Retirement planning often gets reduced to one number: how much income a portfolio can produce. That number matters, but it misses a painful reality. Two retirees can have the same savings, the same expected long term market returns, and the same age when they stop working, and still experience very different outcomes. The difference is often not the average return. It is the order of returns.

That is what people mean by sequence of returns risk. In practical terms, it is the danger that poor investment performance shows up early in retirement, right when withdrawals are largest relative to the portfolio balance. When markets drop, withdrawals made during a downturn force the portfolio to sell assets at depressed values. Then, if the market does not recover quickly enough, the portfolio compounds from a smaller base. Even if the long term market eventually rebounds, the retiree may not recover the lost ground in time.

This risk is most acute in the early retirement years, but it can still bite later if spending rises or if the portfolio remains heavily exposed to volatility when withdrawals continue.

The mechanics behind the risk

Imagine a retiree who needs $60,000 per year from investments. Now consider two scenarios over a ten year period.

In Scenario A, the portfolio earns strong returns in the first few years, building a buffer. Then, returns are weaker in later years. Withdrawals shrink as a share of the remaining balance, and the portfolio has more runway to absorb later softness.

In Scenario B, the portfolio suffers poor returns early. The value drops, but the retiree still needs $60,000. To pay that spending, the retiree sells holdings after the decline. If the decline is severe and followed by more modest returns, the portfolio may never fully regain the lost value before additional withdrawals accumulate. Over time, the retiree can end up with a withdrawal rate that is higher than originally planned because the portfolio base has shrunk.

Sequence risk is not just about “bad markets.” It is about forced selling combined with ongoing withdrawals and compounding. The math is especially unforgiving when a retiree has limited flexibility to reduce spending.

If you are thinking, “But markets go down and up, so why does order matter?” you are already halfway to understanding the key point. Long term averages treat the order as irrelevant. Retirement cash flow does not. Withdrawals create a real-world timeline that interacts with volatility.

Who is most exposed

Most retirees are exposed to sequence of returns risk, but the degree varies. In my experience, the biggest drivers are:

- how much of retirement spending is funded by a taxable or market portfolio rather than stable income
- whether spending is fixed or adjustable
- how concentrated the portfolio is in equities or other volatile assets
- the size of the portfolio relative to spending, often measured as the initial withdrawal rate
- whether the retiree has credible “cash flow bridges” or emergency liquidity

A person who has a pension, Social Security, and annuity income covering most of spending can weather early market weakness because withdrawals from the portfolio are smaller. Someone relying heavily on a portfolio to

fund day to day life is more vulnerable, especially if the early retirement years coincide with a market drawdown.

Even two people with the same portfolio can face different risk if one has a flexible spending plan. If you can cut discretionary spending in a downturn, or delay a major purchase, sequence risk matters less. If you cannot, it matters more.

A practical example: the early downturn problem

Consider a retiree with a $1,000,000 portfolio and a plan to withdraw $50,000 per year, about 5 percent initially. If markets rally early, the withdrawal is a smaller percentage of a growing portfolio. If markets fall early, that $50,000 represents a larger percentage of a shrinking balance.

Let's keep the example simple without pretending we can predict exact outcomes. Suppose the portfolio drops sharply in the first year. You still withdraw $50,000. The portfolio sells investments after a decline, then has less capital working for recovery. If the next year is flat or modestly negative, the portfolio compounds from a lower base again.

Now add a behavior layer many people do not model: retirees and households often react emotionally to losses. Some try to "hold on" and keep withdrawals steady because the plan says they can. Others reduce risk at exactly the wrong time, selling more after losses because it feels safer, or they move from stocks to cash and inflation slowly erodes the buying power. Both reactions can worsen outcomes when they reduce the probability of recovery.

Sequence risk is as much about decision making as it is about market performance.

Why "average return" planning can mislead

Many planning approaches assume that returns will average out over time. The trouble is that retirement is not a static investment horizon. It is a sequence of spending decisions, and spending decisions are tied to portfolio values at specific moments.

One way to see this is to think about volatility drag and timing. Volatility does not only affect how much the portfolio ends up at the end. It affects intermediate balances. Since withdrawals reduce the portfolio, intermediate balances matter.

Even if your long term return assumption is reasonable, a bad sequence can force adjustments sooner than a plan anticipates. If those adjustments are delayed, the portfolio may run into a "math corner" where the remaining assets cannot support the spending policy without major changes.

This does not mean planning based on averages is useless. It means averages must be paired with a cash flow reality check: How long can you fund spending without touching the most volatile assets? How much can you reduce withdrawals if markets fall?

