The 4% Rule for Retirees

When you retire, there is ONE thing you want to avoid - outliving your money.

With a great percentage of our population in or approaching retirement, how to avoid the catastrophe of going broke in retirement is a frequent question.

Financial experts have long relied on a staple of retirement planning known as the 4% rule. The rule is - if retirees withdraw every year no more than 4 percent of their financial nest egg (that includes dividends and interest plus some of the stocks and/or and bonds in their retirement portfolio) adjusted for inflation, their nest egg should last 30 years, the length of time generally used for retirement planning.

This rule originated in 1993 when Bill Bengen examined every 30-year retirement period since 1926, taking into account market conditions and inflation. Using a portfolio with a 60/40 split between large-cap stocks and intermediate-term government bonds, he tested different withdrawal percentages to see which one would allow the portfolio to last 30 years. The 4% solution worked and has been used ever since. The average withdrawal rate was actually 6.2%, but every 30-year period withstood the test if no more than 4% was extracted.

Today, there’s some debate about the 4% rule. Some experts say it’s too high given the low interest rate environment. Others maintain it’s too low given the high returns from equity.

But it’s still a good starting point. Here are a couple of suggestions for adapting the use of the 4% rule in retirement as you enjoy the “journey” of retirement years.

1) Use the 4% rule as your “anticipated” flight plan, knowing that you may need to alter the course when encountering turbulence, unforeseen emergencies, and erratic storms. Do this by not expecting the same dollar amount each year (adjusted upward for inflation). Instead, recalculate a new 4% withdrawal amount each year based on the new current market value of your portfolio.
2) Pay attention to changing weather conditions in your area (your portfolio of investments). You may note that the stock market went up 10%, but what did your personal investment portfolio return? If you are using the 4% rule, it’s important that your portfolio actually return MORE, keeping ahead of your withdrawal rate and inflation. It’s also important to maintain appropriate exposure to both stocks and bonds, rebalancing assets at least once a year. Paying lower advisor fees, investing a higher percentage in stocks, or reducing withdrawals may be necessary to assure the viability of the thirty-year flight plan.
3) Once you’re in the air (in retirement), stay at the controls, maintaining the course in good years and bad. Some years will have enormous returns, but don’t splurge. Save up a bucket of cash to cover a year or two of bad returns.
4) Keep your flight pattern flexible by maintaining a diversified portfolio. Converting to all bonds and CDs may sound like a safe plan for retirement, but the low returns will ground you early.

The 4 percent rule is still a useful navigation gauge for retirement as long as changing conditions are considered. If you have additional questions, visit your local library and read Jane Bryant Quinn’s recent book, *Making Your Money Last.* Chapter 8 is a thorough discussion of the classic 4% rule and how it can be applied to your personal financial situation.