RETIREMENT INCOME · MARKET RISK

Protecting Cash Flow From a Bad Market

Two retirees earn the exact same returns and end up $439,906 apart. The difference is not skill, and it is not luck you can plan around. It is order.

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➤ THE PROBLEM

The risk that only shows up after you stop working

While you are still working, a bad market is an inconvenience. Once you are living off the money, it becomes something else entirely.

Here is why. During your working years, a downturn arrives and you do nothing. You keep contributing. The paycheck covers the bills, the account recovers, and five years later the crash is a story you tell. In fact the downturn helped — every contribution you made during it bought shares cheaply.

Now reverse the flow. You are retired. Nothing is going in, and $2,500 a month is coming out. The market falls 20%, and you still have to eat, so you sell. You are selling at the bottom, and you are selling more shares than you would have needed to at the top to raise the same dollars. Those shares are gone. When the recovery comes — and it does come — it arrives for a smaller pile.

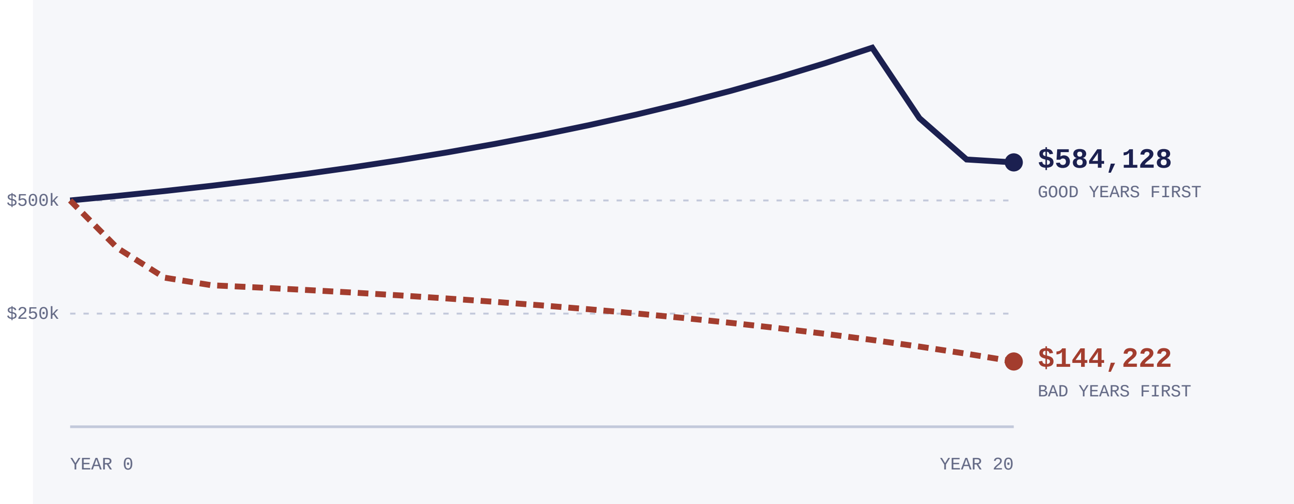
That is sequence-of-returns risk, and it is the single largest reason two people with identical savings and identical average returns can end up in completely different retirements.

> **The claim, stated plainly**
>
> In the withdrawal phase, the order of your returns matters more than the average of your returns. Most retirement projections quietly assume an average. Reality does not deliver one.

THE DEMONSTRATION

Same returns. Different order. Twenty years later.

Two retirees each start with $500,000 and withdraw $30,000 a year. They experience the identical set of twenty annual returns — the same twenty numbers, averaging 5.8% a year. The only difference is which end of the sequence the three bad years land on.



Hypothetical illustration, not a projection and not indicative of any product. Withdrawals taken at year end; no fees, taxes or inflation adjustments applied. Ending balances differ by $439,906.

Neither retiree made a mistake

Nobody panicked. Nobody sold at the wrong moment or picked bad funds. One of them simply retired in front of a downturn and the other did not. If your entire retirement income depends on which of those two you happen to be, that is not a plan — that is a coin flip with your life savings riding on it.

