What is a Safe Withdrawal Rate for Retirees?

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Retirement is very different today than it was even just a decade ago. In many ways, it's far richer and much more fulfilling. People are staying healthier and living longer. As a result of this, however, finding a way to make your savings last has become increasingly challenging.

According to Forbes[1], there's a 1 in 20 chance that a 65 year old retiree will live 30 additional years. As a result, careful consideration must be given to how much money is withdrawn each year in retirement.

The "safe withdrawal rate" refers to the percentage that can be safely withdrawn from your portfolio throughout your retirement, with reasonable likelihood the portfolio will last you for 30 years. Understanding this number is one of the biggest keys to successful retirement planning.

The 4% Rule

While everyone's financial situation is different, a good rule of thumb to start is what's known as "the 4% rule." In 1994, a financial advisor named William Bengen wrote a paper in which he used actual market returns to calculate how investments would perform using different asset allocations.

What he discovered led him to develop the 4% rule, which suggests that retirees should be able to safely withdraw 4% of the total of all of their investments during the first year of retirement, and then adjust that amount for inflation over each subsequent year.

It's important to note that Bengen's research covered the time frames from the Great Depression in the 1930s to the high inflation years of the 1970s. His research also showed that for the 4% Rule to work one needed to have 50-75% of their portfolio allocated to stocks.

To put this concept into action, let's say at the time of your retirement, you have a nest egg totaling $750,000. The rule of 4% indicates that you should be able to comfortably withdraw $30,000 the first year and then make cost-of-living adjustments to that amount for each consecutive year based on the rate of inflation. (You can find current and historical inflation rates by visiting this site[2].)

So, if the inflation rate for second year of retirement stood at 3%, it should be "safe" to withdraw $30,900 in year two, and so on and so forth. The additional $900 would be to cover the increased cost of living that is likely to occur during that year.

What is sequence of returns and why does it matter?

Sequence of returns refers to actual annual returns a portfolio experience during retirement. It matters because it can have a significant impact on the actual outcome of your withdrawal strategy. If you retire and start drawing on your portfolio right before a major market correction that lasts months or even years, you may need to reevaluate your withdrawal strategy. Conversely, if the markets go up significantly in the first several years of retirement, it provides a nice cushion.

Being flexible is important when doing your annual budgeting understanding the impact of a withdrawal on your portfolio will provide added security. Taking larger withdrawals during strong markets and reducing withdrawals during weak markets, or being dynamic, can also increase the likelihood your portfolio will last for your entire retirement.

The Impact of Inflation

Over the past three decades, the annual inflation rate has averaged around 3%[3]. If it continues along this trend, the same goods and services you're purchasing today will cost 6% more in 2022. On a big ticket item that costs $1,000 today, you'd pay $1060 two years from now. That may not seem like much, but over time, it can really add up. In fact, over the course of a 30 year retirement, it is entirely possible for your cost of living to more than double.

Given this fact, along with the reality that Social Security adjustments for cost-of-living increases simply aren't keeping pace with inflation rates, creating a withdrawal strategy that allows for increased annual withdrawals to safeguard against rising inflation will protect your lifestyle.

How can Greystone Financial Group help you?

Working with a Director at Greystone Financial Group to build a personal Financial Plan that factors in variables such as inflation, market risk, asset allocation, your personal goals, and your taxes are a good way to establish a safe withdrawal strategy with the goal that your portfolio will be there for you when you need it, for however long that may be.

1. Simon Moore, Senior Contributor. 2018, *How Long Will Your Retirement Last?* Forbes, viewed 6 Oct 2020, https://www.forbes.com/sites/simonmoore/2018/04/24/how-long-will-your-retirement-last/#67dab1917472

2. Current US Inflation Rates: 2009-2020. US Inflation Calculator. viewed 6 Oct 2020, https://www.usinflationcalculator.com/inflation/current-inflation-rates/

3. Dan Caplinger. 2017, *How Do Taxes and Inflation Affect My Investment Returns?* The Motley Fool, viewed 6 Oct 2020, https://www.fool.com/taxes/2017/06/04/how-do-taxes-and-inflation-affect-my-investment-re.aspx