THE Normandy Group

# *The Firm Update by Derek Landis*

Happy New Year! We welcome 2021 and every new opportunity that can keep us healthy and prosperous throughout this new year. 2020 was certainly filled with its fair share of hurdles and uncertainties. Regardless, we enter 2021 with vigor, with energy, eager to move forward in the face of each challenge.

People globally have experienced significant life changes while enduring this ongoing pandemic. In 2020, some may have spent their first year of retirement at home hunkered down rather than pursuing their dreams. Children have had little choice but to learn remotely for the first time in their lives. New businesses failed, employers and employees alike lost their livelihoods simply because they were shuttered by powerful forces beyond their control. Sometimes in life the timing of events is not ideal, and the sequence of these events, which are completely random, can make or break a personal and, or financial goal.

"Good timing is invisible, bad timing sticks out a mile" Tony Corinda - Magician 1930-2010

For a magician we can see why this might be true, if a trick is poorly timed the audience may see the sleight of hand at work revealing the magician's "secret". If the timing of each trick is consistently subpar it becomes foreseeable that the magician may lose their livelihood. Similarly, timing can play a pivotal role when saving for any financial goal. For instance, we know that the "sequence of returns" can be as important as the amount of money that one invests toward retirement each year. In every account the timing of contributions and withdrawals can also affect the probability for success in achieving the lifestyle to which an investor aspires.

Monte Carlo Simulations, a technique for modeling potential outcomes, focuses on the probabilities for success by varying certain assumptions. Changing the assumptions can provide an array of simulations for a particular portfolio model. Some that will succeed in the investors favor and those that will not. The number of different outcomes from shuffling the sequence of positive and negative returns over time in a portfolio model, could be infinite. It would be difficult to see an end to it.

"I am incapable of conceiving infinity, and yet I do not accept finity". – Simone De Beauvoir

Further, if an investor takes distributions during a financial market downturn, it is likely they will need to sell security positions into weakness, which can amplify the negative effect of a "bear" market. Further, if one incurs a large expense during a market correction, absent having ample cash equivalents in reserve, they may have to sell securities at a lower price. Potentially locking in a loss of value and realizing they may have to sell more shares than otherwise might have been needed. Conversely, skimming profits to meet the same distribution need in a "bull" market could be a better scenario. In mid to late 2020, as unbelievable as it may have seemed, such a "bull" appeared in the U.S. financial markets with symptomatic responses in financially developed and undeveloped countries around the world. Today, the current attitude in Washington D.C. is for 1.9 Trillion in additional fiscal and monetary stimulus, which can mean the U.S. financial markets are likely to continue their momentum to the upside for the foreseeable future. Of course, there is no guarantee of this.

"Although we work through financial markets, our goal is to help Main Street, not Wall Street". - Janet Yellen

What follows is an illustration of the long-term effect that a negative sequence of returns could have on a portfolio compared to an identical portfolio receiving an opposite scenario with a positive sequence of returns. Each of two investors have an opening account balance of $100,000, with an average rate of return of 4% over 15 years while taking a $5,000 distribution each year, respectively. The return column has been flipped for this example with "Investor Blue" who retired at the beginning of an upmarket, and "Investor Green" who began distributions at the beginning of a bear market.

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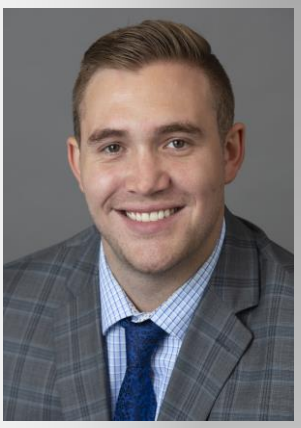

*Derek Landis*

*Investment Advisor Representative*

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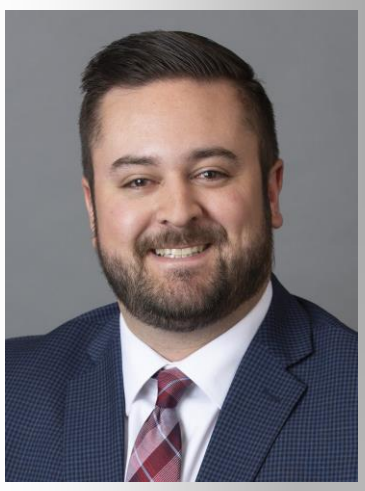

*Charles Partheymuller, CFP®*

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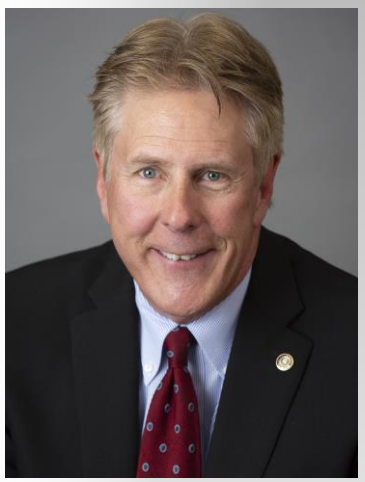

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## The Firm Update continued~

This is a hypothetical analysis for illustrative purposes only and taxes are not considered in this illustration.

