

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:

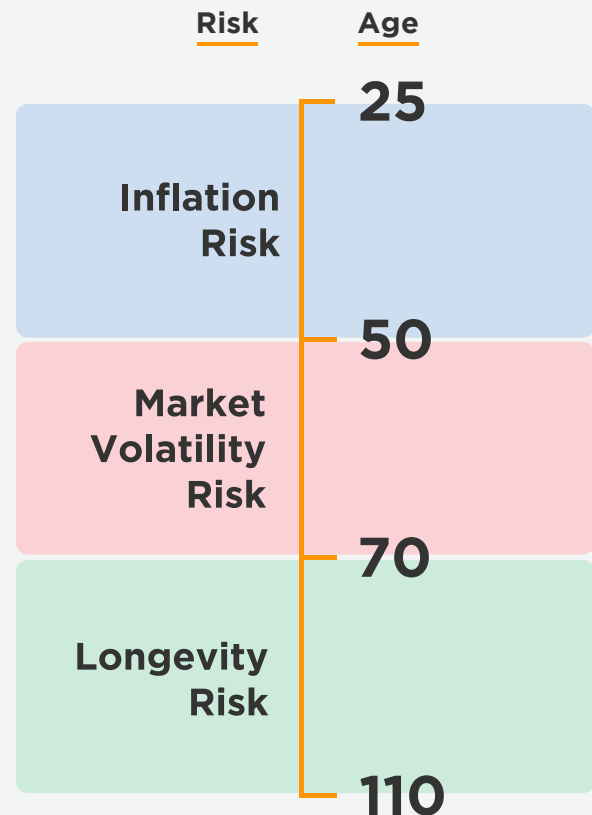
- 1 Define Social Security strategy (see article 1)**
- 2 List your fixed income like pensions, rent, royalties (see article 3)**
- 3 Supplement your fixed income through account withdrawals**

