



## SEQUENCE-OF-RETURNS RISK: WHAT TO KNOW

By: Sean Canonica - May 3, 2025

**Picture this:** after years of hard work and diligent saving, you're finally ready to retire. But just as you begin withdrawing income from your portfolio, the market takes a sudden downturn. This unfortunate timing, known as sequence-of-returns risk, can have a significant impact on your financial future.

In this article, we'll break down how sequence-of-returns risk works and why it's a critical consideration for retirees. You'll learn when to begin planning for it and how the bucket strategy can help prevent it. We'll also share perspectives from financial advisors on how to balance stability and growth within your portfolio as you near retirement.

### How Sequence-of-Returns-Risk Works

Once you retire, it's time to start drawing income from your accounts, such as a 401(k) or Roth IRA. These accounts are typically invested in a mix of assets like stocks, bonds, and mutual funds, rather than held entirely in cash. Sequence-of-returns risk occurs when you begin making withdrawals during a market downturn, forcing you to sell investments at a loss and potentially shrinking your savings faster than you expected.

"Sequence-of-returns risk is one of the largest, yet unmanaged risks I come across with the individuals," says John Jones, investment advisor representative at Heritage Financial. He notes that during the accumulation stage of your life, "you can make adjustments even after poor performance and unforeseen circumstances and still come out fine." However, once you retire, you're prone to "running out of money because of sequence-of-returns risks" due to locking in losses when you sell, he adds.

To imagine the impact, consider two different retirees, A and B, who each retire with \$2 million and plan to draw down \$80,000 annually. Although they experience the same average annual return over a 30-year retirement period, the sequence of those returns differs: Retiree A enjoys strong early gains, while Retiree B faces a downturn in the first few years. Because Retiree B must sell investments at lower prices to fund withdrawals, their portfolio depletes more quickly overall, jeopardizing the longevity of their savings.

### When to Start Planning for It

Because sequence-of-returns risk is a serious threat to your retirement savings, it's important to begin planning for it as soon as possible. This way, if the market does take a turn for the worse, you'll be in a position to weather it and avoid locking in losses.

When you're younger and have a longer time horizon until retirement, it makes sense for your portfolio to comprise long-term, growth assets, such as equities.

However, as you near your post-working days, this becomes risky. For this reason, it typically makes sense to shift your investments to account for market volatility.

How soon should you plan ahead before you retire? "Sequence-of-returns risk should be addressed at least five years before retirement, but realistically it is best addressed 10 years before retirement," says Keith Heritage, financial advisor and managing partner at Heritage Financial.

By planning sooner, you give yourself ample time to address market volatility risks before they happen. If you wait until you retire, you may not have time to react if the value of assets begins to fluctuate. This, unfortunately, would leave you in a precarious situation if you need to sell assets to fund your lifestyle.

### Using a Bucket Strategy to Protect Your Retirement Income

Protecting yourself against sequence-of-returns risk requires thoughtful portfolio management. One of the most common ways to guard against market downturns is by using the bucket strategy. This method divides your retirement savings into three time-based categories:

- Short-term bucket that holds cash and near-liquid investments, such as a money market fund.
- Medium bucket that prioritizes modest growth via securities like bonds or certificates of deposit (CDs).
- Long-term bucket that allows you to invest in growth equities and other more speculative assets.

This strategy helps reduce the risk of selling investments at a loss during downturns by ensuring you have cash or stable assets to draw from in the short term. "Using [the bucket strategy], you have increased the likelihood of your assets surviving longer than having an entire portfolio invested at one tolerance and taking recurring distributions regardless of market conditions," explains Jones.

### Mistakes to Avoid

Being aware of sequence-of-returns risk is important; however, avoiding it in practice requires more than recognizing it. These missteps, which range from market overreactions to poor portfolio management, can increase your exposure. Recognizing these in advance can help you stay on track and avoid undue risk.

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vices, notes that he sees a common mistake when clients are "wanting to take money out of their accounts without assessing the recent performance of funds." When he works with individuals, he explains to them that "they should be mindful of efficiently withdrawing money. This means looking at what the different holdings and accounts have done." If an asset experiences a drop in value, it's often best to avoid selling it until it rebounds, he mentions.

Another issue, echoed by both Tallou and Jones, is poor diversification across buckets. "For example, the people with all of their assets in the 'now' bucket are risk-averse and have all of their savings sitting in basically a money market, which runs the risk of outliving their money and inflation, reducing their purchasing power," Jones explains. On the flip side, having too much allocated to long-term growth assets can leave you overexposed to market volatility, especially early in retirement.

### How a Financial Advisor Can Help

Planning for sequence-of-returns risk requires careful portfolio oversight and attention to market behavior. This complexity, however, makes a financial advisor an invaluable resource. A professional can help you be more prepared for a market downturn and tailor your portfolio to your overall financial plan.

Specifically, a financial advisor can help you determine what your income needs will be when you retire. Then, they will use that to inform how much to keep in each portfolio bucket. When a market downturn does occur, you'll ideally have clarity regarding how to draw down assets while mitigating risk.

Beyond the numbers, a high-quality financial advisor should be able to keep you grounded and calm as you enter retirement. If a market drop were to occur, they can offer guidance and perspective to keep you from making irrational decisions, like unnecessarily selling assets at a loss.

If you need help finding a financial advisor, we recommend this free matching tool. After filling out a few questions about your current situation and goals, it'll connect you with a professional who suits your needs. From there, you can schedule an initial consultation and determine whether they fit.