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How to Adopt a Retirement Distribution Mindset

Switching from a savings mentality during your working years to a spending one in retirement takes a good plan. Here are some strategies for positioning your savings to safely and comfortably support your retirement lifestyle.

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The moment is arriving: After decades of sweating and saving, you're about to retire and glide off into a golden sunset. No more dealing with the boss's temper tantrums, catching the 7 a.m. train into the city or ironing those white shirts on Sunday night.

If it were only that easy to switch your mindset from accumulating savings for retirement to distributing those savings so you can pay your bills for the next 30 or 35 years. If you're like most soon-to-retirees, you've been diligent about saving. You got good advice and implemented it.

However, now that the day is rapidly approaching when those savings need to be turned into ongoing income, you probably have little idea about how to go about doing that.

You're learning the lesson that all retirees must learn: **A retirement savings account is not a retirement plan.** That retirement account will not magically transform itself into the income that you need to pay your bills once you aren't getting a paycheck anymore.

You also need to deal with myths and beliefs about retirement that may get in your way as you consider how best to transform your retirement savings into reliable income. For example, the same stock market that has provided the gains that are allowing you to retire can also turn on you when you least expect it.

When you are working, a correction or bear market isn't fun, but it's not a huge deal either, because you have a paycheck. You can benefit from buying stocks at a lower price and seeing them appreciate and you also have time to wait until the market recovers.

None of these things is true in retirement. So let's dive into four strategies that can help you make a seamless transition from saving while working to spending income from your portfolio in retirement.

Strategy #1: Dump the 4% rule

You've probably heard of the 4% rule and may be subconsciously counting on it to provide income in retirement. To refresh your memory, the 4% rule or standard calls for retirees to withdraw 4% of their savings each year during retirement to provide sufficient income to avoid running out of money in retirement.

Popularized by financial planner William Bengen in 1994, this standard unfortunately **doesn't work for many retirees**. In my practice, I've found that applying this rule would mean that many retirees would run out of money even if they have other sources of money besides savings and Social Security.

That's because market fluctuations and individual retirement objectives don't fit in with a one-size-fits-all standard such as the 4% rule. When you think about it, you can see why. Figure 1 provides a couple of examples of how it might work.

Figure 1: 4% Rule

Retirement Savings	Withdrawal Rate	Annual Income
$500,000	4%	$20,000
$750,000	4%	$30,000
$1,000,000	4%	$40,000

The 4% rule assumes that the market will stay stable over an entire retirement. There's no way that's going to happen. Consider the havoc the market could have wreaked if you retired in 2007 while following the 4% rule as seen in Figure 2. This assumes a $500,000 portfolio invested in the S&P 500 from 2007 to 2011.

Figure 2: Example of 4% withdrawal rate from 2005 to 2010

Year	Retirement Savings	Market Return	Annual Income
2007	$500,000	5.49%	$20,000.00
2008	$527,450	-37.00%	$21,098.00
2009	$332,293.50	26.48%	$13,291.74
2010	$420,284.81	15.08%	$16,811.40
2011	$483,663.76	2.11%	$19,346.55

You can see the problems with this method in a down market. First of all, you can't count on a certain amount of income each year, which makes it difficult, if not impossible, to be sure that you can pay all of your bills. Second, when your portfolio takes a hit in a bear market, it takes a long time to recover. And this occurs while you still need to take income out of it, depleting the principal even further.

An alternative rule is the “Endowment Method.” With this more flexible strategy, 3% to 5% of your portfolios value is withdrawn per year so your retirement income is adjusted up or down to reflect gains or losses. Your income will vary depending on the market performance of the account.

Strategy #2: Reassess your risk tolerance

As I noted, it’s easy to have a high risk tolerance when you’re employed and getting a steady paycheck. Time is on your side — you can ride out any market volatility. You can even benefit from it, because you are buying assets at a lower prices and benefiting when they go up in value.

However, the opposite happens in retirement, and it can be devastating. Regardless of what the market is doing, if you leave your savings heavily invested in the market, you will have to withdraw money to provide income. If that happens during an extended bear market, it could damage your ability to extract income from your portfolio for the rest of retirement.

The best way to deal with this is to reassess your risk tolerance as you enter retirement and position your assets for distribution. It’s only prudent to realize that you’ve got to be more careful in retirement because the savings you have must last for an unknown number of years.

My rule of thumb is to subtract your age from 100 and use that as a benchmark for how much to keep invested in the stock market. If you’re 65, that would mean keeping 35% of your assets in the stock market. That provides exposure to the stock market but won’t devastate your retirement distribution plan if the market experiences an extended downturn.

Strategy #3: Consider guaranteed income strategies

Guaranteed income strategies can provide stability when used as part of a retirement distribution plan. Fixed index annuities are one of the products I use in retirement portfolios because they provide guaranteed income* while also allowing access to the principal for withdrawals if necessary. Of course, keep in mind that annuities can have high surrender fees, so they aren’t liquid investments. That means that once you buy an annuity, you must pay a surrender fee that could be as high as 10% to get your money back out if you need it within the early stages of an annuity contract.

Buying an annuity with a certain part of your principal protects those funds from market volatility and provides the certainty of receiving income throughout your retirement. The insurance company that issues the annuity takes on the risk of investing the money and in exchange, you receive a certain amount of monthly income, depending on how much you invest.

Strategy #4: Create a distribution plan

As I mentioned earlier, a retirement account isn’t a retirement plan, and it definitely isn’t a retirement distribution plan. A retirement distribution plan looks at your retirement investments through the perspective of the income you need to support your lifestyle in retirement, along with other sources of income.

Let’s say you possess retirement assets with your spouse of $750,000, plus monthly Social Security income of $4,500, plus a small pension of $1,000 a month. If you need $8,500 of income a month, adjusted for inflation, you’ll need to generate $3,000 a month of income from your investment portfolio to close the gap between your $5,500 worth of Social Security and pension income and the income you need each month.

You might then purchase an annuity using half of your retirement savings — $375,000 — that could generate half of what you need monthly, or $1,500. Then the rest of that retirement savings could be invested in a combination of stocks and bonds that would offer some growth and income.

Under that scenario, you would need to withdraw $18,000 a year to achieve the remaining income need of $1,500 a month. That's much more doable and less risky because you have constructed a three-leg stool and diversified your portfolio among risk assets such as stocks and bonds and assets that offer guaranteed income.

Creating a distribution plan that aligns your need for income with the actual income that you can reliably and safely obtain from your portfolio positions you for an enjoyable retirement that avoids the worrisome possibility of running out of money.

Written in collaboration with Amy Buttell.

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David Afraimi is a highly energetic financial professional who appreciates the opportunity and unique challenge of working with a variety of clients in order to help them meet and exceed their financial and retirement objectives. David's certifications and licensing include the Series 7, 66, 24, Life & Health, Long-Term Care, and The National Social Security Advisor Certification.

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