4 Withdrawal Strategy

The diversity of methods for retiree withdrawals is as vast as there are retirees. Unfortunately, the most common retiree withdrawal plan is simply not having one.

Simply put, here are 3 steps for organizing your income and withdrawals:

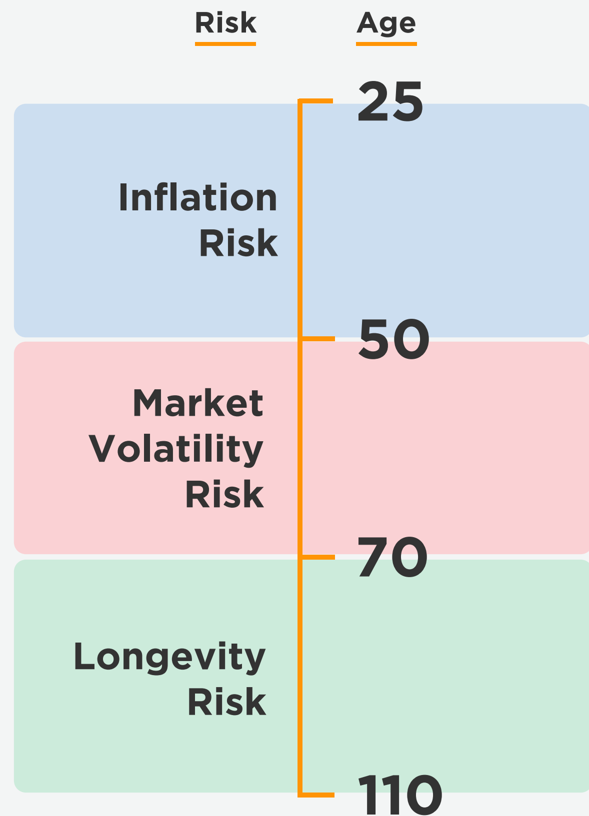
1. **Define Social Security strategy (see article 1)**
2. **List your fixed income like pensions, rent, royalties (see article 3)**
3. **Supplement your fixed income through account withdrawals**

This article covers Step 3. It can be difficult to know how much you can withdraw from your accounts each year. Most financial advisors simulate your withdrawals using hundreds of market scenarios to determine how confident they are in the success of your plan. This is called a Monte Carlo Simulation. If the withdrawal is too high, a simulation like that will help the retiree to know to adjust spending. Some retirees use a fixed withdrawal rate like 3% or 4% and hope that works.

Withdrawal planning is difficult because three major variables are unknown to you as you take the retirement leap of faith:

1. Inflation Risk
2. Market Volatility Risk
3. Longevity Risk

Greatest Risks by Age



During your early working years, your biggest risk is that life could get expensive faster than your wealth increases. Later in life, your biggest risk is outliving your money. In the middle, there is a range of years we call the retirement danger zone. A market crash in the danger zone can be catastrophic to an unprepared retiree.

Planners refer to this variability in annual market returns as the sequence of returns risk. It is a real risk, and it matters, however, don't let it scare you into investing too conservatively or you won't keep up with inflation. The reality is that markets are usually positive, but you need to prepare a portion of your nest egg in case they are not.

Retirement Danger Zone

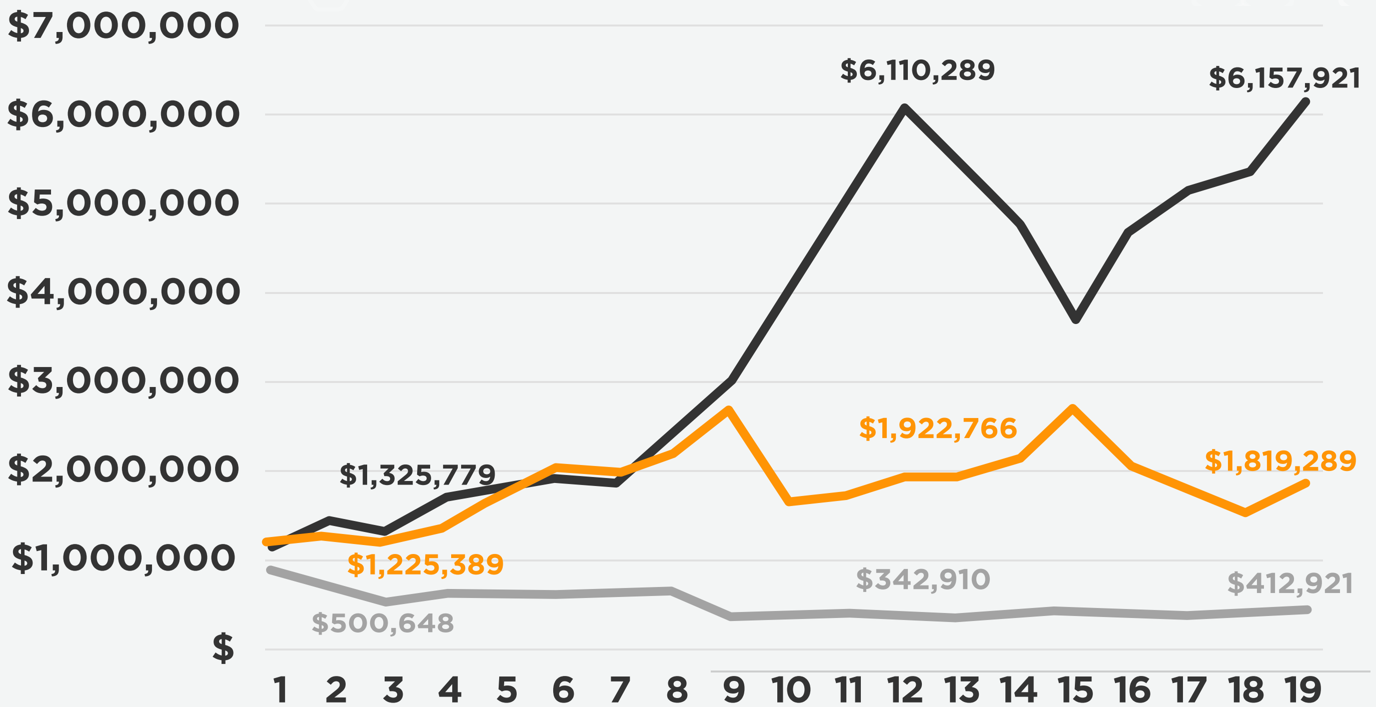
A large market crash early in retirement can have a significant impact on your plan. Sample retiree Kathleen has a $1,000,000 portfolio invested like the S&P 500. Assume she withdraws $50,000 per year, which is 5% of the starting balance. We tested Kathleen's retirement withdrawals through three different market scenarios:

