

## RETIREES



COMMENTARY  
by Christine Benz

# Blueprint for the future

Helping you meet the challenge of retirement

The financial challenges are stacking up for retirees and retiree wannabes. First, there's a good news/bad news story: The length of the typical retirement for U.S. citizens has been on the rise over the past several decades, from just 10 years in 1940 to 18 years in 2000. Meanwhile, the average number of years worked has declined from 50 in 1940 to 42 in 2000.

That means more of us have more free time to pursue what we love later in life, whether that's travel, spending time with grandkids or kicking back with a good book.

But the shrinking ratio of working years to years spent in retirement also heightens the need to save more for retirement, as well as to get more mileage out of what we manage to save.

Further compounding the financial challenges of retirement is the ebbing of pensions, especially in the private sector. In 2011, just 3 percent of private-sector workers were covered exclusively by a pension (as opposed to some other type of company retirement plan), according to data provided by the Employee Benefit Research Institute, down from 31 percent in the late 1970s.

Yet participation in 401(k) and other defined-contribution plans hasn't fully picked up the slack: Fidelity Investments, one of the largest 401(k) providers, recently reported that the average 401(k) balance was \$91,000.

As you might expect, the average 401(k) balances for older participants were higher, and retirement savers may have other retirement assets stashed elsewhere. But it's still safe to say that the typical American hasn't saved nearly enough for retirement.

Add in barely positive CD yields and a profitable — though volatile — stock market, and it's not too hard to see why 77 percent of respondents in a 2010 Allianz survey said they were more worried about running out of money than they were of dying.

Creating a successful financial plan for retirement needn't be a black hole of worry, though. Rest assured that wherever you are in the process — whether you're a 20-something who has just begun to contribute to a 401(k) or you're already retired and drawing living expenses from your portfolio — you can still take steps to improve the viability of your plan.

Helping you do that is the focus of this special retirement-planning supplement on in the next 12 pages, created by Morningstar, Inc.

Since its founding in 1984, Morningstar's overarching mission has been to help investors reach their financial goals. As director of personal finance for Morningstar and editor of this supplement, I've culled research from Morningstar's internal retirement and investment experts as well as outside researchers. I also drew heavily from some of my own work, which appears several times of week on Morningstar.com, Morningstar's website for individual investors. I've aimed to include practical, easy-to-implement ideas for retirement planning across life stages.

No matter your life stage or level of investment acumen, I'm confident you can find strategies in this supplement that you'll be able to take and run with.

Christine Benz is director of personal finance for Morningstar and senior columnist for Morningstar.com. She contributes several articles and videos to the website each week, focusing primarily on retirement planning and investment-portfolio strategies.



## RETIREMENT-PORTFOLIO WITHDRAWAL MISTAKES TO AVOID

BY CHRISTINE BENZ

Some errors in retirement-portfolio planning fall into the category of minor infractions rather than major missteps. Did you downplay foreign stocks versus standard advice about how to put together a portfolio, or hold a bit more cash than you needed? It's probably not going to have a big impact on whether your money lasts throughout your retirement years.

But other errors can have more serious repercussions for the viability of retirement-portfolio plans.

Withdrawal rates — or spending rates, as I prefer — are another spot where retiree-portfolio plans can go badly awry. If a retiree takes too much out of his or her portfolio at the outset of retirement — and, worse yet, that overspending coincides with a difficult market environment — he or she can deal his or her portfolio a blow from which it may never recover. Other retirees may take far less than they actually could, all in the name of safety. While their children and grandchildren may thank them for all they left behind, the risk is that they didn't fully enjoy enough of their money during their lifetimes.

Here are a few common mistakes in the realm of retirement-portfolio withdrawals, as well as tips on how to avoid them.

### MISTAKE 1: Not adjusting with portfolio's value and market conditions

Some of the most important research in retirement-portfolio planning over the past decade has come in the realm of withdrawal rates. One of the conclusions of all of this research? Even though the popular "4 percent rule" assumes that a retiree withdraws 4 percent of his or her portfolio at the outset of retirement, then gradually adjusts that amount for inflation, retirees would be better off staying flexible about their withdrawals. That means they should withdraw less when the markets and their investments are down, while potentially taking more when the market and their portfolios are up.