WHERE THE DAMAGE HAPPENS

The first three years decide almost everything

Look at what happens to the unlucky retiree before the market has done anything except go down twice.

Year	Return	Start of year	Withdrawal	End of year
1	−15%	$500,000	−$30,000	$395,000
2	−9%	$395,000	−$30,000	$329,450
3	+4%	$329,450	−$30,000	$312,628

Three years in, $187,372 is gone — and only $90,000 of that was spending. The other $97,372 was market loss, permanently removed from the base that the next seventeen years of growth would have compounded on. The lucky retiree, running the good years first, is sitting at $532,464 at the same moment.

Why the recovery never catches up

The seventeen years of 8% returns are identical for both people. But one is compounding 8% on roughly $312,000 while the other is compounding it on roughly $532,000, and both are still pulling $30,000 a year out. The gap does not close. It widens every single year, which is exactly what the chart on the previous page shows.

> **The uncomfortable part**
>
> You do not get to choose which retiree you are. You do not know today whether the next three years look like 1995 or like 2000. What you can choose is whether your grocery money is exposed to that question at all.

➤ THE FIX

Stop selling into a down market

The whole problem reduces to one sentence: you are forced to sell when you do not want to. So the solution is to not be forced.

That is what a buffer is. It is a pool of money that does not fall when the market falls, sitting beside your invested accounts, with one job: pay your bills during the years you would otherwise have to sell at a loss. When markets are up, you spend from the portfolio and leave the buffer alone. When markets are down, you flip it — you live off the buffer and let the portfolio recover untouched.

It sounds almost too simple. It works because it directly removes the mechanism that causes the damage. The unlucky retiree above did not lose because the market fell. He lost because the market fell and he had to withdraw $30,000 anyway.

What can serve as the buffer

1. **Cash and short-term reserves**
   One to three years of expenses in a savings account, money market or short CD ladder. Simple, fully liquid, and nothing can go wrong with it. The cost is that it earns very little over the long run, and inflation grinds it down while it waits.

2. **A bond ladder**
   Individual bonds maturing in the years you need them. Better yield than cash, and you can hold to maturity rather than selling. Requires more construction and maintenance, and 2022 reminded everyone that bond funds are not the same thing as bonds held to maturity.

3. **A fixed indexed annuity**
   Principal protected against market loss, with growth credited according to an index — subject to a cap or participation rate. It is the option most people are least familiar with and most often mis-sold, so the next page explains exactly how it works and exactly what it costs.

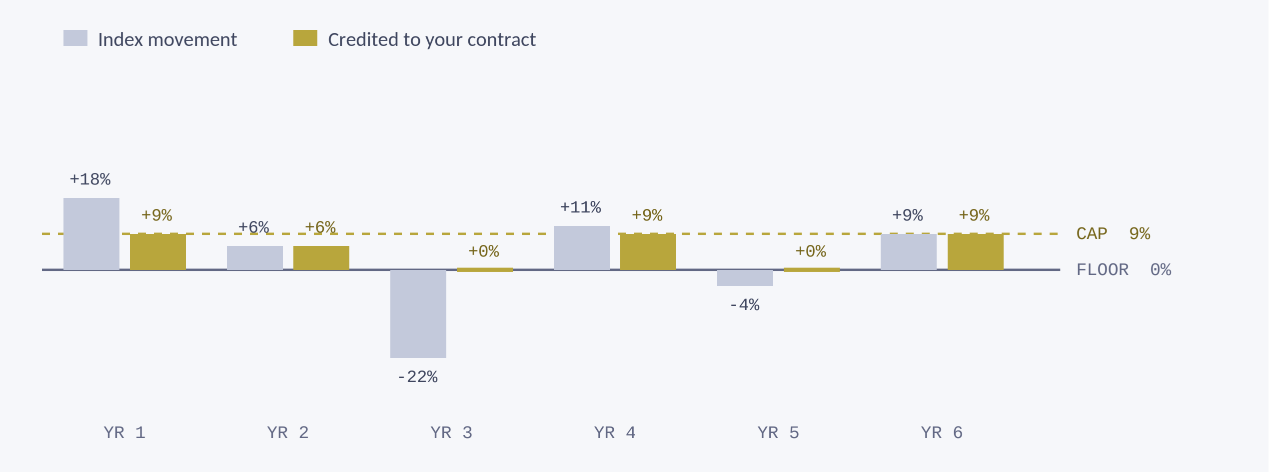
HOW IT ACTUALLY WORKS

The trade: no losses, limited gains

A fixed indexed annuity is not an investment in the market. You are not buying shares. The insurance company credits interest to your contract based on the movement of an index — the S&P 500, most commonly — subject to two limits that define the entire deal.

