McCARTHY GRITTINGER
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The End of the 4 Percent Rule?

Dear Valued Clients & Friends:

The "4 percent rule" was a retirement spending approach that became mainstream in the 1990s. The rule suggested that a retiree with an average portfolio distributed between stocks and bonds (approximately 60-40) should withdraw 4 percent of his or her retirement funds each year (adjusting each year for inflation). If the retiree could stay limited to that 4 percent, he or she would be able to fund retirement for at least 30 years.

The simplicity of the 4 percent rule made it hugely popular with investors. The method made planning easy and was projected to leave the vast majority of retirees with surpluses late in life. Many quickly adopted the method and the approach became a staple of retirement budgeting.

Modern Problems

Recently, the 4 percent rule has begun to fall out of favor with financial planners and investors. The rule, which was designed in the bull market of the mid-90s, relies heavily on regular, high returns from stocks. However, since that time, low economic growth and a major slump in the market has made equities look less attractive.

Some retirees do not want to take on the risk of holding over half their portfolio in potentially volatile stocks and the market is simply not what it was once thought to be. Retirees who are trying to reduce the risk of significant loss are less willing to put faith in perpetual stock growth. In addition to smaller gains, the average lifespan is on the rise and people are living longer in retirement. Strategies have become more conservative to deal with these concerns, and individuals planning for retirement must consider changes to saving and investing.

Ideal Rates In Retirement

The changes in the market do not indicate that the 4 percent rule can never work for retirees, just that it causes problematic exposures. The 4 percent rule works when yearly withdrawals are adjusted for inflation and matched by yearly growth in the market. Even if a portfolio averages 4 percent real growth, it could still underperform a target goal because it suffered severe losses early on.

So is there a better rule to follow? A 3 percent rule, perhaps? Unfortunately, there are no fixed guidelines when it comes to retirement income planning. A retiree must adjust his or her plans regularly to match both changing needs and market performance. The 4 percent rule might be a great place for investors to get a rough estimate when planning, but they should always be prepared to adjust their annual withdrawals lower if necessary.

What Can Investors Do to Make Retirement Work?

Since investors cannot control market performance and the rate of return, they often try to increase allowable withdrawals by increasing total portfolio value. By starting with more money in their retirement plan, a smaller rate of withdrawal will still be worth a solid dollar amount.

To sustain larger dollar withdrawals, retirees must either invest more money or delay retirement by a couple of years. Though neither option may seem pleasant, retirement planning is full of these give-and-take situations; an investor must find a way to make retirement income sustainable.

Changing rates

There may be many reasons to change withdrawal rates during retirement, but retirees must always keep one eye on the market and the other on the future. A profitable year might entice higher withdrawals, but a retiree could benefit far more if the extra earnings were reinvested for later expenses. On the other hand, if withdrawals are greatly restricted early on, people might miss their opportunity to travel and enjoy active life in retirement.

There are no simple answers when it comes to the chaos of the market and the unknown developments of the future. Investors should prepare themselves for changes and be ready to adjust their portfolios as things come into focus.

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In Conclusion

The so called "4 percent rule" isn't wrong per se. In fact it can be a great starting point. However, the major stumbling block is the uncertainty in market risk and return. There is no one spending rate for everyone throughout retirement. Many factors play in the appropriate withdrawal rate: spending goals, time horizons, longevity... The optimal withdrawal rate varies from retiree to retiree and from year to year.

No matter what happens, it is important to plan with your trusted MGFG financial advisor. If you have concerns about your retirement strategy or want to better understand your financial options, please give *Your Anxiety Removal Team* a call with all your questions.

We look forward to continuing to serve you in all of your investment and planning needs.

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