GYROSTAT
CAPITAL MANAGEMENT

Sequencing risk: The hidden retirement threat — and how absolute return equity income funds can defend against it

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Retirement's hidden risk

As investors transition into retirement, one of the most dangerous and frequently overlooked threats is sequencing risk.

Even with strong average returns, the order in which returns occur can permanently impair outcomes. This risk isn't abstract. It's structural, behavioural, and time-sensitive — and it cannot be diversified away through traditional means.

The solution? Equity portfolios explicitly designed to deliver income and withstand early-period drawdowns, especially through dynamic, risk-managed strategies like Absolute Return Equity Income Funds.

Quantifying the risk: Same returns, different outcomes

Consider two identical portfolios, each with average annual returns of 6.0% and starting balances of $1 million, from which $60,000 is withdrawn annually.

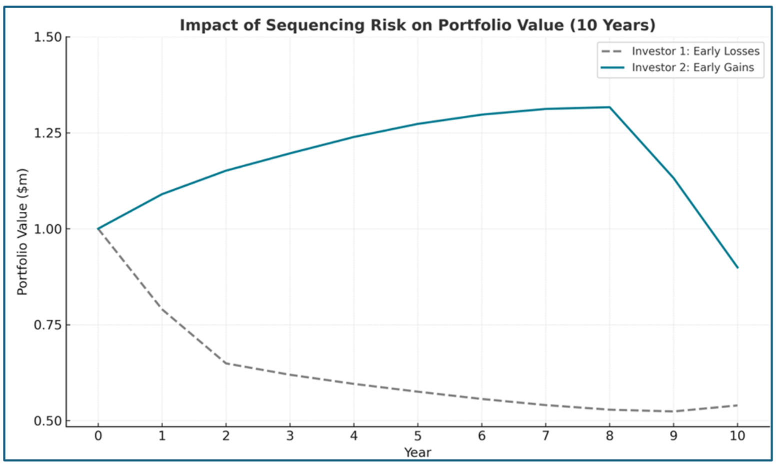
Although both earn a 6% average return over a decade, Investor 1 experiences negative returns in the first two years, while Investor 2 encounters them at the end. The results are stark: Investor A finishes with approximately $539,000, while Investor B ends with nearly $899,000. Same average return, vastly different outcomes over $ 360,000.

This difference isn't theoretical. It's structural. And it strikes precisely when retirees are most vulnerable: the beginning of their drawdown phase, when recovery time is limited and emotional responses are heightened.

The impact: The hidden risk of return sequence

Assumptions

- Starting Balance: $1,000,000
- Annual Withdrawals: $60,000 (beginning of each year)
- Return Profile: Same average return (6.0%)
- Timing: Returns after withdrawals
- Key Insight
  Two retirees with identical average returns may end up with vastly different outcomes.
- Early losses in retirement compound negatively with drawdowns.
- One retiree ends with ~$360,000 less after 10 years, purely due to return order.



Source: Gyrostat analysis case study

The following table illustrates the dramatic differences in account balances during the 10 year retirement study period.

Year	Investor 1 Return	Investor 1 End Balance	Investor 2 Return	Investor 2 End Balance
0	—	$1,000,000	—	$1,000,000
1	-15%	$790,000	15%	$1,090,000
2	-10%	$649,000	12%	$1,151,200
3	5%	$619,450	10%	$1,196,320
4	6%	$595,617	9%	$1,238,989
5	7%	$575,310	8%	$1,273,108
6	8%	$556,335	7%	$1,297,225
7	9%	$540,405	6%	$1,312,058
8	10%	$528,446	5%	$1,316,661
9	12%	$523,869	-10%	$1,131,995
10	15%	$539,449	-15%	$899,196

For retirees, the accumulation-phase approach of dollar-cost averaging is no longer available. This absence of ongoing contributions amplifies the impact of early losses and heightens the risk of permanent capital depletion.

The psychology behind inaction

Why do so few retirees take proactive steps to protect against sequencing risk?

Many insure their homes, cars, and health, yet fail to insure their retirement capital. This often stems from behavioural biases, particularly domain ignorance — a misclassification of investment portfolios as mere return generators rather than the primary enabler of retirement lifestyle.

Unprotected, portfolios remain exposed to degradation and the real possibility of lifestyle disruption.

Traditional defences: Helpful but incomplete

Most advisers recommend holding two to three years of cash reserves to avoid selling assets in a downturn. While this can reduce withdrawal risk, it also depresses long-term returns and fails to address drawdowns in the equity portion of the portfolio.

