ActivePaper

Revisit formula for retirement saving, spending

21st century realities mean making critical adjustments to retirement planning

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A long-held rule of thumb about how much money you need to save for retirement is under siege.

The upshot is that you may need to save even more upfront to enjoy the retirement lifestyle you want.

Some academics and financial planners say the so-called 4 percent rule, which was conceived two decades ago, is out of step with 21st-century realities. But others maintain that, with some modifications, it can still be relevant.

The rule calls for saving enough money so that, in conjunction with your Social Security benefits and any other income you might have, you can cover your expenses by withdrawing 4 percent each year from your investment portfolio, plus an adjustment for inflation.

The problem, some say, is that given the returns you're likely to reap on your investments, taking 4 percent-plus every year could lead to outliving your money.

"If someone can afford to take less than 4 percent, we advise that," said Janet Fox, president of ACH Investment Group in Raleigh. "Your money can work better, harder and longer for you. It makes sense."

GENTRY MULLEN - MCT

Fox

A study published in the Journal of Financial Planning pointed out that the 4 percent rule was conceived when the average return on bonds was much higher than it is today. That's problematic for portfolios that devote a significant portion of their assets to bonds – which financial planners have long advocated for retirees because they are low-risk in comparison to stocks.

The study concluded: "The 4 percent rule cannot be treated as a safe initial withdrawal rate in today's low interest rate environment."

"We're dealing with an environment today where bond yields are at a historic low," said study co-author Wade Pfau, a professor of retirement income at the American College in Bryn Mawr, Pa. "Even though 4 percent worked historically, it's not clear it will always continue to work, especially in this kind of market environment."

Here's how the 4 percent rule works: If you have a $250,000 portfolio, you would withdraw $10,000 the first year. The second year you would withdraw $10,300 (assuming a 3 percent inflation rate); the third year you would withdraw $10,609. Those withdrawals would supplement other income, including Social Security benefits and a pension – if you're fortunate enough to have one.

One problem with the 4 percent rule is that it

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Confidence about retirement

Workers today are a little bit more confident that they're saving enough money for retirement.

A survey by the Employee Benefit Research Institute released in March found that confidence about retirement finances has rebounded from record lows recorded in the wake of the recession.

The latest survey found that 18 percent of workers are very confident and 37 percent are somewhat confident about having sufficient funds to afford a comfortable retirement.

By contrast, just 13 percent of workers were very confident of a comfortable retirement in 2013. And 41 percent were somewhat confident in 2009.

Still, 43 percent of workers today are not too confident or not at all confident of having enough money for retirement.

Staff writer David Ranii

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assumes people need their money to last for 30 years past retirement, said Raleigh financial planner James M. Richardson of Richardson, Carrington, Weaver and Associates.

Today, retirees often live longer than 30 years, "because they retire younger and live longer," Richardson said.

Regrettably, he added, some end up retiring earlier than they planned – or wanted to – because of circumstances beyond their control, such as layoffs.

Richardson

Another issue with the 4 percent rule is what's known as the sequence-of-returns risk.

Essentially, it means that negative investment returns in the first few years of retirement can seriously erode your assets.

Brooks

"If you have a big market drop early in your retirement and you keep on spending the same amount, it means you have to spend an increasing percentage of whatever is left," Pfau said. "That digs a hole for the portfolio."

Consequently, many financial planners suggest that retirees adjust their spending based on their investment returns. Cut back in the lean years and save the big expenses for the flush years.

Katzenstein

"If we have a couple of great years, I may tell clients, let's take a little and pay off things that need to be dealt with," Richardson said.

"If you know you're going to have to buy a car, let's do it now."

"Then," he added, "when things are bad you can scale down without really having to change the lifestyle."

To be sure, some financial planners say the 4 percent rule can still work.

The key, they say, is to seek out alternatives to investing big chunks of your portfolio in fixed-income investments such as bonds. Investing in preferred stocks, real estate investment trusts and stocks that pay dividends, such as utilities, can yield solid returns without a lot of risk.

"We have gone to some nontraditional sources of income," said Joe Gordon, managing partner of Gordon Asset Management in Durham. "You have to look at creative, alternative sources of income."

There is, however, a fundamental problem with the 4 percent rule that neither tweaking portfolios nor being flexible on spending from one year to the next can cure.

"Most Americans haven't saved enough money to begin with," said Ben Brooks, director of wealth management at Capital Investment Cos. in Raleigh. "In most cases, people are going to draw down more than 4 percent because they don't have enough money saved."

Financial planners say that, in those situations, they work with clients to reset their expectations for retirement and reduce expenses.

"We start to ask, what is it you really have to have to make yourself happy?" said Richardson.

One way to significantly reduce expenses is moving to a more affordable area.

"We tell people, maybe you don't want to try and live in Raleigh but if you move to Garner, then you're fine," Richardson said.

Many people choose to delay retirement because of insufficient savings.

"Some people say, I don't think I will ever be able to retire," said financial adviser Steven Katzenstein of HPG Wealthcare Advisors in Raleigh.

Katzenstein recalls, years ago, seeing a cartoon in which a client walks into a financial planner's office and announces: "I'm retiring this coming Thursday. I haven't saved a dime. This is your chance, financial planner, to become a legend."

"None of us in this industry," Katzenstein added, "want that client to come in."

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