TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Monthly Perspectives From The Daley Group Wealth Management

Retirement Withdrawals: The Four Percent Rule Revisited

How much can I spend in retirement so that I don't outlast my money? This is one of the more common questions we hear as we help clients to plan ahead.

This question also spawned the birth of the "four percent rule," which has become a commonly-used guideline within financial planning circles. It is a simple way to think about retirement withdrawals. Adding all of your investments, you can withdraw four percent of the total during the first year of retirement. In subsequent years, you adjust this amount for inflation. This provides a good proxy for not outliving your money, assuming a 30-year retirement.

Where Did the Four Percent Rule Come From?

The "rule" has been around since 1994 when rocket-scientist-turned-financial-advisor Bill Bengen took on the task of determining a safe withdrawal rate to protect investors from running short of funds in retirement. Bengen's model assumed that there would be no severe market downturns and the investor would rely upon a predictable, steady stream of income. Here are some of his original findings:[1]

- The "absolutely safe" withdrawal rate based on historical market returns was three percent. A portfolio would never be fully drawn down in less than 50 years.
- A four percent withdrawal rate was considered safe as it never resulted in a portfolio being exhausted in less than 33 years.
- The "worst-case" for a 4.25 percent withdrawal rate was a portfolio that lasted 28 years.
- While the model was based on a 50/50 stock/bond portfolio, Bengen suggested allocating a greater proportion to equities, between 50 and 75 percent.

Of course, like most generalizations, Bengen's simple rule of thumb might not fit every investor's situation. After all, retirement spending isn't necessarily constant from year to year. Some retirees have greater expenditures earlier in retirement as they opt to enjoy their healthy years travelling the world or enjoying other costly pursuits; others may be confronted with high healthcare or caregiving expenditures as they age.

The rule was also based on a suggested portfolio composition and historical returns that were relevant in 1994. Things looked a lot different back then. Treasury yields hovered around 8 percent; today, they are closer to 2 percent. Historical inflation at that time was around 5.7 percent for the previous 25 years; today, the 25-year rate averages around 2.2 percent (see chart).

Chart: A Lot Has Changed Since 1994...

	1994	2021
10-Year Govt. of Canada Marketable Bonds Rate (A)	8.63%	1.90%
25-Year Historical Rate of Inflation (B)	5.7%	2.2%
5-Year Avg. Residential Mortgage Rate (C)	7.89%	3.26%
Cost of 1L Whole Milk (D)	$1.36	$1.51
Cost of Eggs (doz. lg.) (E)	$1.49	$3.77
Price of Gas (reg. unleaded)/L (F)	$0.52	$1.25

A: Bank of Canada; www150.statcan.gc.ca/n1/pub/11-210-x/2010000/t098-eng.htm (v122487); B: awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/; C: Bank of Canada; www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3410014501; D: fraserinstitute.org/sites/default/files/PerfectFoodinaPerfectMess.pdf; E: archive.macleans.ca/article/1994/1/24/the-cost-of-feeding-canada; D, E, F: www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000201; F: www150.statcan.gc.ca/n1/pub/57-601-x/2010004/t182-eng.htm

The Rule, Revisited for Today

Given that much has changed over 27 years, you may wonder if the rule has also changed. According to Bengen — yes — and his conclusion may be surprising. He recently suggested that if he were to update the model, he would actually recommend a higher withdrawal rate: "5.25 or even 5.5 percent, which is going to enrage people even more because it's higher...but that's what history has demonstrated."[2]

Planning Ahead

Having this rule of thumb can be helpful to act as a general guide. However, one of our main roles is to support the planning process to account for your particular circumstances and to make course adjustments as life transpires. If you would like to discuss your retirement income plan in greater depth, please don't hesitate to call.

1. retailinvestor.org/pdf/Bengen1.pdf; 2. awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/

The Daley Group Wealth Management — TD Wealth Private Investment Advice
5140 Yonge Street, Suite 1600, North York, ON M2N 6L7
www.thedaleygroup.ca

Kevin Daley, CIM®, FCSI®
Senior Portfolio Manager
Senior Investment Advisor
416 221 4999
Kevin.Daley@td.com

Gerson D'Souza, CIM®, FCSI®
Portfolio Manager
Senior Investment Advisor
416 512 1106
Gerson.Dsouza@td.com