



Retirement: Is the 4% rule still relevant?



Rodney Brooks, USA TODAY

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For the last 20 years there has been a steadily consistent rule of thumb by America's financial planners when it comes to retirement — the 4% rule.

And what exactly is the 4% rule?

In short, it's a guideline that helps retirees determine how much money they should take from their nest egg each year. The goal is to help make sure the money lasts.

In other words, if you adhere to the rule and have a nest egg of \$500,000, you should limit your withdrawals for living expenses to 4%, or \$20,000 a year.

So, the big question is, after 20 years, is the rule still relevant? Most planners interviewed say yes — but only as a rule of thumb, and certainly not for everyone.

"First of all, there is a misconception," says Matthew Sadowsky, director of retirement and annuities for TD Ameritrade. "It is a rule of thumb, not a law. It is often misunderstood. In its purest form, if you withdraw 4% and grow with inflation, your portfolio should not run out for 30 years. It does not mean you will not run out of money."

"It's a good general guideline," says Dan McElwee, executive vice president at CFP Ventura Wealth Management in Princeton, N.J. "It doesn't work for everyone. "They have to sit down, look at their situation, and say, 'Does this make sense?'"

"Is it still valid?" asks Sadowsky. "If you believe the future looks like the past. The less comfort or certainty you have that the future looks like the past, the less confidence you can have in the 4% rule."

Stephen DeCesare, president of DeCesare Retirement Specialists in Marlton, N.J., says he still recommends the rule. "I think it is a good starting point. It was well researched 20 years ago. And it addresses one of the most important things in retirement planning — the risk of losing out to inflation."

Still, DeCesare says, while it's good as a rule of thumb, "Each person's plan is specific. I'm still recommending it as a good starting point," he says. "It does address inflation."

A key to making the rule work, says McElwee, is that people have to be honest with

themselves. "I can't tell you how many meetings we ask clients, 'How much did you withdraw?' They say 4%. I do a calculation, and it's 7% or 8%. They bought a new car, did something for the kids. Sometimes is OK — the next year they can withdraw 2%."

"Some can do it by themselves," McElwee says. "Some need to do it with a professional. I do believe withdrawal rates need to be monitored continuously during retirement. It's not something you just set up once and not look at again."

Dan Keady, senior director of planning at TIAA-CREF, says his biggest objection is calling it a rule. And there are several things that are dramatically different today from what they were 20 years ago — primarily among them, interest rates.

"If someone was earning 1% and they withdraw 4%, it would be depleted rapidly," he says. The rule needs to be a guide. People still need to figure out their non-discretionary expenses, subtract Social Security and cover the difference by putting a portion of their assets into an annuity.

"We would say 4% is a reasonable withdrawal rate, but you should monitor values over time and course-correct based on what actually happens," Keady says. "If someone was taking 4% and their assets were depleting faster, they need to cut back. If things are going well, they can give a bigger boost. It is not a rule. It is a guidepost for people to look at."

Marcy Keckler, vice president of financial advice strategy at Ameriprise Financial, agrees that the rule is a great starting point.

"It's something you want to apply judgment to on a case-by-case basis," she says. "If someone has the good fortune of having pension income they can count on and having Social Security and potentially other sources of income, they may be in the fortunate situation where the majority of their living expenses are covered by income already coming in. They can think of withdrawals from their portfolios for fun stuff. They may be able to go higher (than 4%)."

You must also consider how the markets have performed, she says. "If you have experienced substantial losses, it may be time to dial down withdrawals. If your portfolio has performed well, it might be a year you can withdraw a little more."

The key, she says, is to tailor your withdrawals to your personal situation as well as your recent portfolio performance.

One financial expert who doesn't think the rule is still relevant is David John, senior strategic policy adviser with the AARP Public Policy Institute.

One analysis showed a fair number of times that it had failed — or when the account ran out before it was supposed to, he says.

"Like all good rules of thumb, it applies when times are good, but doesn't meet today's realities," he says. "The low-interest-rate environment we've got right now means the fixed-income (part of the portfolio) is unlikely to come anywhere close to a 4% return," he says. And, he says, stock market volatility makes it dangerous to assume that the

equity portion of your portfolio would make up the difference on a consistent basis.

He says he prefers a 3% rule, or better, watching your withdrawals and timing them to the better market returns. And he says the problem with any retirement is you don't know how long it will last.

For that reason, he says, if you have the resources, he recommends a longevity annuity, one that kicks in after a certain age.

"A longevity annuity guarantees you won't run out of money towards the end," he says.

There are exceptions to the rule, says Tim Courtney, chief investment officer at Exencial Wealth Advisors in Oklahoma City. "I would say that retiring in your 50s would lead you to begin with a withdrawal rate much lower than 4%, probably closer to 3%."