Chapter 21

WHY LOSING MONEY IN EARLY RETIREMENT STAGE IS DISASTROUS

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CONSEQUENCES OF LOSING MONEY IN EARLY RETIREMENT STAGE

The contradiction of Warren Buffett words at face value #1

Scenario A

1st Year Retirement	Portfolio Return	=	-30%
2nd Year Retirement	Portfolio Return	=	-20%
3rd Year Retirement	Portfolio Return	=	+10%
4th Year Retirement	Portfolio Return	=	+20%
5th Year Retirement	Portfolio Return	=	+20%

How your 1 million Retirement Portfolio perform, Annual Needs = 100k

1st Year Retirement	700k (loss 30%)	=	600k
2nd Year Retirement	480k (loss 20%)	=	380k
3rd Year Retirement	418k (gain 10%)	=	318k
4th Year Retirement	382k (gain 20%)	=	282k
5th Year Retirement	338k (gain 20%)	=	238k

It's very important not to lose money in your portfolio. Look at the scenario "A" here. So the thing is you would be very surprised to see that if in a scenario "A" whereby if you have a retirement portfolio of one million, so you're starting with 1 million, and when you do retire on the very first year the market drops about minus 30 percent and your portfolio was down by minus 30 percent. In the second year, a portfolio assumes it was now about 20 percent. Imagine these first two years after you retire is the recession time and by the third year your portfolio would be up again 10 percent, fourth-year up again 20 percent, and the fifth year will be up again 20 percent. So as you can see in the five years average out of the return is pretty much the same. You have minus 50 percent in the first two years plus accumulatively 50 percent in the third to fifth year. So if you have a 1 million retirement portfolio just for the simple computation's sake and you say there my annual needs to retire are 100 thousand whatever currency that you want to be. In the first year of retirement imagine if your portfolio was hit by a Down negative 30 percent your portfolio would have lost 300k and will be left about 700k and it will end up to about 600k. So the next year it is 600k there will be another 20 percent loss will come about 480k but still again from these retirement nest egg you need to withdraw 100k to sustain your day to day expenses. So by the end of the second year, it will be down at 380k. At the end of the fifth year, your portfolio will have the remaining balance of about 238k.

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Scenario B

1st Year Retirement	Portfolio Return	=	+20%
2nd Year Retirement	Portfolio Return	=	+20%
3rd Year Retirement	Portfolio Return	=	+10%
4th Year Retirement	Portfolio Return	=	-20%
5th Year Retirement	Portfolio Return	=	-30%

How your 1 million Retirement Portfolio perform, Annual Needs = 100k

1st Year Retirement	1.2 mil (gain 20%)	=	1.1 mil
2nd Year Retirement	1.32 mil (gain 20%)	=	1.22 mil
3rd Year Retirement	1.34 mil (gain 10%)	=	1.24 mil
4th Year Retirement	992k (loss 20%)	=	892k
5th Year Retirement	624k (loss 30%)	=	524k

Now compare this to scenario “B” whereby it just reverses the sequence of return. Imagine in the first year of retirement you gain 20 percent, in the second year you gain again 20 percent, in the third year you gain 10 percent. But in the fourth and fifth years again the recession happens. So your portfolio is losing minus 20 percent in the fourth year and minus 30 percent in the fifth year. You can see the sequence is exactly the reverse. But the percentage is the same and how would that your one million retirement portfolio perform assuming everything is the same except the reversal of this sequence is that at the end of the fifth year you end up being slightly more than half a million. You can compare it back with the “A” scenario. Now that is double the amount, i.e., 524k. So that is why it’s not about losing how much, it’s also about the sequence of loss if possible as you do not want your portfolio to have any negative at all. But if it happens you can see that the sequence of loss is so important. Now it is unfortunate that whatever happens, the recession happens at the point when you retire, and you can see that it is going to be a difference between leaving very luxuriously and leaving very poorly.