**Retiring at the Beginning of an up market**

| Year | Investment Value | Withdrawals | Return |
|---|---|---|---|
| 0 | $100,000 | N/A | N/A |
| 1 | $103,000 | $5,000.00 | 8.00% |
| 2 | $109,330 | $5,000.00 | 11.00% |
| 3 | $124,009 | $5,000.00 | 18.00% |
| 4 | $136,371 | $5,000.00 | 14.00% |
| 5 | $147,735 | $5,000.00 | 12.00% |
| 6 | $156,031 | $5,000.00 | 9.00% |
| 7 | $168,195 | $5,000.00 | 11.00% |
| 8 | $178,332 | $5,000.00 | 9.00% |
| 9 | $185,816 | $5,000.00 | 7.00% |
| 10 | $190,106 | $5,000.00 | 5.00% |
| 11 | $177,502 | $5,000.00 | -4.00% |
| 12 | $158,302 | $5,000.00 | -8.00% |
| 13 | $129,557 | $5,000.00 | -15.00% |
| 14 | $116,783 | $5,000.00 | -6.00% |
| 15 | **$105,944** | $5,000.00 | -5.00% |

Average Return: 4.0%

**Retiring at the Beginning of a down market**

| Year | Investment Value | Withdrawals | Return |
|---|---|---|---|
| 0 | $100,000 | N/A | N/A |
| 1 | $90,000 | $5,000.00 | -5.00% |
| 2 | $79,600 | $5,000.00 | -6.00% |
| 3 | $62,660 | $5,000.00 | -15.00% |
| 4 | $52,647 | $5,000.00 | -8.00% |
| 5 | $45,541 | $5,000.00 | -4.00% |
| 6 | $42,818 | $5,000.00 | 5.00% |
| 7 | $40,816 | $5,000.00 | 7.00% |
| 8 | $39,489 | $5,000.00 | 9.00% |
| 9 | $38,833 | $5,000.00 | 11.00% |
| 10 | $37,328 | $5,000.00 | 9.00% |
| 11 | $36,807 | $5,000.00 | 12.00% |
| 12 | $36,960 | $5,000.00 | 14.00% |
| 13 | $38,613 | $5,000.00 | 18.00% |
| 14 | $37,860 | $5,000.00 | 11.00% |
| 15 | **$35,889** | $5,000.00 | 8.00% |

Average Return: 4.0%

Despite having the same average annual return, **Investor Blue** has $70,055 more than **Investor Green** due to their sequence of returns.

Source: retireone.com

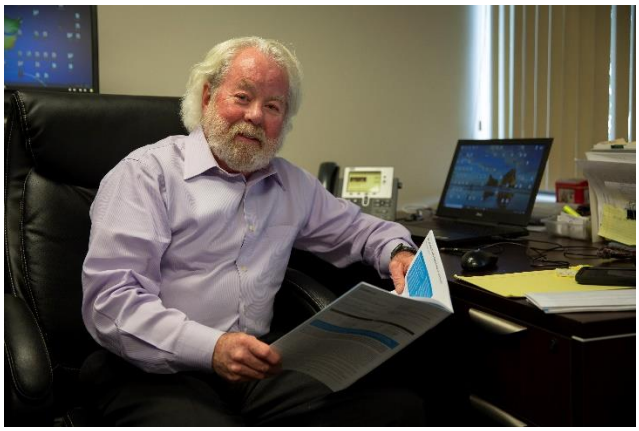
As you can see in year 15 there is a large difference in remainder account balances due to the sequence of returns. Obviously, Investor Blue has more dollars working during positive years while Investor Green was taking distributions during market distress, amplifying losses, and having to sell underlying shares at a discount. By sheer luck, Investor Blue's timing was better than Investor Green's. Investor Green's remainder balance, after distributions of $45,000 over 15 years, was significantly less than the amount originally invested. Not only did Investor Blue maintain the initial investment but the account gained an additional $5,944. Investor Blue also received the same amount in distributions for 15 years as Investor Green, $45,000. There is a $70,055 advantage held by Investor Blue in their cash balance at the end of the period.