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

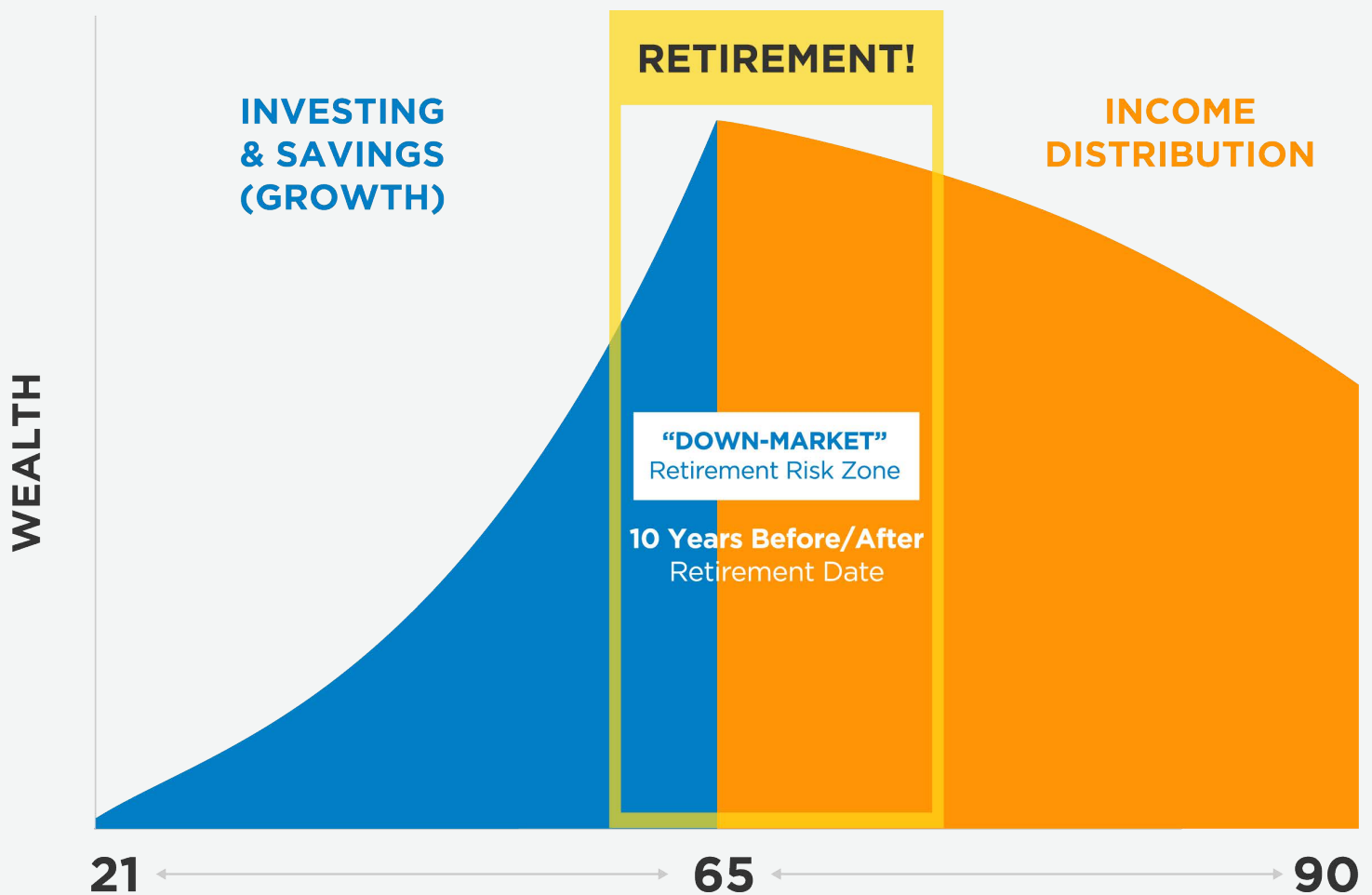
Greatest Risks by Age



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

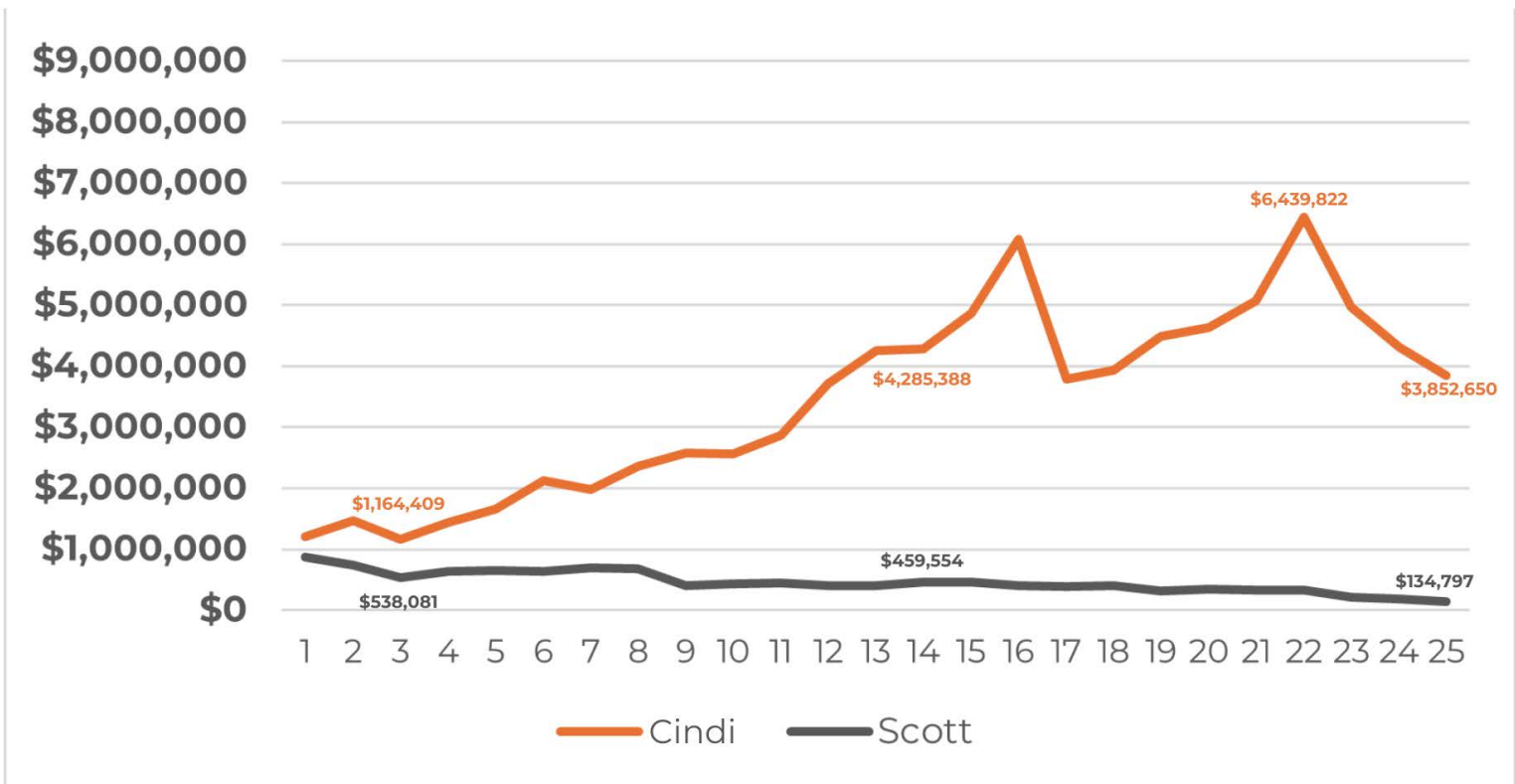


Down markets early in retirement can have a significant impact on your plan. Sample retirees Cindi and Scott begin with a \$1,000,000 portfolio. Assume each withdraws \$40,000 (4% of initial balance) at the beginning of each year. This annual withdrawal is adjusted for 2.5% inflation. Using actual total returns from the S&P 500 Index from 2000 - 2024, the average return is 9.36%, regardless of the order in which these returns occurred. You can see the dramatic impact the withdrawals would have on the ending account balance if the same market results had simply occurred in the opposite order.

Year	Scott		Cindi		Annual Withdrawal
	Actual Returns (2000 - 2024)	\$1,000,000	Reverse Order	\$1,000,000	
1	-9.10%	\$872,640	25.02%	\$1,200,192	\$40,000
2	-11.89%	\$732,758	26.29%	\$1,463,944	\$41,000
3	-22.10%	\$538,081	-18.11%	\$1,164,409	\$42,025
4	28.68%	\$636,973	28.71%	\$1,443,268	\$43,076
5	10.88%	\$657,319	18.40%	\$1,656,553	\$44,153
6	4.91%	\$642,115	31.49%	\$2,118,694	\$45,256
7	15.79%	\$689,793	-4.38%	\$1,981,539	\$46,388
8	5.49%	\$677,505	21.83%	\$2,356,182	\$47,547
9	-37.00%	\$396,124	11.96%	\$2,583,417	\$48,736
10	26.46%	\$437,766	1.38%	\$2,568,424	\$49,955
11	15.06%	\$444,779	13.69%	\$2,861,828	\$51,203
12	2.11%	\$400,573	32.39%	\$3,719,292	\$52,483
