PRUDENTIAL

The importance of sequencing returns as part of a retirement solution

When looking at taking withdrawals from pension tax wrappers, 'sequencing of returns risk' becomes an important, but sometimes difficult issue, to explain. Taking a withdrawal from a fund that is falling can have a detrimental impact on a customer and their future income needs.

Sequencing of returns – a reminder of its importance

Let's look at a hypothetical example to see why sequencing of returns risk is critical. The examples below, show three potential capital returns with no income being taken, with varying returns:

- **Example A** starts with positive returns but ends with a poor performance.
- **Example B** starts with a poor performance but ends well.
- **Example C** is a mix of positive and negative performances.

Mathematically, it doesn't matter which option you pick, they all return exactly the same total return of 1.75%. These figures do not relate to a fund or person, they are for illustrative purposes only.

Example A		Example B		Example C	
Year	**Potential capital return**	**Year**	**Potential capital return**	**Year**	**Potential capital return**
1	25%	1	–5%	1	25%
2	5%	2	–20%	2	–5%
3	20%	3	–15%	3	5%
4	–15%	4	20%	4	–20%
5	–20%	5	5%	5	20%
6	–5%	6	25%	6	–15%
Total return 1.75%		**Total return 1.75%**		**Total return 1.75%**	

Now, let's see what happens when we look at the same investments, but take an income

The amount left of the original investment after six years as a percentage of the original investment, becomes very interesting:

Example A	Example B	Example C
77.02%	64.01%	74.96%

The figures above show the amount of capital (as a percentage of the original amount) that would remain after six years, assuming a withdrawal of 5% (from the original capital amount) has been made each year. This does not take into account any product, fund or advice charges. The figures don't relate to a fund or a person and are purely an example for illustrative purposes.

This is just for UK advisers – it's not for use with clients.

When taking a loss means the gain has to be so much better!

The reasons why **Examples A** and **C** are better than **B** is fundamentally down to the sequence of returns, which is vital when taking withdrawals from an investment. If losses occur early, the fund has to work harder to make up ground.

For example, a 20% loss in year one, requires a 25% gain to make the loss back. Taking withdrawals compounds the loss even further and the bigger the loss and withdrawals, the bigger the gain required to make the loss back. In summary, the order in which the returns occur, is potentially more important than the average return over a period of time. And, all this can be even trickier to explain when you have to add in fees and charges on top of a poor first year's performance.

We now live in a world where people are living longer and therefore they need their retirement income to last longer, which raises a number of issues for advisers to consider:

- Managing client cash flow requirements.
- Managing client 'future' lump sum and income requirements.
- Choosing investment solutions that can match their clients needs.

Why consistency is important

The simple answer would be to have a fund that always provides a consistent investment performance, regardless of the market conditions. Why does consistency help:

- Consistent investment performance can help provide a client's fund with greater stability over longer periods of time offering the potential for lump sums or increased income to be considered or planned for.
- The sequencing of when any income or lump sums are taken in conjunction with how the investments perform is paramount to the longevity of the fund.
- The amount of income that is taken can help ensure sustainability based on the client's personal circumstances or needs (escalating, reducing etc.).

Finding a solution

It may be reasonable to assume that your clients will use large amounts of their accumulated wealth when they first retire and that this will vary as they move through their retirement.

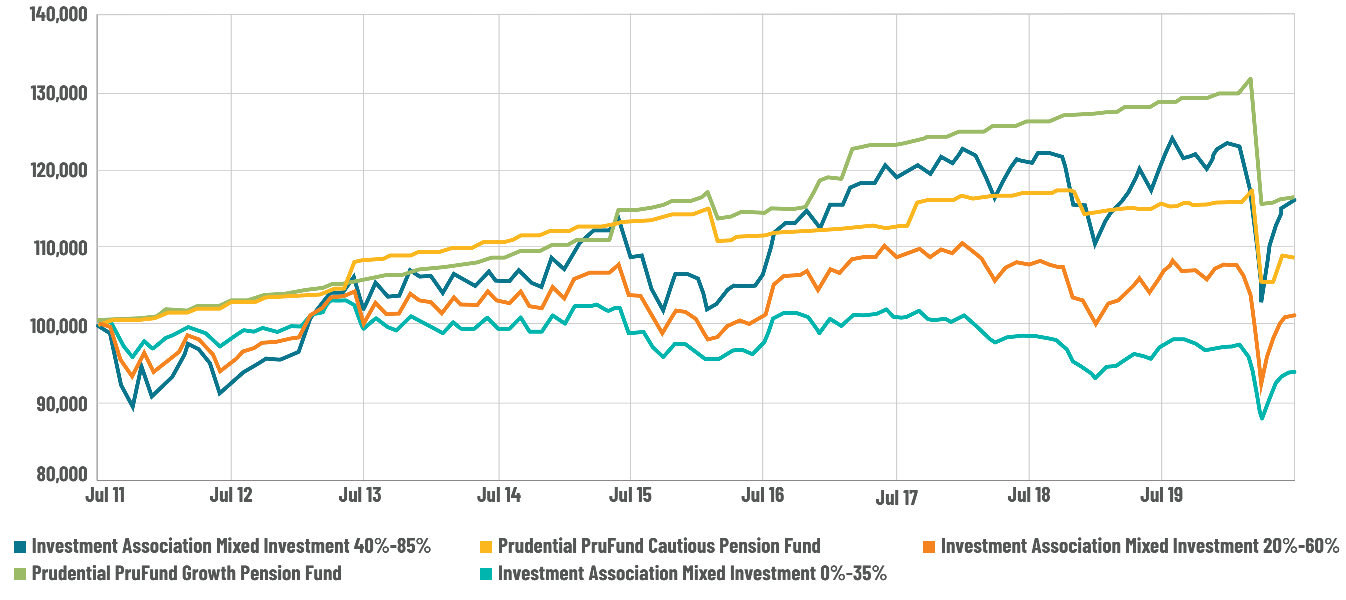
The capital and/or income and the wrappers your clients utilise will vary dependent on their needs, objectives and personal circumstances. However, retirement lifestyles are changing and we now need to keep an eye on developments and changes into the future as clients start to consider things such as long-term care.

