What's Happening to Withdrawal Rates

By Jonathan Guyton, CFP®

Jonathan Guyton, CFP®, is a principal of Cornerstone Wealth Advisors, Inc. in Minneapolis, where they practice what they preach. Guyton also writes for The Wall Street Journal, *serves as a Dean of FPA Residency, and won the* Journal's *Call for Papers in 2004 for groundbreaking research exploring dynamic withdrawal policies in retirement.*

Withdrawal rates have been much in the retirement planning news during the pandemic. What's safe, what's not, and what won't be any more have all been popular topics. In this column, I'd like to share a few observations based on what I see (and don't see) in recent research and what I share with clients when they ask.

First, most retires have more money than several years ago. This is a big deal! In fact, they probably have a lot more money if their plans were centered on evidence-based withdrawal strategies and portfolio construction. Importantly, they also have more than might have been previously projected or predicted.

Consider a retiree, Sally, who retired with $1 million eight years ago (start of 2014). If she began taking out 4.0 percent, $40,000, in 2014 and annually adjusted this for inflation thereafter, she would now have about $1,390,000 had she maintained a 60–40 portfolio during this time. That's 39 percent more than eight years ago. She entered 2022, now taking out $46,700, with her withdrawal rate at only 3.4 percent after following the 4 percent rule since 2014. Retirees following flexible or dynamic withdrawal policies (with "guardrails") would have also seen similar reductions in their withdrawal rates.

The news is just as good for those about to retire, like Dick. Today, he has 20 percent to 30 percent more money than his plan might have reasonably projected five years ago based on a 60–40 allocation. This means that, based on his inflation-adjusted spending goal from five years ago, he can begin retirement with a withdrawal rate that's 20 percent to 30 percent lower than in those prior projections.

Good financial planners know that withdrawal rates (the percentages) fluctuate even if inflation-adjusted withdrawal amounts (the "real" dollars) do not. After periods of poor equity returns, withdrawal rates rise. The opposite is true after periods of strong equity returns. This is Retirement Income Planning 101. The key is that, due to this rise in portfolio values, current withdrawal rates for most retirees are significantly lower than a few years ago.

Those who say yesterday's safe withdrawal rates are no longer safe given today's low-yield environment and must now be lowered should take note:

4.0 Percent Rule Based on 60–40 Global Equity Allocation: 2014–2022

Year	Jan. 1 Value	With-drawal Amount	With-drawal Rate	Value Post-Fixed	Distri-bution Equity	Yearly Fixed *	Returns Equity **	Year-End Fixed	Values Equity	Dec. 31 Value	Portfolio Return	Inflation Rate ***	Preliminary WD Rule Application for Next Year	
2014	$1,000,000	($40,000)	4.0%	$384,000	$576,000	4.3%	8.9%	$400,512	$627,187	$1,027,699	7.1%	1.6%	Increase	($40,640)
2015	$1,027,699	($40,640)	4.0%	$394,824	$592,236	1.7%	–1.0%	$401,536	$586,116	$987,651	0.1%	0.1%	Increase	($40,681)
2016	$987,651	($40,681)	4.1%	$360,855	$586,116	1.1%	9.9%	$364,824	$644,141	$1,008,966	6.5%	1.3%	Increase	($41,209)
2017	$1,008,966	($41,209)	4.1%	$387,102	$580,654	1.9%	23.4%	$394,457	$716,720	$1,111,178	14.8%	2.1%	Increase	($42,075)
2018	$1,111,178	($42,075)	3.8%	$427,641	$641,462	0.7%	–7.7%	$430,635	$592,283	$1,022,918	–4.3%	1.9%	Increase	($42,075)
2019	$1,022,918	($42,075)	4.1%	$388,560	$592,283	6.4%	28.5%	$413,428	$761,281	$1,174,709	19.8%	2.3%	Increase	($43,043)
2020	$1,174,709	($43,043)	3.7%	$452,666	$679,000	9.1%	18.2%	$493,859	$802,351	$1,296,210	14.5%	1.4%	Increase	($43,645)
2021	$1,296,210	($43,645)	3.4%	$501,026	$751,539	–3.0%	20.7%	$485,995	$907,108	$1,393,103	11.2%	7.0%	Increase	($46,700)
2022	$1,393,103	($46,700)	3.4%	$538,561	$807,841									
		($380,068)												

Notes: * Fixed is Barclay's Intermediate U.S. Government Bond index. ** Equity is weighted 2/3 MSCI ACWI IMI index, 1/3 Russell U.S. 3000 Equity index for a ~3:1 US:Foreign equity mix. *** Inflation rate is CPI-U. No withdrawals are taken from equity assets in a year following one with a negative equity return (2016, 2019). All withdrawals are taken on Jan. 1 of each year.

they already are lower. Sally only needs to withdraw 3.4 percent of her retirement assets in the coming year for her spending to continue keeping pace with inflation. And those who say that today's new retirees like Dick can't sustainably withdraw as high a percentage as past retirees should also take note: in percentage terms, Dick doesn't need to because he has so much more money than his planning would have been reasonably projected. All is well here.