13	16.00%	\$402,262	16.00%	\$4,251,975	\$53,796
14	32.39%	\$459,554	2.11%	\$4,285,388	\$55,140
15	13.69%	\$458,211	15.06%	\$4,865,737	\$56,519
16	1.38%	\$405,803	26.46%	\$6,079,950	\$57,932
17	11.96%	\$387,855	-37.00%	\$3,792,959	\$59,380
18	21.83%	\$398,372	5.49%	\$3,936,986	\$60,865
19	-4.38%	\$321,269	15.79%	\$4,486,399	\$62,386
20	31.49%	\$338,354	4.91%	\$4,639,596	\$63,946
21	18.40%	\$323,007	10.88%	\$5,071,708	\$65,545
22	28.71%	\$329,270	28.68%	\$6,439,822	\$67,183
23	-18.11%	\$213,248	-22.10%	\$4,962,977	\$68,863
24	26.29%	\$180,170	-11.89%	\$4,310,688	\$70,584
25	25.02%	\$134,797	-9.10%	\$3,852,650	\$72,349
Average:	9.36%		9.36%		

Sequence of Returns Matters

Notice how different the portfolio balances are, after 25 years of retirement, in the following chart.



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 any 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.

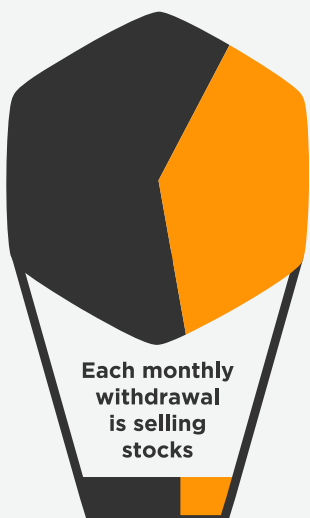


Avoid the Head-in-Sand Approach

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.

Even retirees with well-diversified portfolios of stocks and bonds often make the mistake of withdrawing proportionally from all their investments. Most people don't realize they have this head-in-the-sand withdrawal 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 sell stocks at a loss and increase the risk of running out of money.

Withdrawing proportionately across all funds 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.

