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What's your number? How long will your "retirement ribbon" stretch? We have all seen the catchy TV commercials that are designed to get us thinking about how much we will need to save for retirement. In order to calculate your "number", you need to start with a reasonable spending rate.

The spending rate is the percentage of your retirement savings you withdraw each year to "pay" yourself during retirement. Many retirees have always feared outliving their savings, so how much can you safely spend in retirement? In the early 1990's William Bengen, a financial planner, studied 30-year retirement periods going back to 1926 and created the "4% rule" for retirement at age 65. Bengen came up with the 4% rule by performing a sensitivity analysis on a balanced portfolio of stocks and bonds over rolling 30-year retirement periods using historical return data. His analysis revealed that 4% was the maximum amount a retiree could draw from their nest egg and have a 90% chance of success (i.e. not outliving your money). Bengen's 4% rule works as follows: 1) In year one: Withdraw 4% from your balanced portfolio of stocks and bonds; 2) Each year thereafter: Withdraw the previous year's dollar amount, plus enough to account for inflation. According to this rule, if you have a balanced portfolio of stocks and bonds, you can make the annual withdrawals from your portfolio without the worry of running out of money for at least three decades. Like most simple rules of thumb, the 4% rule has its drawbacks.

For starters, the 4% rule was developed in the 1990's when stock returns averaged 18.2% per year and the average yield on the 10-year Treasury bond was 6.7%. Contrast that with the current environment. The trailing 10-year annual return for the stock market (as measured by the *S&P 500 Stock Index*) is 7.7% and the 10-year Treasury bond is currently yielding 2.5%. Interest rates have been low for six-plus years and if they continue to stay low for a prolonged time period, the 4% rule may be too aggressive for a low return environment. Another problem with the 4% rule is the risk of a prolonged market decline the first few years of your retirement. 2008 is a recent example. If your retirement account loses 25% of its value the year you retire, the 4% rule may not be valid.

In recent years, the 4% rule has been re-tooled as the "2.8% rule". A *Morningstar* paper by authors Michael Finke, Wafe Pfau and David M. Blanchett found that a retiree with a portfolio allocation of 40% stocks and 60% bonds could withdraw 2.8% initially with annual inflation adjustments and still have a 90% chance of success over a 30-year retirement. Critics of the 2.8% rule say it may be too conservative and doesn't allow for rising rates in the future.

Another approach is to dynamically alter the withdrawals each year according to a mix of variables. For instance, one dynamic approach uses the IRS life expectancy tables. The IRS publishes life-expectancy tables in Appendix C of Publication 590 at www.irs.gov. In order to use this dynamic approach, you take the balance of your retirement account(s) as of December 31 of the previous year, you look up your age in the IRS table and divide your account balance by the life expectancy given for that age. For example, let's say you saved \$2.0 million and retired at age 62. Your life expectancy, according to the IRS, would be 23.5 years. You divide \$2.0 million by 23.5, arriving at a withdrawal amount of \$85,106. The following year, if your account balance grew by 5% to \$2.1 million, you would withdraw \$92,511 (the Dec. 31 balance divided by your 63-year-old life expectancy of 22.7 years). If your account balance declined 5% to \$1,900,000, you could withdraw only \$83,700.

Another dynamic approach starts with a set withdrawal percentage such as 3-4%, but instead of maintaining the initial spending amount plus inflation each year, you keep the percentage constant and allow the withdrawal amount to fluctuate depending on the account balance. While this approach ensures the investor's nest egg is never depleted it can produce large variances in the annual account withdrawals. A modified version of this approach limits annual adjustments to the initial withdrawal amount to a 2.5% reduction from the prior year when markets have declined and a 5% increase when markets have risen. Still another approach calls for adjusting your spending rate each year based on the trailing 12-month yield on the 10-year Treasury bond, currently at 2.5%. Again this approach ensures the investor's nest egg is never depleted, but it could lead to large variances in the annual withdrawals as interest rates jump around.

Our Advice: Stay Flexible

As you can see, there are many recommendations and approaches to determining your "number" and an appropriate annual spending rate. Our advice is that you stay flexible. It is easy to get bogged down with the multiple inputs and iterations of the above referenced rules of thumb. We think a better approach is to keep things simple, stay flexible and review your plan regularly.

For an investor with a balanced portfolio of stocks and bonds, a 3-4% spending rate is a good place to start in calculating your annual retirement withdrawal amount. For example, if you accumulate \$2.0 million in retirement savings at age 65, you could withdraw \$30,000 to \$40,000 annually from a balanced portfolio of stocks and bonds. Some retirees can be more aggressive with their spending rate if they want to spend down their principal value over time and reduce future expenditures. We would be happy to meet with you to discuss the various spending rate approaches and help you calculate your "number."

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