andrew Thompson for more information about the AB Lifetime portfolio, for copies of the professors' papers or to start a discussion about strategies suitable for decumulation.

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