**What to do instead:** The simplest way to tether your withdrawal rate to your portfolio's performance is to withdraw a fixed percentage, versus a fixed dollar amount adjusted for inflation, year in and year out. That's intuitively appealing, but this approach may lead to more radical swings in spending than is desirable for many retirees. It's possible to find a more comfortable middle ground by using a fixed percentage rate as a baseline but bounding those withdrawals with a "ceiling" and a "floor." A qualified financial advisor can help you determine if your withdrawal strategy is reasonable given the amount of assets that you have.

### MISTAKE 2: Not building in a "fudge factor"

Another drawback to employing a fixed-dollar withdrawal method — especially if the viability of your plan revolves around a fixed annual dollar amount that's too low — is that it won't account for the fact that your actual expenses are likely to vary from one year to the next. Try as you might to anticipate them, discretionary expenditures like travel, new car purchases or unplanned outlays for home repairs or medical expenses have the potential to throw your planned withdrawal rate off track.

If you calibrate your anticipated spending based on your basic monthly outlay alone (for groceries and utilities, your property-tax bill, and so forth) and don't leave room for these periodic unplanned expenses, your actual spending rate in most years is apt to run higher than your planned outlay. In short, a withdrawal plan that looked sustainable on paper actually may not be.

**What to do instead:** Smart retirement planning means forecasting not just your regular budget items but those lumpy outlays, too. In addition to building those extraneous items into your budget, it's also wise to add a "fudge factor" in case those unplanned outlays exceed your forecasts. Armed with that more-accurate depiction of your anticipated spending, you can then test the viability of your withdrawal rate.

### MISTAKE 3: Not adjusting with your time horizon

Taking a fixed amount from a portfolio — whether you're using a fixed dollar amount or a fixed percentage rate — also neglects the fact that, as you age, you can safely take more from your portfolio than you could when you were younger. (That assumes, of course, that you're planning to spend most of your portfolio and are not planning to leave behind large sums for your heirs or for charity.) The original "4 percent" research assumed a 30-year time horizon, but retirees with shorter time horizons (life expectancies of 10 to 15 years can reasonably take higher amounts).

**What to do instead:** To help factor in the role of life expectancy, David Blanchett, Morningstar Investment Management's head of retirement research, has suggested that retirees can use the IRS' tables for required minimum distributions as a starting point to inform their withdrawal rates. That said, those distribution rates may be too high for people who believe their life expectancy will be longer than average.

### MISTAKE 4: Not adjusting based on your portfolio mix

Many retirees take withdrawal-rate guidance, such as the 4 percent guideline, and run with it, without stopping to assess whether their situations fit with the profile underpinning that

guidance. The 4 percent guideline, for example, assumed a retiree had a balanced stock/bond portfolio. But retirees with more-conservative portfolio mixes should use a more-conservative (lower) figure, whereas those with more-aggressive asset allocations might reasonably take a higher amount.

**What to do instead:** Be sure to customize your withdrawal rate based on your own factors, including your portfolio mix. Here again, a financial advisor can help you create a customized spending target based on your mix of investments.

### MISTAKE 5: Not factoring in the role of taxes

The money you've saved in tax-deferred retirement-savings vehicles might look comfortably plump. However, it's important to factor in the role of taxes when determining your take-home withdrawals from those accounts.

**What to do instead:** Here's another area where it pays to be conservative in your planning assumptions; to be safe, it's valuable to assume a higher tax rate than you might actually end up paying. Pre-retirees and retirees may also benefit from consulting with a tax advisor or a tax-savvy financial advisor to help stay within the lowest possible tax bracket throughout their retirement years; such advisors may also be able to help retirees optimize their sequence of withdrawals from various account types to keep tax bills down.

### MISTAKE 6: Staying wedded to your portfolio's income payout

Many retirees operate with the assumption that they can spend whatever income distributions their portfolios kick off — no more, no less. As yields on safe securities like CDs and short-term bonds have shrunk over the past several decades, they've had to make do with less or have ventured into higher-yielding securities with higher risk. They assume that as long as they spend only their portfolio's income distributions, their retirement plans will always be safe.

However, the distinction between income distributions and principal withdrawals is an artificial one.

**What to do instead:** While there's no one single "right" way to manage a portfolio to deliver your spending needs in retirement, it's wise to have a plan. Will your withdrawal come from income distributions, periodic withdrawals of capital (through selling highly appreciated securities like stocks, for example) or a combination of the two? The method that Morningstar favors is building a portfolio with an emphasis on long-term total return; retirees can then see how far any income distributions from that portfolio take them, and then use proceeds from rebalancing their portfolios to help make up for the rest.