Retirement Planning, Part 9
By Gary Case

In this column I'll discuss what I call "Excess Withdrawal Risk." Until recently many people were misled into overly optimistic withdrawal rates in their early retirement years because their expectations of the future were conditioned by the high equity returns realized from 1982-2000. Many retirees simply assumed that they could look forward to drawing out 7%, 8%, or even more per year—then count on rising stock prices to keep the total value of their portfolios virtually unchanged, or even growing.

The severity of the most recent market drop has exposed this fallacy. Many financial advisors today report that they are actually "downsizing" retirees' budgets and lifestyle expectations. Some are even seeing clients forced to go back to full-time jobs—precisely because of overly generous withdrawals in their early retirement years.

So comes the question, "How much can I withdraw from my portfolio during retirement and not outlive my money?" This is a controversial topic in the financial world today. Past studies at Trinity University and a 2003 study from Fidelity Investments indicate that a 4% withdrawal rate optimizes chances of a portfolio lasting 40 years. A recent study by John Guyton published in the October 2004 issue of The Journal of Financial Planning indicates a withdrawal rate of 6.2% might be sustained for the same time period. All studies cited assume increasing withdrawals to compensate for inflation.

Although there are several variables in how the studies were conducted, portfolio composition is most closely associated with the varying withdrawal rates. Higher percentages of equities (stocks, real estate, etc.) equal higher probabilities of maintaining the initial withdrawal rate. Commensurately, higher percentages of equities in a portfolio increase the potential for greater fluctuation in portfolio values…not the formula many retirees seek during their retirement years.

Suffice it to say that withdrawal rate calculation and monitoring is critical to the long-term success of a retirement income portfolio. On one hand, some would say there is wisdom in using portfolio assets early in retirement for activities that might be impossible to enjoy later in life.

On the other hand, many advisors might direct retirees to consider using more conservative withdrawal rates in the early years of retirement. In either case, those who have planned wisely and preserved their investments may have the ability to sustain reasonably higher withdrawal rates later in retirement, with less risk of depleting assets in their lifetimes.

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