

## A Comparison of Retirement Income Strategies

You're getting ready to stop working, you have a \$1 million nest egg, and you're planning for thirty years in retirement. What do you prefer—\$40,000 per year increasing at a 3.0% inflation rate, or \$50,000 per year on a straight-line basis? These are typical questions faced by thousands of retirees every day, and they represent two of the most common approaches to retirement income planning. Unfortunately, most people don't understand how different they are and don't know that they have better options.

So what will it be, \$40,000 inflation-adjusted or \$50,000 straight-line? Of course, to answer the question, some calculations are required—and at \$50,000 per year, straight-line, you would get \$1.5 million over thirty years. Whether that's reasonable or not can only be determined by comparing it with other strategies. So let's consider the alternative—\$40,000 per year going up at 3.0 percent.

Under this scenario, the \$40,000 you receive in the first year increases to \$41,200 in year two, \$42,436 in year three, and so on. In year nine it passes the \$50,000 mark, and of course, it continues to increase beyond that—growing to about \$94,262 in year thirty. Ultimately, you would get more than \$1.9 million over the entire thirty-year period—or about \$400,000 more than the straight-line, \$50,000 approach.

Despite the significant differences between them, these two strategies remain the most common approaches to retirement income planning. The \$50,000 straight-line approach represents a *product-driven* strategy, while the \$40,000 inflation-adjusted approach is more of a *process-driven* strategy.

Consider the \$50,000 straight-line model. It's a good example of a Guaranteed Minimum Withdrawal Benefit, or GMWB, within a variable annuity contract. It's *product-driven* in the sense that you have to own a variable annuity before you can take advantage of this kind of benefit—and with so many of today's GMWBs offering 5.0% withdrawal rates, you should be able to find plenty of contracts that will guarantee \$50,000 per year—or 5.0% on a \$1 million investment. When it comes to retirement income planning, this is one of the most popular approaches within the financial services industry.

Conversely, the inflation-adjusted \$40,000 option is more of a *process-driven* strategy, and is often referred to as a *sustainable withdrawal rate* approach. The *process* involves maintaining a diversified portfolio of investments throughout retirement, and then simply selling something every year to get the income you need.

The whole idea of *sustainable withdrawal rates* can be traced back to the 1990's and the work of three college professors at Trinity University in Austin, Texas. Motivated by a recognition of the significant risks associated with traditional retirement planning strategies, they set-out to establish better guidelines for older investors who may need to go after potentially higher rates of return in riskier asset classes, but who also need to be able to generate safe, steady, dependable income throughout longer and longer retirement periods. Essentially, their work led to a series

of new recommendations about how much income can be taken out of fluctuating retirement accounts.

The *Trinity Study* used historical investment data to analyze the effect of market volatility on periodic income withdrawals. Depending on the composition of the portfolio and the level of confidence required, it concluded that retirement spending should be limited to a *sustainable withdrawal rate* of about 4.0% of the initial investment. In practical terms, this means that if you want to use history as your guide, and if you plan to sell investments each year to generate the income you need, and if you want to have a reasonable chance of maintaining that income over a thirty-year retirement period, you should probably limit your withdrawals on a \$1 million portfolio to about \$40,000 per year—increasing annually with inflation. This strategy is also one of the favorites of the financial services industry.

The problem with *sustainable withdrawal rate* approaches, however, is that they require you to sell something every year. In other words, they force you to dollar-cost-average out of your retirement accounts—which is probably the worst thing you can do. Essentially, you end-up selling more shares when the markets are down, and selling fewer shares when the markets are up—which is exactly the opposite of a good investment strategy.

Fortunately there's a better way, called The Grangaard Strategy®—and a central tenant of this new approach is that you should never put yourself in the position of having to liquidate investments every year. Instead, you should give yourself the time you need to make better sales decisions throughout retirement. And that can make all the difference. The Grangaard Strategy® uses income ladders to replace your paycheck in retirement, while taking advantage of investment “holding periods” to achieve potentially higher rates of return on the growth side of your portfolio. The holding periods—ranging from five to twenty-five or even thirty years, can give you the time you need to ride-out the inevitable ups and downs in the market, while going after the more aggressive potential returns you may need to fund your income ladders and maintain your lifestyle over longer retirement periods.

Using assumptions based upon recent interest rates, historical stock market performance, and reasonable investment expenses, we can evaluate a retirement scenario using this approach, and then compare it with *sustainable withdrawal rates* and GMWBs. To do that, we'll use a fixed income return of 3.2% for the income ladders, a five-year growth-account return of 4.8%, and other growth-oriented returns as follows: 7.2% for the ten-year holding period, 8.2% for the fifteen-year holding period, 9.2% for the twenty-year holding period, and 10.2% for the twenty-five year holding period. All of these assumptions are based upon historical investment data, adjusted for estimated annual expenses of 1.8%

The good news is that this analysis results in a 5.6 % inflation-adjusted withdrawal rate over a thirty-year retirement period. Returning to our \$1 million example, that amounts to about \$56,000 per year, increasing annually at a 3.0% inflation rate. In total, it adds-up to a little over \$2,664,000. That's \$761,000, or 40.0% more than the 4.0% *sustainable withdrawal rate* approach, and \$1,164,000, or almost 78.0% more than the GMWB approach. Obviously, these are differences that most of us cannot afford to ignore.

Presented with this type of analysis, some in the financial services industry will argue that this alternative approach is more complicated, more time-consuming, and more difficult to implement—and they're probably right. It does take a little more time and effort to do it this way. *Sustainable withdrawal rate* and GMWB approaches are simpler and easier, because they're essentially just one-size-fits-all, generic approaches to retirement planning—and it takes very little effort to implement them. But at what cost to the consumer? Is it reasonable to ask someone to give up 40.0% to 75.0% of their retirement lifestyle just to make the job a little easier for the financial services industry? I don't think so. But then I also don't think many people are being asked the question in the first place—because at this point, most of them don't have any idea that there are better alternatives. But that's changing—and it's changing fast.

You can learn more about The Grangaard Strategy® approach to retirement income planning, and educational events being offered in your area, by visiting [www.TheGrangaardStrategy.com](http://www.TheGrangaardStrategy.com). Paul Grangaard can be reached at [paul@pagrangaard.com](mailto:paul@pagrangaard.com) or by telephone at 651-917-0139.

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