There are worst case scenarios which track similarly to the example above, especially if one were dealing with a large unavoidable expense during a bear market such as 2000 through 2002. Many today will remember those years for the dotcom bust and the days following 911. Unsettling days for sure.

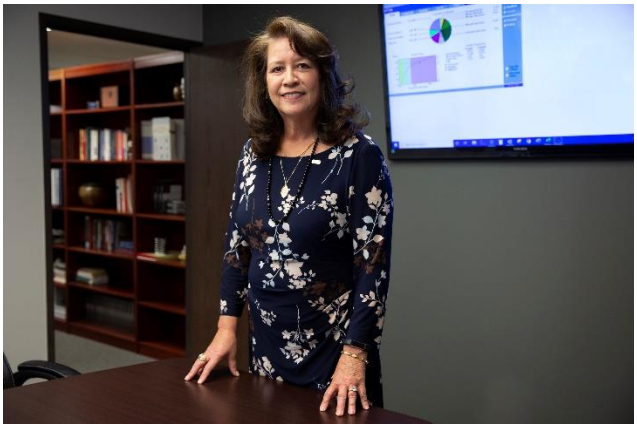
Although we cannot predict or control the movement of markets or the timing of events, we can attempt to mitigate and prepare for sequence risk. Clearly identifying time horizons is important, and portfolio diversification where asset classes do not always correlate to 1 can help lower this type of risk. Some things you can control some things you cannot. Reach out to us with questions and we will be happy to assist.

We wish you and your families a happy and healthy 2021, thank you for your continued trust and confidence.

Best regards,
Derek Landis, Investment Advisor Representative



Jack Anderson, CEP



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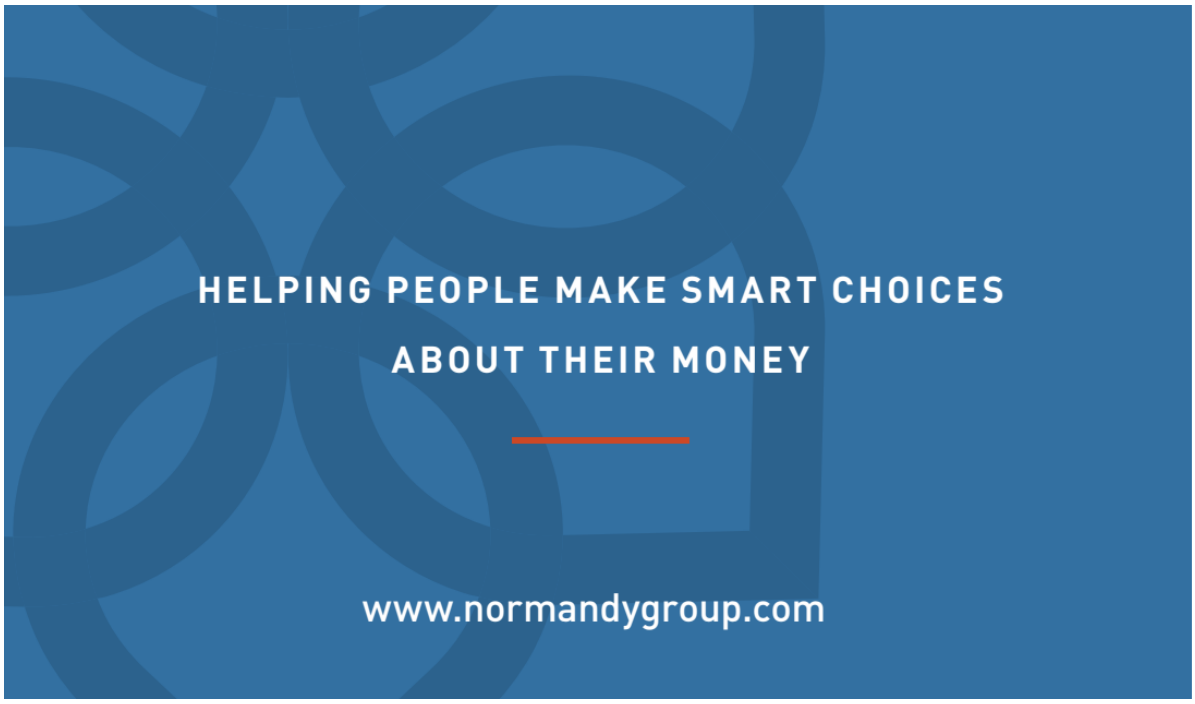

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