'Changing the order of factors does not change the product.'

3x4x5 produces the same answer as 5x4x3.

Remember this from math class?

Or are you suddenly reading with shallow breath and looking frantically for a nice article to read?

When investing a lump sum and leaving the money alone the order of returns is indeed irrelevant.

But once you start drawing money each year you suddenly are impacted by the order of good and bad returns.

This is arguably one of the biggest challenges for investors.

When you're within about 5 years of drawing from your investments you enter what many call the retirement red zone. A sudden drop near term may cause you to sell investments low to satisfy a planned draw from your investments.

Assume Luke and Uma start with $1 million each and both draw $50,000 per year with the following sequence of returns:

	Scenario 1: Luke	Scenario 2: Uma
Year	Rate of return	
At retirement	N/A	N/A
Year 1	16.7%	-25.6%
Year 2	31.1%	-1.5%
Year 3	9.4%	9.4%
Year 4	-1.5%	31.1%
Year 5	-25.6%	16.7%
Five-year average return	6.0%	6.0%

This information is hypothetical and is provided for informational purposes only. It is not intended to represent any specific investment, nor is it indicative of future results.

They have the same return figures, just in opposite order.

Which means same average return.

But at the end of the five years Lucky Luke has $1,010,110 while Unlucky Uma has $875,625.

Unfortunately for Uma, starting out with a bad year <u>and then selling to draw another $50K</u> meant she had to sell low, and the investments she sold could not participate in the good years later on.

Being forced to sell stocks low can happen if your portfolio is in an all-in-one fund like a target date fund. Whenever you sell a target date fund you sell a little of everything in the fund, typically a chunk of stocks, a chunk of bonds, and a chunk of cash.

Naturally, this vulnerability to selling stocks low also applies if you own only stocks.

So, do you know which way the market will go next? Will you have Luke's or Uma's experience?

For sure, you don't know.

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One approach to this challenge is to keep enough stable investments in your portfolio to carry you through 3 – 5 years of planned withdrawals. This way, if the stock market tanks you can draw from the stable investments and give your stocks time to recover.

If Uma retired in late 2007 she would have seen stock prices drop by over 50% within 18 months as measured by the S&P 500.

If she had a 5-year buffer of stable investments, according to JP Morgan, she'd see her stock portfolio (S&P 500) recover by the spring of 2012. Just before her buffer was drawn down.

For perspective, this was the largest stock market drop over the last 90 years.

So, I think it's advisable to arrange your portfolio to reduce the chance of a nasty stock market forcing a change in lifestyle.

If you're not comfortable doing this on your own you may want to consider working with a financial advisor.

Next week, we'll look at your estate documents. Do your written instructions reflect your current intentions? Until then,

Good luck.

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