The last 30 years

Starting in the early 2000's when the market crashed

The last 30 years in reverse

Notice how different the portolio balances are, after 19 years of retirement, in the following chart.



LAST 30 YEARS FORWARD

EARLY 2000'S AT THE BEGINNING

LAST 30 YEARS BACKWARDS

Good Withdrawal Strategies Can Be Boiled Down To:

1. Now & Later Money

Assign money a time frame. Protect the "now" money in conservative investments and take growth risk on the "later" money. Protect 3 to 10 year's worth of "now" money, so you can leave "later" money in the market to grow, and recover after the down years. The number of years worth of "now" money depends on your risk tolerance. You should only fear the market if your short-term money is in long-term investments.

Ways to do it:

- **Bond or CD Ladder –** spend the interest and bond principal as each bond matures.
- **Fixed Indexed Annuity –** take free withdrawals of 10%/year from the contract.
- **Fixed Rate Annuity –** take free withdrawals of 10%/year from the contract until used.
- **Bond Funds/ETFs –** withdraw from conservative bond funds.

2. Multi-Stream

Take multiple withdrawals simultaneously. Each income stream is designed to last longer than you. Some are guaranteed; some are not.

Multi-stream strategies may be a combination of the following:

- **Traditional pension-like annuity**
- **Annuities with income riders**
- **Individual bond interest only**
- **Dividend Paying Stocks, dividend only**
- **Reits, MLPs, other income-focused equities**
- **Portfolio of Funds**

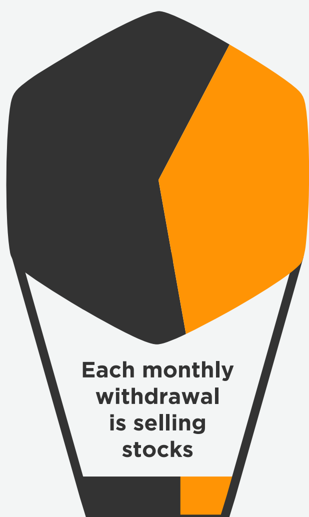
There are pros and cons to any of these strategies. The goal is to diversify the types of income. Most retirees prefer simplicity and choose 2 to 3 of these options and take withdrawals from each.

Avoid the Head-in-Sand Approach

Many retirees unknowingly put on a blindfold to the sequence of return risk and hope that we don't see a major correction in the near term.

This is the least thought-out plan and you are exposed to the most sequence of returns risk. However, it will produce high returns if the market never experiences any significant volatility. Most people don't realize they have this plan until the market drops. Then, to avoid selling investments at a loss, they would need to stop taking income, which is painful. Few retirees reduce their withdrawals. Instead, they increase the risk of running out of money.

In this head-in-the-sand approach you are withdrawing proportionately across all funds. This is problematic in down markets because investments automatically sell at a loss.



How do you prudently plan for the unknown?

Capita estimates your future account withdrawal needs and ensures that cashflow is sustainable using two steps: Segmenting withdrawals into time periods and building a plan with either "now and later money" or a "multi-stream" strategy.

Assigning money to time periods allows each dollar to have a more focused purpose and yields higher retiree income. Your plan will need to change as your opinions, goals, and life circumstances change. This is where a good advisor is key.

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