One solution to the problem might be to invest in low risk assets such as cash. However, in a low interest rate world, where you're trying to avoid as much capital erosion as possible, the ability to provide any potential growth and withdrawals at the same time, is slim.

How have investments performed over the last few years?

Against the backdrop of the Pensions Freedom and client retirement activity, the table below looks at an investment of £100,000 taking a fixed income of £350 per month, and compares our PruFund pension funds' performance against selected Investment Association mixed asset sectors:

Pensions fund/sector	29/06/12	28/06/13	30/06/14	30/06/15	30/06/16	30/06/17	30/06/18	30/06/19
Prudential PruFund Growth Pension Fund	£103,182	£106,041	£108,615	£114,685	£114,546	£123,460	£126,291	£128,872
Prudential PruFund Cautious Pension Fund	£102,810	£108,353	£110,629	£113,143	£111,501	£112,694	£117,131	£115,548
Investment Association Mixed Investment 0%-35%	£97,448	£102,838	£99,771	£98,953	£97,924	£100,979	£98,469	£97,272
Investment Association Mixed Investment 20%-60%	£95,364	£100,630	£103,070	£103,694	£101,310	£108,982	£107,757	£106,651
Investment Association Mixed Investment 40%-85%	£92,599	£102,069	£105,741	£108,676	£106,398	£119,176	£121,022	£120,998



Source of performance data: Financial Express (FE) and the time period of the graph is 30/06/2012 to 30/06/2020.

These figures are based on a client investing £100,000 on 30/06/2011 taking a fixed income of £350 per month at the end of the month. The figures are intended only to demonstrate performance history of the fund over the period shown and include a representative fund charge of 0.65% p.a. and any further costs. They take no account of product or advice charges. The application of charges will impact the overall performance. Please also note that our charges may vary in the future and may be higher than they are now. Fund performance is based upon the movement of the daily price and is shown as total return in the fund's currency of denomination with gross income reinvested. Some, if not all, of the funds comprising the IA sector averages are net of fund charges. Performance is shown on a bid to bid price basis.

Our PruFund range of funds – a potential investment solution for your clients

Alternatively, you may prefer to look to multi-asset funds to try and generate a return to help meet client objectives? This is where Prudential may have the answer to some of your client growth and income requirements through our PruFund funds.

PruFund funds aim to grow your client's money while giving a smoothed investment experience. The PruFund range of funds all invest in Prudential's With-Profits Fund, which is the largest with-profits funds in the UK. However, there are differences across the range of PruFund funds in their objectives and mix of assets, and how PruFund delivers returns to investors when compared to other With-Profits business, which means the returns received by investors will vary by fund choice. Please refer to "Your With-Profits Plan – a guide to how we manage the fund (PruFund range of funds)" for more information. As a with-profits investment, PruFund funds are designed to spread risk by investing in a range of different asset types. The PruFund funds have an established smoothing process which aims to provide your clients with some protection from the extreme short terms ups and downs of the markets.

The value of any investment can go down as well as up so your customer might not get back the amount they put in.

Support available

We've a range of tools and calculators – Retirement Modeller, Defined Benefit Pension Input amount tool, Capped Drawdown GAD calculator and many more.

A range of webinars to help you with your retirement plans for your clients.

Visit pruadviser.co.uk or talk to your Account Manager for more information.

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