BOULDER COUNTY BUSINESS REPORT

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Plan savings, withdrawal rates for retirement

As the baby boomer generation enters retirement, or others begin to plan for retirement, a common question arises on what is a safe withdrawal rate during retirement.

The general rule of thumb is 4 percent of your initial portfolio value, adjusting the withdrawal amount each year by the rate of inflation.

For example, if you have $2 million at the beginning of retirement, you can withdraw $80,000 the first year and then adjust that amount by inflation each subsequent year. Say inflation is 3 percent the first year — your second year withdrawal amount is $80,000 multiplied by 1.03, or $82,400. Say inflation is 2 percent the next year — your third year withdrawal would be $82,400 multiplied 1.02 or $84,048 and so on.

Using this safe initial withdrawal rate, statistics say you have a 95 percent chance of your portfolio lasting 30 years with a balanced portfolio invested 60 percent in stock funds and 40 percent in bond funds.

Of course, the question then becomes: How much do you save to reach a initial retirement portfolio amount that will allow you to live comfortably with a safe withdrawal rate?

A recent paper by Wade Pfau, an associate professor at the National Graduate Institute for Policy Studies in Tokyo, attempts to answer that question. The study is featured by Dan Moisand in the April 2011 Financial Advisor Magazine.

The article states that if you saved 16.62 percent of your salary, each year for 30 years, you would accumulate enough to replace half of your salary at retirement.

Using some conservative figures, we find this to roughly be true if at 30 years old, you begin with a salary of $50,000 with average annual investment returns of 8 percent and inflation of 3 percent.

GUEST OPINION
Robert J. Pyle

At age 60, your final salary would total about $121,000 with a total portfolio value of about $1,390,000. With a 4 percent withdrawal rate, this would lead to an initial withdrawal amount of about $55,627 or about 45 percent of your final salary. Adding in Social Security, this would amount to 65 percent to 70 percent of your final salary amount to live on for 30 years.

One interesting point to come out of this example is how much you accumulate with each year of savings.

By age 35 (or five years into saving), you should accumulate an amount equal to your salary; by age 39, you should accumulate more than twice your salary. This will continue on and finally amount to an accumulation of about 12 times your salary at age 60.

We extended our analysis out to age 65 and found the numbers to be more reasonable. See Savings rate chart for results with a 16.62 percent of salary annual savings rate.

This gives you a general rule of thumb when saving for retirement and a yardstick in terms of multiples of salary needed by certain ages. The assumptions only count your savings and not any employer match, which may be available through your company retirement plan.

Unfortunately, the average savings rate in America is way less than 16.62 percent, currently hovering around 6 percent.

The above illustration is a general rule of thumb for savings and spending rates. It is never too early to start saving for retirement. We always recommend that you talk to a wealth manager regarding your personal situation.

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