The levers retirees can pull

The good news is that sequence of returns risk is not entirely uncontrollable. You cannot steer markets, but you can shape how your withdrawals interact with market outcomes. I like to think of mitigation as having three buckets of leverage: reduce the withdrawal pressure, add flexibility, and build resilience before trouble arrives.

1) Lower withdrawals, at least during rough years

A lower withdrawal rate reduces the risk that early downturns permanently impair the plan. Sometimes the best lever is simply adjusting spending in the first few years of retirement.

This does not have to mean living like you are still working. It can be a deliberate choice to postpone big-ticket purchases, delay relocation, or scale back on discretionary travel when portfolio values are stressed. Many retirees find that they can comfortably spend less for a year or two if they have a plan for what to do.

You do not want "panic flexibility." You want a pre-decided rule or framework so that a downturn triggers a planned response rather than a frantic scramble.

2) Add stable income to reduce portfolio withdrawals

If a portion of retirement spending is covered by stable sources like pensions, Social Security, or other guaranteed income, sequence risk shrinks. Stable income works like a shock absorber, because it reduces how much the portfolio must sell during market declines.

There is an important nuance. Stable income is most protective when it arrives regardless of market performance. But it can also shift the risk in time. For instance, delaying Social Security can increase early withdrawal needs. That may be fine for some households, but it increases exposure to early sequence risk if you do not have assets set aside for the bridge.

3) Use a spending and asset allocation strategy that anticipates volatility

Asset allocation matters, but not only because stocks are volatile. It matters because volatile assets are often the ones you are most likely to sell when you need cash.

A well-designed strategy tries to align cash flow needs with asset liquidity. Many retirees benefit from having some portion of near-term spending needs held in less volatile instruments. The goal is not to "avoid stocks forever." The goal is to avoid forcing a large sale of stocks at depressed prices.

This is where "buckets" thinking often comes in. You might hold a portion of expected spending for the next year or two in conservative assets, then fund later spending from a mix that can tolerate more volatility.

Even if you do not formally use buckets, the idea is the same: match withdrawal timing with liquidity.

4) Rebalance, but do it with discipline and timing in mind

Rebalancing can reduce risk, but it must be done correctly. If you rebalance aggressively during downturns, you may buy more after declines, which can be beneficial. If you rebalance without considering tax impact, or you sell in a way that creates large tax bills, you might undermine the benefit.

In taxable accounts, tax drag can change the retirement portfolio allocation optimal approach. In retirement accounts, taxes are delayed, so the calculus is different. The best practice is to coordinate rebalancing and withdrawal location, meaning which accounts you sell from and when.

5) Consider annuities carefully when they truly solve the problem

Annuities come up often in sequence risk conversations because they can provide income that is not tied to market timing. The catch is that annuities are complex and can be expensive or restrictive.

If you explore annuities, it should be with a clear objective, such as covering a portion of essential spending for life, reducing the amount of portfolio that must be liquidated during downturns, or providing income you cannot outlive. If the annuity does not meaningfully change the cash flow risk profile, it may not be worth the trade-offs.

Also, fees, surrender charges, inflation adjustments, and the structure of benefits matter more than glossy promises. A good fit exists for some retirees, but a poor fit is common when someone buys an annuity for "returns" rather than for income stability.

Two behaviors that quietly increase sequence risk

One of the most frustrating things about sequence of returns risk is that it often turns into a behavioral spiral.

Cutting investment risk at the wrong time

When markets fall, many people feel the need to "de-risk." Sometimes that means selling stocks. The problem is that the retiree is already selling during the downturn to fund spending. Additional selling locks in losses and reduces future growth potential exactly when it is needed most.

There are times when reducing risk is appropriate, but in a sequence risk framework, you want that decision to be planned ahead, not improvised during stress.

Allowing withdrawal plans to become mandatory

Another behavior is failing to preserve discretion. A retiree who assumes withdrawals must always match a fixed target might feel compelled to maintain spending even when the portfolio is down.

In reality, many expenses have some flexibility: travel schedules can shift, home upgrades can wait, and some spending categories vary with time. You do not need to turn life into austerity. You need enough adjustable spending so you are not forced to sell volatile assets at the worst time.

Building a "cash flow floor" with real-world accounts

Sequence risk becomes easier to manage when you have a cash flow floor. That floor can come from multiple sources, including Social Security, pensions, and part time work. It can also come from liquid assets held outside the most volatile portion of the portfolio.