Recent events make Sally's and Dick's financial positions more secure, but we must see them in context. Since withdrawal rates fluctuate and thus invite validation, planners and clients who follow evidence-based withdrawal strategies always have three strategic choices: (1) follow their plan and keep adjusting for inflation because research says it has never failed previously; (2) follow their plan's adjustment guardrails when triggered because research says these will keep your plan on track (and the retiree feeling more empowered, by the way); or (3) determine whether or not to keep following their plan based on first making predictions of future returns.

The 4 percent rule and other static spending approaches rely on the first strategy above, while dynamic withdrawal policies (or those with some type of guardrails) rely on the second. Both approaches are right where they should be today. Withdrawal rate percentages have fallen significantly in the last decade. Both retirees and those about to be retired are in stronger financial positions than ever before.

When equity markets do decline, Sally's withdrawal rate will increase, obviously, but this time from a level that is much lower than ever before. And retirees who follow dynamic withdrawal policies will make adjustments should they hit their policy guardrails. Such adjustments are also further away than ever before.

But what of the third, prediction-based, approach? Researchers sometimes make predictions of future returns that deviate from long-term history and then analyze their impact. Without exception, these deviations are always for (much) lower future returns for equities and/or bonds. My main concern with such research is not that their predictions are rarely reevaluated. It's the implication that before you can know what to do, you must first make a prediction of the future rather than

adjusting to it in real time as it unfolds.

A recent example of such predictive research, "The State of Retirement Income," was published by Morningstar in November 2021. (Disclosure: A withdrawal strategy of which I am a co-author was modeled and evaluated in their work.) Significantly, it assumes that returns of a balanced portfolio will be over 25 percent less than their historic annual norms for each of the next 30 years. Morningstar concludes that as a result, regardless of the static or dynamic withdrawal strategy utilized, your withdrawal rate must be up to 18 percent lower than under historical return assumptions to be sustainable for 30 years at a 90 percent success rate.

Theirs is certainly not the first study to conclude similarly. In the past, such studies have essentially said to retirees, "Here's our prediction of the future and—based on that—what you're doing isn't sustainable." The conclusions, therefore, turn on the predictions they make.

Hindsight is always 20/20, but retirees who accepted such predictions and did not adjust when they proved unfounded have likely sacrificed lifestyle quality unnecessarily. No wonder Bengen's "4.3 percent rule" (with small-cap stocks) became a "3.3 percent rule" under such assumptions about future returns. That's what it takes to make this true.

However, it's by putting Morningstar's method and findings into the full context of today's conditions that I find them to be helpful and illuminating. To paraphrase their conclusion, "Withdrawals, as a percentage, need to be much lower to be confident of their sustainability throughout retirement." Well, they already are!

Even if 30-year returns are indeed over 20 percent lower for that long, things look quite good. Most important, current withdrawal rates are already at these much-reduced levels. This is highly encouraging for people like Sally and Dick. And for financial planners seeking a study to help reassure clients that they are on solid ground even if the "even if" does happen, this is it.

But what about today's abysmal interest rates and bond yields? Doesn't that change everything? For starters, Morningstar's study already shows us the impact of fixed income returns that are about one-third less than recent levels. Such returns are already baked into the study's predictions of the next 30 years.

And there's more to glean for today from research of yesteryear. In a March 2015 *Journal of Financial Planning* paper comparing various approaches to equity allocations, authors Michael Kitces and Wade Pfau—like most researchers—chose intermediate-term U.S. government securities for their fixed income allocation. They said this amongst their findings: "In all but the most favorable valuation environments, retirees should consider more defensive bond allocations; specifically, Treasury bills as opposed to longer-term bonds, because . . . stocks/bonds portfolios underperformed stocks/bills portfolios from unfavorable and moderate starting valuations."

Think about that. In all but the most undervalued markets (certainly not today's), retirement portfolios produce greater sustainability with the shortest-term fixed income holdings, which are government guaranteed to hold their value come what may, even if their average yield isn't any higher than inflation. It may be the most misunderstood aspect of asset allocation in retirement investing. Once again, we see that chasing yield does not pay.

Most remarkable, perhaps, is that none of the above conclusions are new. And none require a crystal ball—only a clear-sighted focus on the big picture and a grounding in evidence-based advice. That's nothing new for financial planning done well, either. ■