00:00:01:06	Instead of return risk. The main risk of investment is generally well known.
00:00:06:22	Investing for long term growth means investing in real assets,
00:00:10:13	which of course brings with it market volatility
00:00:13:15	and potentially losing value at any given point on those. Not so major.
00:00:18:06	The obvious, though, is secrets in inference own risk,
00:00:21:06	as the FCA and others have called it.
00:00:25:08	Well, what is this? It's effectively the when income is being taken.
00:00:30:06	The order returns are delivered in can significantly impact the future value of
00:00:35:00	the fund, even if the returns are identical, but delivered in a different order.
00:00:40:16	This might happen where units have been in cash to provide an income,
00:00:44:05	as potentially is the case for income drawdown or an investment bond paying income.
00:00:50:15	Let's look an example to prove the point here.
00:00:54:06	£275,000 is invested over six years and the returns from portfolio eight,
00:01:00:00	B and C are as follows. What you'll note from the table is that
00:01:04:00	the percentage returns of the three portfolios A, B and C are the same numbers,
00:01:08:07	albeit arranged differently. Here's the results.
00:01:11:16	If no income is taken, the colors of red, amber and green represent the worst,
00:01:16:09	medium and best result over a given period, as no income is being taken after six years.
00:01:22:06	The values are the same despite fluctuations over the six year period.
00:01:28:04	But when we introduced income taken, it's a different story.
00:01:32:10	The values continue to fluctuate, but the end result is vastly different.

00:01:37:07	Here's that same investment, but with 1500 pounds per month income. Well, why is this?
00:01:44:00	Let's look at portfolio B as an example.
00:01:46:21	This highlights the risk that with poor performance in the first three years,
00:01:50:15	losses by income being taken are effectively being crystallized
00:01:54:12	and others not recovered over the time period.
00:01:57:19	By contrast, portfolio IE has the best style
00:02:00:06	and therefore gains rather than losses have been crystallized.
00:02:02:18	So the number is much better. Portfolio C sits in the middle.
00:02:07:12	So what methods can an adviser adopt to counteract this risk?
00:02:10:21	Well, there are several strategies. Let's look at the first example.
00:02:15:13	It might be that an adviser used a cash fund to pay income in the short term.
00:02:19:16	Typically, these funds don't fall in value and so there is no sequence of return risk.
00:02:24:21	However, one problem here is that deposit rates are very low at the moment
00:02:29:05	and in some cases almost non-existent.
00:02:31:15	This means that though there is no fall in value for money earmarked for withdrawal,
00:02:34:21	sitting in cash, there is no growth income. Let's look at another example.
00:02:40:11	The second measured method here is one that has become known as the bucket approach.
00:02:44:15	The premise of this is that the fund is divided into
00:02:47:00	a series of buckets invested according to when the client may need the income.
00:02:52:04	So used in conjunction with the first method,
00:02:54:09	you may have cash in the short term bucket and then perhaps two
00:02:57:10	or three more buckets intended to provide income points in the future.

00:03:01:20	The general principle is that the longer and so income is needed to be drawn from
00:03:05:12	the individual bucket, the more aggressive and thus more potential growth there is.
00:03:10:13	This can work well, but still has a problem of low returns on the cash element.
00:03:14:19	And also, of course, there is no guarantee of the other buckets providing
00:03:18:18	the right performance for the earmarked time period.
00:03:22:09	Variation on this theme, though,
00:03:23:15	could be that a longer term bucket is promoted by income earlier than expected if
00:03:28:10	it has performed well. Let's look at another example.
00:03:33:04	Another method is taken natural income.
00:03:36:06	This involves bond, dividend or rental income generated by a portfolio becoming
00:03:41:01	the client's income. This enables the investor to avoid drawing
00:03:45:15	on their capital or selling fund units, thus avoiding sequencing risk.
00:03:51:00	However, this approach is also not without drawbacks.
00:03:53:18	Even if the yield is stable in percentage terms when applied to the capital value,
00:03:58:18	it is likely to fluctuate. This means that
00:04:01:03	the investor's income will fluctuate from year to year.
00:04:04:23	All your clients comfortable with a volatile income.
00:04:08:10	This might not work if, for example,
00:04:10:22	a retiree needing to budget around a particular income requirement.
00:04:14:20	This can often make this particular strategy unattractive in isolation for all but
00:04:19:11	the relatively wealthy. Of course,
00:04:22:03	the investor could top up their income by cashing in units.

00:04:25:11	Then you are back to the main problem that this is trying to be avoided having cash
00:04:29:15	units at the wrong time. Let's look at another example.
00:04:34:12	Final method is the one of a multi-asset smooth fund.
00:04:38:15	The fund can be invested in a wide range of different assets.
00:04:42:05	This in itself providing an element of consistency of return.
00:04:46:06	Smoothing mechanism is also applied to the fund,
00:04:48:17	meaning that the unit price is only adjusted if
00:04:51:03	the underlying value goes outside of set parameters.
00:04:55:06	Otherwise, the fund will grow by an expected growth rate,
00:04:58:08	which can also help to give investors an idea of their expected outcome.
00:05:02:22	Typically, these funds remove some of the day to day volatility that
00:05:06:10	an investor in real assets would normally expect to see.
00:05:10:01	These, however, also have drawbacks.
00:05:12:11	For example, the fund could perform poorly over time.
00:05:15:10	Or it may be that there is an adjustment to the value relatively soon after
00:05:19:23	the investment because of a market correction . Fun. One important.
00:05:24:17	Points mentioned is that none of these strategies are mutually exclusive.
00:05:28:10	It might be. The two or more are used for the same point in order to give them
00:05:34:01	the level of certainty they need and ensure that capacity for loss is not breached.