FOR PROFESSIONAL ADVISERS ONLY

Sequencing Risk

Helping your clients secure a long-term income from their investments

Realising Ambitions.
Securing Futures.
We are Brooks Macdonald.

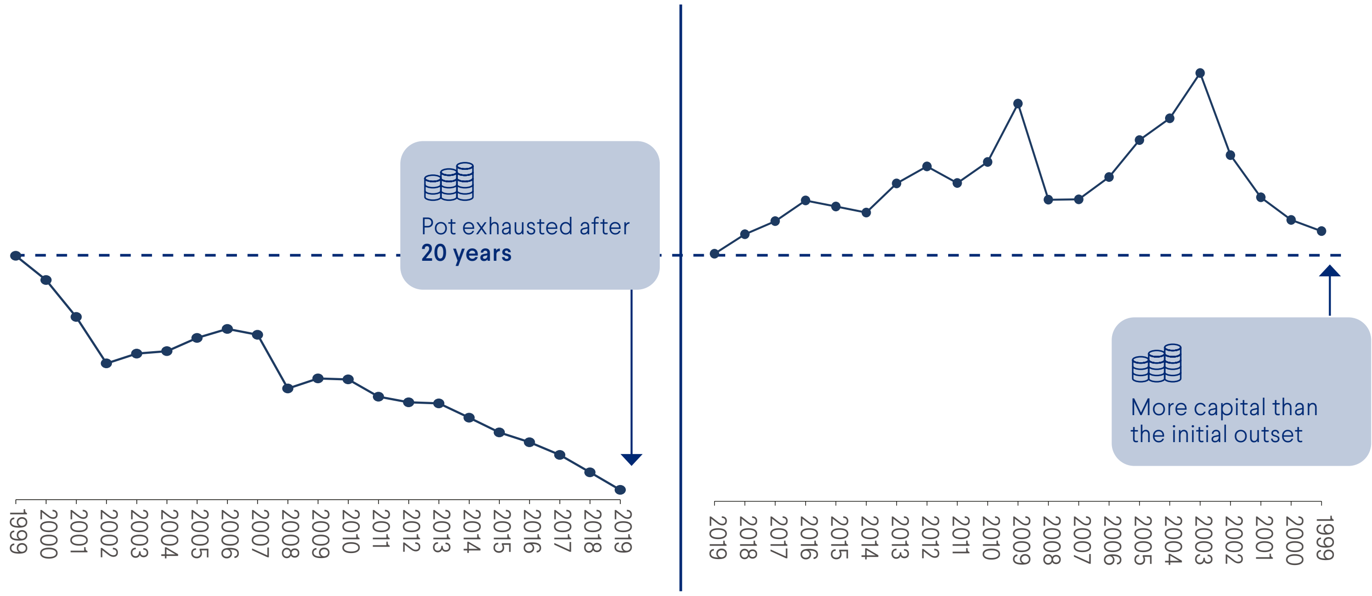
Sequencing risk is one of the most important considerations for investors who are either planning their retirement or currently withdrawing income from their portfolio. It refers to the danger of experiencing poor investment returns early in retirement, which can significantly impact the long-term sustainability of a retiree's savings.

Over the course of time clients have been educated to look beyond shorter-term returns and instead encouraged to assess the longer-term average annual returns of an investment. However, this can be misleading when planning for the withdrawal phase because it doesn't account for the "sequence" of returns.

To help explain this the two graphs below illustrate two very different outcomes for a portfolio where the same amount of income is being withdrawn and the average annual returns over the whole period are the same. The one on the left shows a client who starts their retirement journey at the beginning of the year 2000 and was invested into a balanced portfolio, drawing an income equal to 5% of the initial investment, with this increasing to account for inflation each year. As you can see the fund runs out before the end of 2023.

If, however, we alter the sequence of the returns by reversing the order in which they are received, whilst the average return over the whole period would be the same, the portfolio has been able to retain some capital value.

