

How Can You Make Your Retirement Money Last?

These spending and investing precepts may encourage its longevity.

All retirees want their money to last a lifetime. There is no guarantee it will, but, in pursuit of that goal, households may want to adopt a couple of spending and investing precepts.

One precept: observing the 4 percent rule. This classic retirement planning principle works as follows: a retiree household withdraws 4 percent of its amassed retirement savings in year one of retirement, and withdraws 4 percent plus a little more every year thereafter — that is, the annual withdrawals are gradually adjusted upward from the base 4 percent amount in response to inflation.

The 4 percent rule was first formulated back in the 1990s by an influential financial planner named William Bengen. He was trying to figure out the “safest” withdrawal rate for a retiree; one that could theoretically allow his or her savings to hold up for 30 years given certain conditions (more about those conditions in a moment). Bengen ran various 30-year scenarios using different withdrawal rates in relation to historical market returns, and concluded that a 4 percent withdrawal rate (adjusted incrementally for inflation) made the most sense.¹

For the 4 percent rule to “work,” two fundamental conditions must be met. One, the retiree has to invest in a way that will allow his or her retirement savings to grow along with inflation. Two, there must not be a sideways or bear market occurring.¹

As sideways and bear markets have not been the historical norm, following the 4 percent rule could be wise indeed in a favorable market climate. Michael Kitces, another influential financial planner, has noted that, historically, a retiree strictly observing the 4 percent rule would have doubled his or her starting principal at the end of 30 years more than two-thirds of the time.¹

In today’s low-yield environment, the 4 percent rule has its critics. They argue that a 3 percent withdrawal rate gives a retiree a better prospect for sustaining invested assets over 30 years. In addition, retiree households are not always able to strictly follow a 3 percent or 4 percent withdrawal rate. Dividends and Required Minimum Distributions may effectively increase the yearly withdrawal. Retirees should review their income sources and income prospects with the help of a financial professional to determine what withdrawal percentage is appropriate given their particular income needs and their need for long-term financial stability.

Another precept: Adopting a “bucketing” approach. In this strategy, a retiree household assigns one-third of its savings to equities, one-third of its savings to fixed-income investments, and another third of its savings to cash. Each of these “buckets” has a different function.

The cash bucket is simply an emergency fund stocked with money that represents the equivalent of 2 to 3 years of income the household does not receive as a result of pensions or similarly scheduled payouts. In other words, if a couple gets \$35,000 a year from Social Security and needs \$55,000 a year to live comfortably, the cash bucket should hold \$40,000 to 60,000.

The household replenishes the cash bucket over time with investment returns from the equities and fixed-income buckets. Overall, the household should invest with the priority of growing its money;

though the investment approach could tilt conservative if the individual or couple has little tolerance for risk.

Since growth investing is an objective of the bucket approach, equity investments are bought and held. Examining history, that is not a bad idea: the S&P 500 has never returned negative over a 15-year period. In fact, it would have returned 6.5 percent for a hypothetical buy-and-hold investor across its worst 15-year stretch in recent memory — the 15 years ending in March 2009, when it bottomed out in the last bear market.²

Assets in the fixed-income bucket may be invested as conservatively as the household wishes. Some fixed-income investments are more conservative than others — which is to say, some are less affected by fluctuations in interest rates and Wall Street turbulence than others. While the most conservative, fixed-income investments are currently yielding very little, they may yield more in the future as interest rates presumably continue to rise.

There has been great concern over what rising interest rates will do to this investment class, but, if history is any guide, short-term pain may be alleviated by ultimately greater yields. Last December, Vanguard Group projected that, if the Federal Reserve gradually raised the benchmark interest rate to 2.0 percent across the three-and-a-half years ending in July 2019, a typical investment fund containing intermediate-term fixed-income securities would suffer a -0.15 percent total return for 2016, but return positively in the following years.³

Avoid overspending and invest with growth in mind. That is the basic message from all this, and, while following that simple instruction is not guaranteed to make your retirement savings last a lifetime, it may help you to sustain those savings for the long run.

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Citations.

1 - money.cnn.com/2016/04/20/retirement/retirement-4-rule/ [4/20/16]

2 - time.com/money/4161045/retirement-income/ [5/22/16]

3 - tinyurl.com/hjfggnp [12/2/15]