Are You Getting the Income You Deserve?

Most financial professionals would agree that by taking on more investment risk, you should be able to expect higher rates of return—and that those higher rates of return should ultimately lead to more income in retirement. Unfortunately, many advisors are recommending strategies that don't seem to conform to these well-known expectations, and the financial services industry will have a lot of explaining to do when America's retirees wake up and find out they've been advised to shoulder equity-level risks while being told to expect fixed-income-quality lifestyles.

Consider the two most common approaches to retirement planning—the "Trinity Study" approach and Monte Carlo simulation. Both techniques assume a significant allocation to equities throughout retirement, and both rely on historical investment data to develop future planning expectations. Trinity Study models use actual historical returns. Monte Carlo simulation uses randomly generated returns based on the same historical data, and both rely on the concept of *sustainable withdrawal rates* to answer the two big questions in retirement planning—"how much income can I get from my portfolio?" and "how much capital will it take to get the income I want?" The answers they provide are troubling at best.

Sustainable withdrawal rates are simply the percent of a portfolio that can be withdrawn on an annual basis over a given period of time, without an unacceptably high risk of running out of money too soon. Monte Carlo approaches often result in recommended withdrawal rates between 3.0 and 4.0 percent, while Trinity Study approaches usually come in around 4.0 percent or perhaps a little better. Not surprisingly, the most common rule of thumb tends to hover around 4.0 percent. That's only $40,000 per year on a $1 million retirement portfolio—and of course, for many retirees, that just won't cut it.

Here's the issue. Many of us are willing to deal with the additional risks associated with investing some of our retirement assets in the stock market—but we're presumably doing so in order to earn higher rates of return. Our interest in pursuing higher rates of return, it would seem, is most likely driven by our need or desire for better lifestyles in retirement. And yet, the financial services industry continues to promote 4.0 percent *sustainable withdrawal rate* approaches that lead to anything but.

So—why is the 4.0 percent benchmark too low? Because—we can often do that well with a portfolio consisting of nothing but U.S. Treasury Securities. Consider recent interest rates. Not long ago, you could have assumed a 4.5 percent rate of return for U.S. Treasuries of virtually any maturity. To replace your paycheck after you stopped working, you could have planned to create sequential five-year income accounts using laddered, interest-bearing obligations—allowing you to spend principal and interest on a scheduled basis over each future five-year period. In the mean time, you could have funded a series of growth-oriented accounts with portfolios made up entirely of zero-coupon U.S. Treasury Bonds—each of which would have been used to fund one of the future "income ladders." A portfolio constructed this way, using 4.5 percent return assumptions across the board, would generate a *sustainable withdrawal rate* of 4.1 percent—without investing in any risky assets at all. In other words, you could have gotten about the same amount of income using a risk-free retirement portfolio—guaranteed by the U.S. Government, without taking on any of the stock market risks associated with either the Trinity Study or Monte

Carlo strategies. So—why would you put any of your retirement assets at risk in the stock market if you were happy with a 4.0 percent *sustainable withdrawal rate*. It just doesn't make any sense.

You might wonder why Trinity Study and Monte Carlo approaches tend to result in such low withdrawal rates, even while assuming significant exposure to the stock market? The answer is—because they assume that you will be dollar-cost-averaging out of your retirement accounts. In other words, they both assume that you will sell investments every year to get the money you need to live on in retirement. Of course, if you sell something every year—which, in essence, means that you will be dollar-cost-averaging out of your investment accounts, you will be forced to sell more shares when the markets are down, and fewer shares when the markets are up, to get the money you need to live on. And this is exactly the opposite of what you should be doing in retirement. It's never a good idea to put yourselves in the position of having to sell investments every year, when you know for sure that they will be going up and down like the stock market always does. But Trinity Study and Monte Carlo approaches assume that you will do just that—and, as a result, are forced to recommend withdrawal rates low enough to protect you against this bad advice.

So, instead of telling us to avoid the dangers associated with dollar-cost-average out of the markets like they should, the financial services industry has simply embraced the problem—and try to mitigate the damage by using Trinity Study and Monte Carlo analyses to justify lower *sustainable withdrawal rates*. As a consequence, we're all being asked to accept considerably less income in retirement than we should actually be able to get, in order to offset the significant risks that come with selling too frequently out of fluctuating accounts—which the financial services industry should be advising us **not** to do in the first place.

If they don't start helping us get the income we deserve, based upon the risks that many of us are willing (or being forced) to take, the financial services industry is going to lose whatever credibility it still has with today's retirees. Let's face it, lower withdrawal rates are much better for the industry than they are for us. Trinity Study and Monte Carlo approaches are easy to implement, they demand very little advisor training, and they require minimal ongoing portfolio management. Essentially, they are just one-size-fits-all approaches to retirement income planning—and it doesn't take a rocket scientist to see why they would be appealing to the industry. But at what cost to you? How much income should you give up, to protect the financial services industry and make your advisors life a lot easier?

There is one other thing that too few people understand. Both Trinity Study and Monte Carlo approaches tend to result in large residual account balances. In other words, in most instances, retirees will have a lot of money left over at the end of their lives. It's just the way things tend to work out when you're only taking 4.0 percent *sustainable withdrawal rates* out of retirement accounts that are significantly invested in equities. So, when common sense tells you that your retirement assets may be decreasing gradually over time—as you spend some of your principle to support a better lifestyle, they will, most likely, be growing quite substantially. Of course, that's definitely good for the financial services industry—and maybe even for your heirs, but it's probably not so good for you.

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. Paul Grangaard can be reached at paul@pagrangaard.com or by telephone at 651-917-0139.