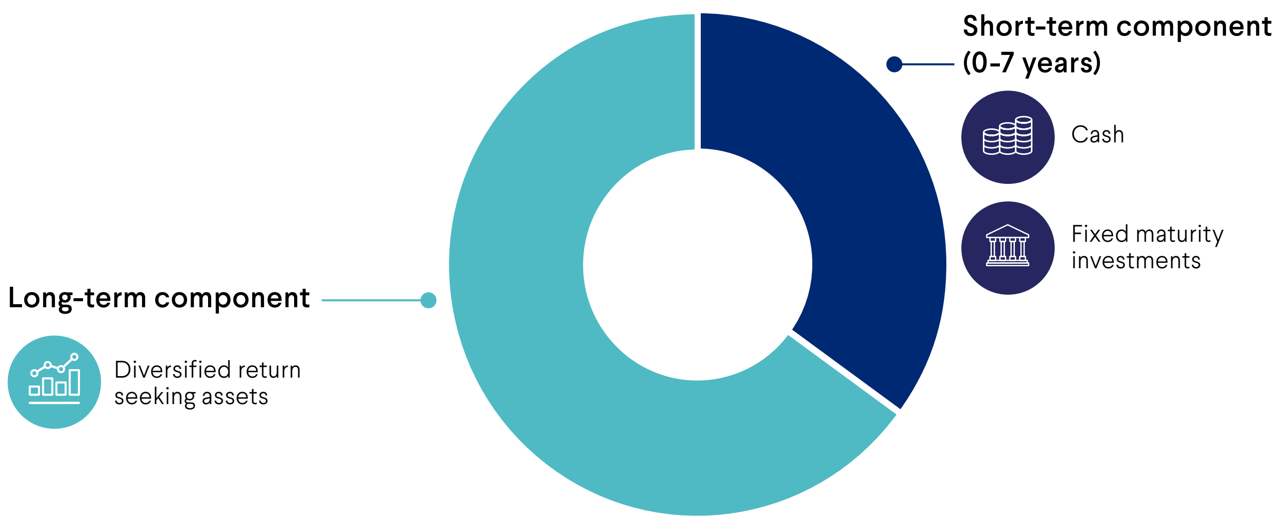
Sequencing Risk



Past performance is not a reliable indicator of future results.
Source: Barclays Equity Gilt Study 2023, data to December 2019.

Brooks Macdonald's Retirement Strategies have been explicitly designed to help mitigate sequencing risk by dividing the portfolio's assets. This is commonly known as "bucketing" and involves dividing the investments into separate components based on time horizons.

A different approach to mitigating the risks and managing your client's portfolio