- A floor, usually 0%. In a year the index falls, you are credited nothing. You do not lose principal to market decline.
- A cap or participation rate. In a year the index rises sharply, you receive only up to the cap, or only a stated percentage of the move.

Here is the same six years of index movement, and what a contract with a 9% cap and a 0% floor would have credited.



Illustrative only. Caps, participation rates and spreads vary by carrier and product, are set by the insurance company, and may change after the first contract year. Index crediting typically excludes dividends. Not a projection of any specific contract.

Look at year 3. The index fell 22% and the contract was credited 0%. That is the entire value proposition, and it is also the entire cost — look at year 1, where an 18% index year was credited 9%. You gave up nine points of upside to avoid a twenty-two point loss.

Whether that trade is good depends entirely on the job

As your growth engine, this is a poor trade — over thirty years the capped upside costs you real money. As the bucket that pays your bills in the years you must not sell, it is a very good trade, because that bucket's job is to not fall, not to win.

BEFORE YOU SIGN ANYTHING

Seven questions to ask any agent

Including me. If someone will not answer all seven in writing, that tells you what you need to know.

1. **What is the surrender schedule, year by year?**
   Ask for the actual table. A seven-year schedule starting at 8% means that if you need your money in year two, it costs you real dollars to get it.

2. **How much can I withdraw each year without a charge?**
   Most contracts allow 10% annually after the first year. Confirm it, and confirm when it starts.

3. **What is the cap or participation rate today, and can it change?**
   Almost always yes, it can change after year one. Ask what the minimum guaranteed cap is — that is the worst the company is allowed to do to you.

4. **What does the income rider cost, in dollars?**
   Not in basis points. If it is 1.05% on a $200,000 contract, the answer is roughly $2,100 a year. Ask whether it is charged on the account value or the benefit base, because those are different numbers.

5. **Does the rider's growth rate apply to money I can actually withdraw?**
   Usually not. Roll-up rates apply to a benefit base used to calculate income, not to a lump sum you can walk away with. This is the single most misunderstood feature in the industry.

6. **What is the carrier's financial strength rating?**
   Your guarantee is only as good as the company behind it. Ask for the AM Best, S&P or Moody's rating, and ask why this carrier rather than a stronger one if the rating is not top-tier.

7. **What does this pay you, and does anything else pay you more?**
   A fair question, and you deserve a straight answer to it.

Wealth Path FINANCIAL

NO COST · NO OBLIGATION · 15 MINUTES

Find out whether you are exposed — before you find out the hard way.

Fifteen minutes. Bring your account balances and roughly what you plan to withdraw each month, and I will show you what a bad first three years would actually do to your plan. If the answer is that you are fine, that is what I will tell you.

- I will read any annuity you already own and explain what it really does
- You get the surrender schedule and every cost in writing before anything is signed
- No cost for the call, the review, or the written plan

Pick a time that works for you

Fifteen minutes, by phone or video. Bring one question.

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SCAN TO BOOK

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Annuity contracts contain limitations, exclusions, surrender charges, holding periods, termination provisions and terms for keeping them in force. Withdrawals may be subject to surrender charges and market value adjustments, and withdrawals of taxable amounts are subject to ordinary income tax; withdrawals before age 59 1/2 may be subject to an additional 10% federal tax. Fixed indexed annuities are not stock market investments and do not directly participate in any equity, bond or other investment. Index crediting is subject to caps, spreads and participation rates that may change, and typically excludes dividends. Optional riders are available at additional cost and may not be available in all states.

Long-term care benefits are subject to policy benefit triggers, elimination periods, benefit limits, underwriting and state availability. Product features and availability vary by state and by carrier.

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