Retirement Planning: The Rules of Yesterday No Longer Work

Retirement – the "golden years" and ultimate vacation that so many Americans spend a lifetime working and saving to achieve. Whether your dream retirement includes travel plans or more time at home with the grandkids, consistent income is a necessity to support your goals. Imagine boarding a plane for your dream vacation, and the pilot comes over the intercom and announces there is a 50/50 shot of reaching your destination. Obviously, this is unacceptable. Now, if an investment plan had a 50/50 chance of providing your needed income throughout retirement, is that any better?

A common rule of thumb in the financial industry for retirement income planning is known as the 4% rule, which indicates a retiree should be able to withdraw 4% of the account value each year without running out of money.

The 4% rule has been a staple for retirement planning for decades, based on historical market averages. However, it makes a large assumption based on asset return that may not prove to be valid in today's low-yield markets. By taking a careful look at historical averages, it's possible to see that there is a failure rate to the 4% rule. That rate of failure may be as low as 6% to ***more than 50%,*** dependent on real returns. In 1994, William Bergen conducted a study that indicated a retirement portfolio would last 33 years using the 4% rule, and this study was discussed in a recent paper by Finke, Pfau, and Blanchett (2013).[1] In this report, it was estimated that the safe withdrawal rate would be closer to 2.5% based on inflation and market volatility, as well as lowered interest rates. It goes on to state that, ***with current negative real yields, odds are more than half that one will run out of money using the 4% rule today.*** Even if the interest rates and yields returned to their previous numbers, there has already been damage done to many retirees' portfolios that may force them to take less income and more risk, or face the risk or running out of money.

Historically, retirees have turned to bonds to provide income and stability within their portfolios; however, with today's interest rates, many are finding that the yields cannot provide adequate income for their retirement. That begs the question: What are you to do? There must be a way to create an income plan for retirement today. There is, but so many people are stuck on the 4% rule that they fail to realize the likelihood that it was nothing more than a historical anomaly. In other words, it worked for a while in the past but did not produce a long-term, sustainable way to plan and save for retirement. It is contingent on market returns, which have no guarantee. Not having the 4% rule to rely on can leave people feeling lost when it comes to retirement planning, and can also make it more difficult for some financial planners to advise their clients about which direction to take. Fortunately, there can be ways to create a comprehensive income plan to provide the consistent, reliable income needed to support your retirement.

Over the course of this three-part series, we will review both traditional and newer investment solutions that may make sense as part of a comprehensive income plan today. With careful planning and dedication, you can see your retirement goals realized, and you do not have to go it alone. Contact us today to request our latest white paper, "Destination: Retirement – Why the 4% Rule May Not Get You There." To discuss your investment challenges and retirement goals, schedule a complimentary consultation today. Give us a call at (256) 715-0094!

[1] Finke, M., Pfau, W.D., and Blanchett, D.M. (2013). The 4% rule is not safe in a low-yield world. Social Sciences Research Network. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2201323