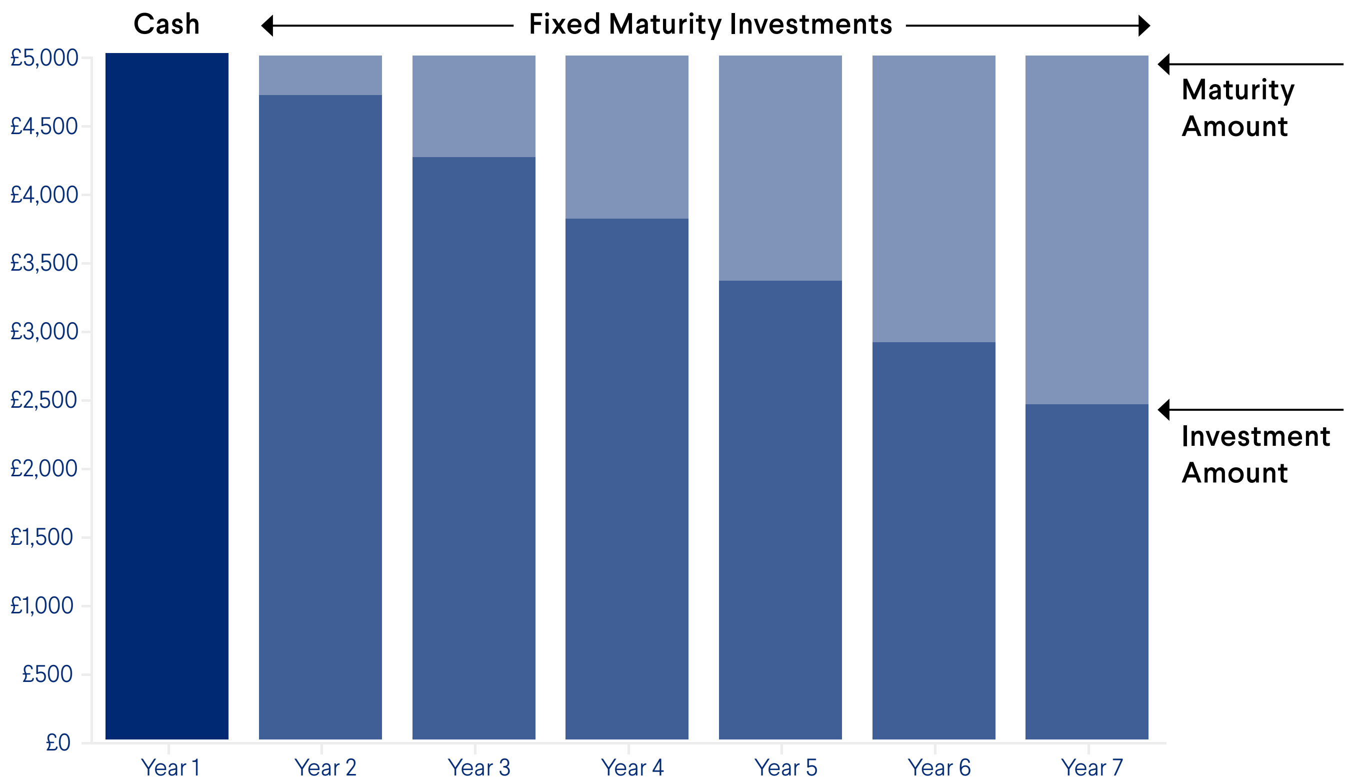


For Brooks Macdonald's Retirement Strategies, the shorter-term component uses cash and Fixed Maturity Investments to meet the first 7 years of the client's income requirements, with the remaining funds being invested for longer-term growth to support future income needs. A Fixed Maturity Investment is one with a defined maturity date on which the investment ceases to exist and a capital amount is returned to the investor. The aim of this approach is to avoid selling assets at a loss by achieving an appropriate balance between longer-term growth and shorter-term assurance and thereby this approach can assist in providing clients peace of mind which helps prevent panic-driven selling during market declines.