To go further, advisers must improve the design of the equity sleeve.

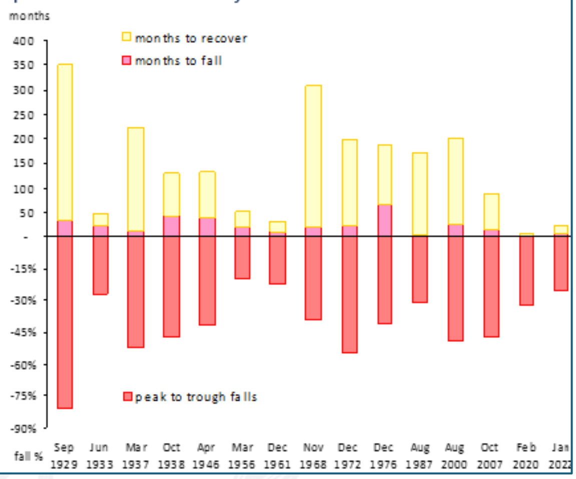
Volatility is not merely random noise, it clusters. Crashes are not anomalies; they are structural features of markets. Risk does not unfold smoothly; it gaps. Despite decades of quantitative refinement, many models continue to assume bell-shaped distributions in which five-sigma events are "impossible." Yet they occur repeatedly.

Investment cycles – major sell offs a regular and hazardous part of the investment cycle

S&P 500 Index - 90 Year Historical Chart: Peak to trough falls > 20%, duration of falls, time to recover to pre fall levels

The graph shows the extent of falls from peak to trough S&P 500, the duration of the fall, and time taken to recover to pre fall highs.

Source: http://www.macrotrends.net/2324/sp-500-historical-chart-data



"Markets are far more violent than the Gaussian model assumes. Crashes are not outliers — they are part of the system."

Benoit Mandelbrot, The (Mis)Behavior of Markets

"The illusion that we understand the past fosters overconfidence in our ability to predict the future."

Daniel Kahneman, Thinking, Fast and Slow

Absolute return Income equity: Designed for uncertainty

Absolute return income equity funds, such as those offered by Gyrostat, are designed around uncertainty itself. Protection is integrated from inception, tail risk is recognised as a constant, and the strategies dynamically adapt as conditions evolve.

At Gyrostat, we don't ignore theory — we design beyond it.

Gyrostat Class A performance compared with worst 5 quarters from the ASX accumulation index (since Fund inception December 2010).

A track record of increasing in value on major market falls

Period	ASX accumulation return	Gyrostat Class A return
Apr - Jun 2022	-11.90%	+ 8.70%
Jan - Mar 2020	-23.10%	+ 9.22%
Oct - Dec 2018	-8.24%	+ 4.18%
Jul - Sep 2015	-6.58%	-0.26%
Jul - Sep 2011	-8.17%	+ 1.29%

Stock specific protection reliably increases in value on share price falls.

GYROSTAT
RISK MANAGED EQUITY FUNDS

This is not market timing. It is systematic, rules-based protection that adjusts continuously with market reality.

Results that support resilience

Since 2010, Gyrostat's Class A Absolute Return Equity Income Strategy has delivered:

- **Lower Risk:** 14 consecutive years without a single quarterly drawdown exceeding 3%
- **Positive Returns During Major Market Falls**: Consistent gains when markets declined sharply
- **Non-Correlated Returns**: Performance largely independent of market direction

Performance Summary (to 30 June 2025)

Class	1 Yr	2 Yr p.a.	3 Yr p.a.	4 Yr p.a.	Max Quarterly Drawdown	Beta
Class A – Australian Equity Absolute Return (AUD)	+9.80%	+8.12%	+8.45%	+9.40%	-1.26% (past 3 years)	-0.08
Class B – Australian Equity Absolute Return (AUD)	+10.49%	+9.45%	+11.03%	+8.11%	-0.84% (past 3 years)	-0.22

These returns have been delivered consistently across market regimes, smoothing the ride for retirees and providing a tangible shield against sequencing risk.

Conclusion: Peace of mind over pure growth

Sequencing risk is not merely an academic construct. It is a real threat to both financial security and emotional wellbeing in retirement. Dynamic hedging within an absolute return framework provides a credible solution, reducing the likelihood of forced drawdowns, dampening volatility, and enabling investors to stay invested with confidence.

At retirement, it’s no longer only about the magnitude of returns.

It is about the order in which those returns arrive, and what that sequence means for the sustainability of the lifestyle.