



Christopher Kuehne, MS, CFP
Certified Financial Planner
NAPFA-Registered Financial Advisor
Fee-Only Financial Planning
Investment Management Services

How To Avoid Running Out Of Money In Retirement

As all of you know who have completed a full Retirement Plan with me, I like to test the success rate of such a plan, aiming for a plan that succeeds at least 75% of the time. The more conservative you are, the closer that success rate should be to 100%. I estimate the success rate using a statistical tool called Monte Carlo simulation analysis. It varies the rate of return randomly, throughout a prescribed range, in order to simulate actual market conditions. Normally I run the plan through the simulator 1,000 times to get a good indication of rate of success.

The success of a retirement plan is critically dependent upon how much money you take out of your retirement accounts each year. I've always emphasized to you that if your living expenses in retirement are too high, you risk running out of money in your 80s or 90s.

Highly respected research focusing on withdrawal rates has been done over the last few years by William Bengen, a certified financial planner in California. He has recently written a book, *Conserving Client Portfolios During Retirement*. In order to determine what percentage, on average, would be safe to withdraw from savings in retirement, he took the market returns and inflation rates of 1926 through 1975 and back-tested various withdrawal rates of hypothetical individuals who retire in each quarter of each year during that period. As you know, that 50-year time frame includes two devastating periods in the 1930s and the 1970s when stock market rates of return were far below investor expectations for a number of years.

What has emerged from Bengen's research is the well-known 4% rule (actually 4.15%). What it means is that if a conservative retiree withdraws 4.15% of her portfolio each year, adjusted for inflation, that portfolio has close to 100% chance of success of lasting through a 30-year retirement. Such a withdrawal scheme, Bengen maintains, will be able to succeed through virtually any market conditions, including the Great Depression.

His most recent research gives individuals a chance to customize the 4% rule, taking into account various risks they might be willing to take. For example, if a retiree were

willing to add some small stocks to her portfolio (the base results assume 60% large stocks and 40% bonds), the allowable withdrawal rate goes from 4.15% up to 4.42%.

Another possibility is that our retiree might be willing to accept a chance of success of less than 100%. That makes sense, since, hopefully, not every 30-year retirement period will contain a bear market that is as severe as the Great Depression. If she were willing to accept a 94% chance of success, the rate of withdrawal could be as high as 5%. Taking on more risk, if the retiree were able to feel comfortable with an 80% chance of success, then she could withdraw as much as 6% per year.

So the range, as you see, is pretty much between 4.15% and 6%, for most retirees. There are other ways to get to a higher withdrawal rate than 6%, but it entails things like assuming only a 20-year retirement. Keep in mind, too, that if you want to retire early, you may be looking at a withdrawal rate of less than 4%.

What I take away from Bengen's research is that it's important for us to start using such a framework as an overlay to the retirement planning exercises I go through with all clients every few years.

In addition, it's a useful metric for me to use as I develop your retirement plan or, if already complete, revisit it. If you think you might be approaching the upper end of the withdrawal range (4.15% to 6%) in retirement, then we need to discuss what level of risk you are willing to live with in your portfolio and adjust our investment strategy accordingly.

By the way, there is a corollary to the 4% rule, called the rule of 25 that you may find interesting. If you determine that, in retirement, you'll need \$100,000 from your savings each year (after accounting for any other income, such as Social Security or a pension), then you multiply it by 25, giving you, in this case, \$2.5 million. That's the amount of savings you'll need to adhere to the 4% rule. There's a lot of nuance to this, however, so you might want to contact me, and we can go over it together.