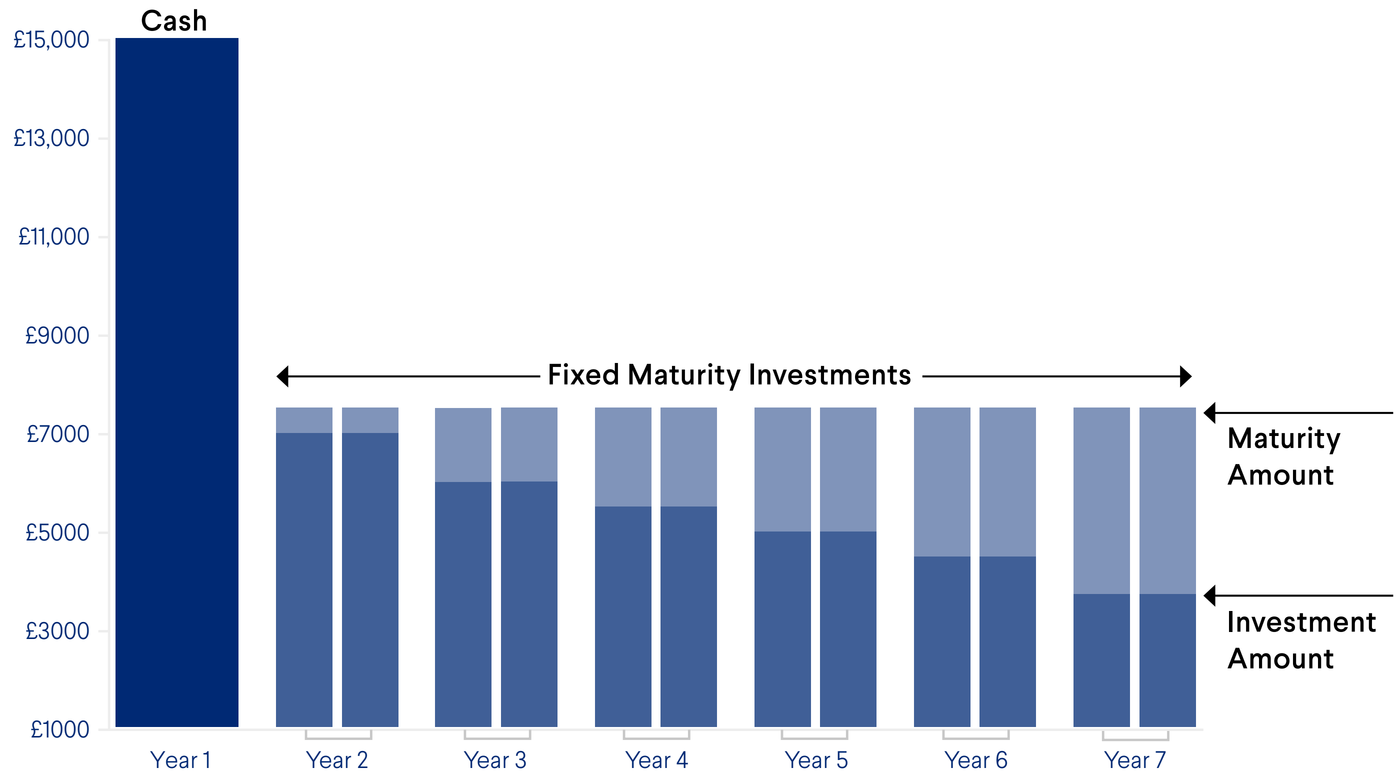
Sequencing risk is highly sensitive to the level of income being withdrawn, especially in the early years of retirement. The more a retiree withdraws from their portfolio, the greater the impact of market downturns on the longer-term financial stability of the plan. Therefore, Brooks Macdonald's Retirement Strategies are constructed to cater for varying withdrawal rates by using cash and a series of Fixed Maturity Investments where the amount invested, and maturity dates are aligned to meet a client's income needs as and when they become due.

For example, the below illustration demonstrates the design of the Brooks Macdonald **Modelled Strategy** at inception for an investor needing to draw an income of up to 4% for an initial investment of £100,000. The first year is held within cash and is followed by a series of Invesco BulletShares USD Corporate Bond ETFs as the Fixed Maturity Investments. It aims to provide maturity amounts of £5,500 for each of the subsequent 6 years' anniversaries which accommodate a further 1.5% for Investment, Adviser and Platform fees.