In the real world, the account type matters. Selling investments in taxable accounts triggers capital gains and possibly state taxes. Selling from retirement accounts triggers ordinary income tax and may affect Medicare premiums depending on household income.

So the question is not just what you withdraw. It is where you withdraw from.

A disciplined approach often includes these moving parts working together:

- use stable income and conservative holdings for near-term spending
- plan taxable sales to manage capital gains
- consider retirement account withdrawals with a tax bracket lens
- keep a minimum liquidity buffer so a downturn does not force sales at any price

This is not about perfection. It is about reducing the number of moments when you must sell at the exact wrong time.

A simple framework to stress test your plan

You do not need a PhD to run a useful stress test. What you do need is a willingness to ask: what happens if the first few years are ugly?

A common mistake is stress testing only by lowering expected returns slightly. Sequence risk usually requires a more targeted scenario: returns that are poor early, even if later years recover.

If you work with a financial professional, ask how they evaluate sequence risk. If you do it yourself, you can use a structured approach like comparing outcomes under multiple market paths rather than one average.

Here is a practical checklist I often suggest to retirees and couples sitting down to review a plan:

- Estimate essential spending for the next 2 to 4 years, including taxes and insurance premiums.
- Identify reliable income that covers that spending regardless of market performance (Social Security timing, pension, etc.).
- Decide how much discretionary spending you can cut temporarily without harming long term goals.
- Check whether your near-term liquidity is enough to avoid selling long-term volatile assets during a downturn.
- Review which accounts you would sell from first if the portfolio drops in year one or year two.

This exercise makes the risk tangible. It turns “sequence of returns” from an abstract concept into a cash flow decision tree.

When sequence risk shows up later

Sequence risk is often framed as an early retirement problem, and that is because withdrawals are highest relative to the portfolio balance then. But sequence risk can show up later in a different form.

For example, spending may rise due to healthcare costs, home repairs, helping family members, or increased travel after a spouse’s health improves. If you hit a market decline during that later spending increase, the portfolio can face renewed withdrawal pressure.

Also, some retirees start withdrawing from the portfolio later, for example after delaying Social Security or because they have a pension start date. That can still create sequence risk, just at a different point in time. The key is the intersection of portfolio value and the cash flow you require.

In my experience, retirees who plan well early still benefit from revisiting their assumptions periodically, especially after big life events. Sequence risk is not a one-time calculation. It is an ongoing reality of spending.

Trade-offs you should understand before changing strategy

Mitigating sequence risk often involves trade-offs, and those trade-offs should be explicit.

- Holding more conservative assets reduces the chance you have to sell stocks after declines, but it can lower long term growth potential. If you overdo it, inflation can become the bigger enemy.
- Adding guaranteed income like annuities can stabilize cash flow, but costs and restrictions can reduce flexibility. A bad fit can lock in risk you did not anticipate.
- Delaying major decisions about spending cuts until after markets fall feels emotional, but sometimes it costs you. The trade-off is between planned flexibility and the discomfort of pre-committing to changes.
- Rebalancing can help, but it can also create taxes in taxable accounts. The trade-off is between maintaining target risk levels and managing after-tax outcomes.

There is no universal best answer. The right mix depends on your spending needs, your flexibility, your tax situation, and your tolerance for uncertainty.

A second, short checklist for retirees who want to act now

If you want immediate steps without turning the process into a spreadsheet marathon, use this as a focused starting point:

- Write down your expected spending for the next 12 months and separate it into essential and discretionary categories.
- Identify which expenses you can pause for 6 to 18 months if markets are down.
- Review your withdrawal order plan, including which account you would sell from first.
- Confirm you have enough liquid reserves to cover at least one year of spending shocks.
- Schedule a plan review for later in the first year of retirement, not just once at the beginning.

That last one matters. People often feel confident at the start of retirement, then reality sets in with bills, taxes, and decisions that were easy to ignore on paper.

Putting it all together

Sequence of returns risk is not about predicting the market. It is about acknowledging that retirement is a timing-sensitive process. When you withdraw from your portfolio, you are not just taking money, you are shaping how much risk you keep exposed during the next phase of recovery.

The most effective responses tend to share a few traits. They reduce how much the portfolio must fund essential spending during early downturns. They preserve flexibility so you can adjust spending without panic. They align withdrawal timing with asset liquidity and tax considerations. And they treat the plan as a living system rather than a one-time set-and-forget calculation.

If you are near retirement, the most useful question is simple: if markets drop in the first year, what happens to your cash flow, your spending, and your selling decisions? Your answers to that question often determine whether sequence of returns risk remains a threat or becomes a risk you can manage with confidence.