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Flexibility: The Key to Retirement Spending

Benjamin Franklin once said, "Nothing is certain but death and taxes". This is especially true when it comes to retirement planning. There are many critical factors that are simply out of a retiree's control. Retirees have no control over the short term markets, the rate of inflation, or even their life expectancy. Yet, retirees are expected to make educated decisions as to how much money they can withdraw each year from their retirement savings.

Setting Reasonable Withdrawal Expectations

As discussed in a previous newsletter, retirement planning begins with setting reasonable withdrawal expectations. The rule of thumb is that the average retiree can withdraw around 4% of their portfolio each year. However, withdrawal rates can vary for each retiree based upon three factors: (1) number of years a retiree plans to withdraw monies (2) portfolio asset allocation, and (3) the success rate the retiree is willing to assume.

Withdrawal Rates with an 85% Success Rate Based Upon Various Time Horizons

Portfolio (1)	10 years	15 years	20 years	25 years	30 years	35 years	40 years
Conservative	10.00%	6.75%	5.25%	4.25%	3.75%	3.50%	3.25%
Moderate	10.50%	7.25%	6.00%	5.25%	4.75%	4.50%	4.25%
Aggressive	10.00%	7.00%	6.00%	5.25%	4.75%	4.75%	4.50%

Withdrawal Rates with a 75% Success Rate Based Upon Various Time Horizons

Portfolio (1)	10 years	15 years	20 years	25 years	30 years	35 years	40 years
Conservative	10.50%	7.25%	5.75%	4.50%	4.00%	3.75%	3.50%
Moderate	11.50%	8.50%	6.75%	6.00%	5.25%	5.00%	4.75%
Aggressive	11.00%	8.00%	6.75%	6.00%	5.50%	5.25%	5.00%

(1) The conservative allocation is 20% stocks and 80% bonds. The moderate allocation is 50% stocks and 50% bonds and the aggressive allocation is 80% stocks and 20% bonds. Results are based on annual data from years 1926-2008.

Source: Vanguard, "Research Note: Revisiting the 4% Spending Rule", dated June 2009

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For example, a retiree who is a moderate investor, who expects to live another 30 years, and wants to plan for a 85% success rate, can expect to withdrawal 4.75% (or $23,750) in the first year from a $500,000 portfolio.

Planning Flexibility into your Retirement Budget:

Once a retiree understands reasonable withdrawal rates, the next step is creating a retirement spending plan that is within those rates. A retiree's budget should include non-discretionary, as well as discretionary expenses. Non-discretionary expenses support basics NEEDS and includes food, clothing, and shelter. Non-discretionary expenses are not flexible and should be considered a retiree's minimum distribution. Discretionary expenses represent a retiree's WANTS. Discretionary expenses include items like vacations, entertainment, and eating out. A retiree is advised to consider discretionary expenses to be flexible. In years when the market is up, a retiree may be able to withdraw a little extra for that special vacation. In years when the market is down, a retiree will want to reduce discretionary expenses to give their investments a little time to recover.

In summary, the key ingredient to a successful retirement budget is flexibility. The more a retiree can tolerate some short-term fluctuation in spending, the more likely a retiree will achieve his/her long-term retirement goal. The best way to create flexibility within a retirement budget is to pay off debt prior to retirement. Unfortunately, in an article dated 11/22/2010, USA Today reported that nearly 40% of retirees are accumulating debt during retirement. Debt can be a costly mistake for a retiree. It is not flexible and may cause undue stress during bear markets.

For more information, please feel free to contact Tri-Star for a personalized retirement plan.