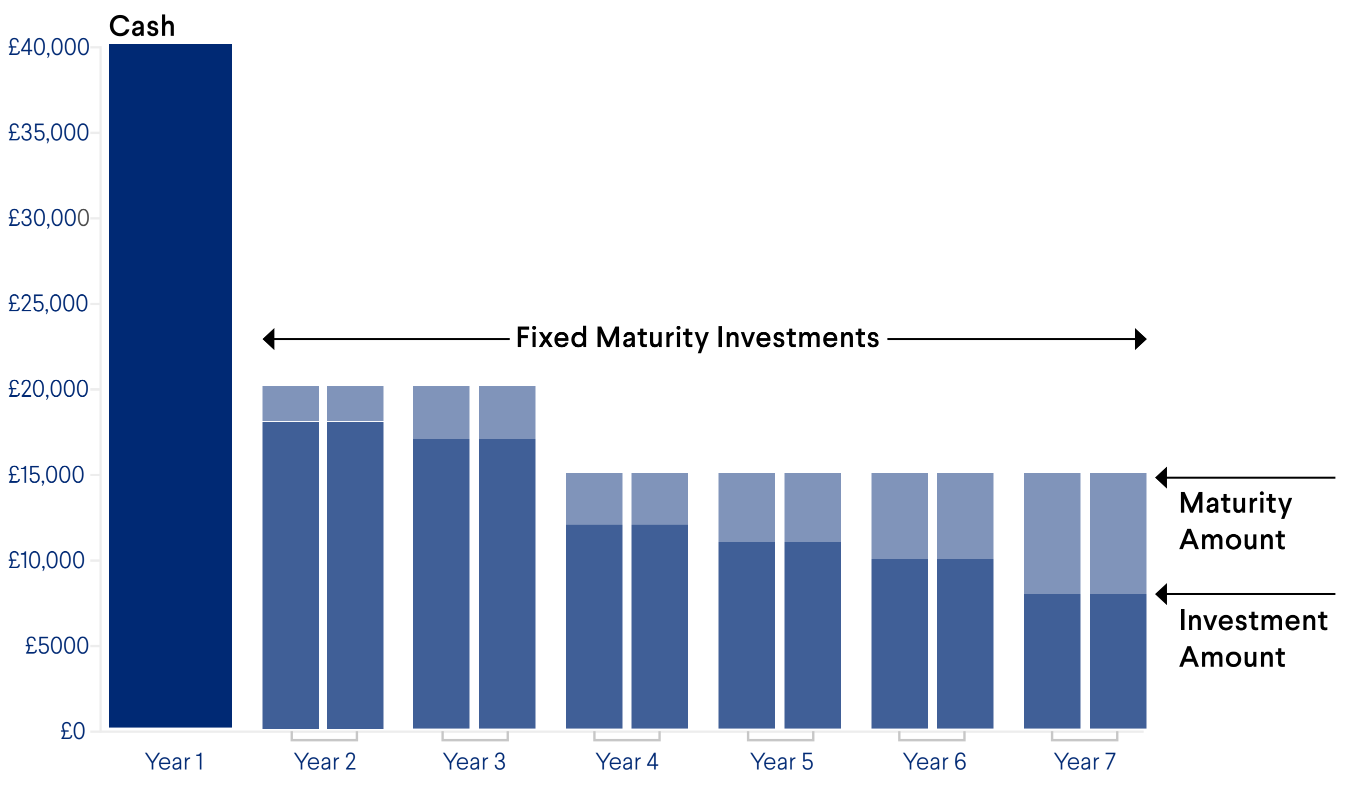
These allocations initially align with the annual withdrawal capacity specified in the portfolio objective. This withdrawal capacity can be used flexibly, for example to meet client needs, fees or any other agreed disbursements The portfolio is designed to deliver a total amount; the client/adviser is free to divide this up as appropriate to their needs.



The Brooks Macdonald **Tailored Strategy** is similar in design in that the first year is again held in cash however instead of Fixed Maturity Investments that mature annually it is constructed using a series of Defined Return Structured Products that mature every six months. The below illustration demonstrates an example for withdrawals totalling £15,000 per annum where again allowance has been made to accommodate fees.



The Brooks Macdonald **Bespoke Strategy** again uses cash and a series of structured products or government bonds that mature every six months, with the difference for this strategy being that we can vary the maturity level of each individual product to match more complex or targeted income requirements. The below example shows a client requiring gross withdrawals of £40,000 for the first three years which then reduce by £10,000 to align with the date for when they become entitled to their state pension.



Brooks Macdonald's Retirement Strategies are carefully structured to mitigate sequencing risk and help provide clients with financial stability in retirement. By strategically allocating funds into distinct time-horizon components, these strategies balance immediate income needs with long-term growth potential. This approach aims to preserve capital, reduce the impact of market fluctuations, and assist in providing confidence to clients for their financial future.

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Important information

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