Does the 4% Withdrawal Rule Still Apply?

Even before the recent market decline, advisors were questioning the retirement strategy.

By **Kate Stalter**, Contributor   May 13, 2020, at 2:15 p.m.

The 4% rule was developed in the 1990s to help retirees avoid the risk of outliving their money.**(TETRA IMAGES/GETTY IMAGES)**

ON ITS FACE, THE "4% rule" is pretty straightforward: Retirees withdraw 4% of their portfolio value every year and avoid the risk of outliving their money.

The rule is based on academic research of investment returns over several decades and incorporates annualized returns, compounding and dividends. Investors can also adapt their withdrawals to account for inflation.

But are there problems with that rule, which was developed in the 1990s. Does it still hold true, even in today's market, which has undergone several steep downturns in the

past 26 years? Does it account for various investing styles or just a "buy and hold" approach?

An Outdated Approach

"We have never felt that the standard 4% withdrawal rule was particularly relevant," says Jill Fopiano, president and CEO at O'Brien Wealth Partners in Boston.

"Each person's situation is unique in terms of their assets, income and expenses, never mind their life expectancy and goals," she says. "Layer different market environments on top of this, and it's overly simplistic to calculate one percentage that applies to everyone. You're far better off having a cash flow plan that factors in your own specific information."

Retirees Living Longer

Many Americans go into retirement without any sense of how long their money will last and how much they can safely spend. In theory, a financial plan spells out a withdrawal strategy that will make the money last as long as possible. The 4% rule doesn't necessarily apply in every situation.

"The idea behind the 4% rule does still make sense, although that rate is likely a little lower now," says Brandon Renfro, a financial planner and assistant professor of finance at East Texas Baptist University.

"We will only know in hindsight. The thing to remember about the 4% rule is that the withdrawal rate was determined to work even in the worst-case historical scenario for a 30-year retirement," he adds.

For today's retirees, who may live longer than prior generations, the 4% rule may have to be adapted.

"We are in a worst-case scenario now with a poor market and historically low interest rates," Renfro says. "However, the depth and duration of those conditions are unknown. If we have a strong market rebound over the next few years, it could more than make up for the loss now. If the market is in a slump for several years then it will drag withdrawal rates down with it."

Renfro recommends opting for a lower withdrawal rate, perhaps starting with 3%, and remaining flexible if you recently retired or plan to soon.

"Although the original 4% rule was only adjusted for inflation, more recent research has shown that a variable withdrawal rate can dramatically improve retirement outcomes. Reevaluate your withdrawal each year and adjust if you need to," he says.

Before the recent market downturn, advisors counseled clients to work longer, if possible, to help offset retirement account shortfalls. For today's generation of pre- or new retirees, those shortfalls are often due to a lack of savings and investments, rather than market performance.

Not only does the current market downturn cause problems for those with meager savings, but job losses and pay cuts exacerbate the situation.

The uncertainty puts retirement in more peril than ever for many workers," says Robert Johnson, professor of finance at Creighton University's Heider College of Business in Omaha, Nebraska.

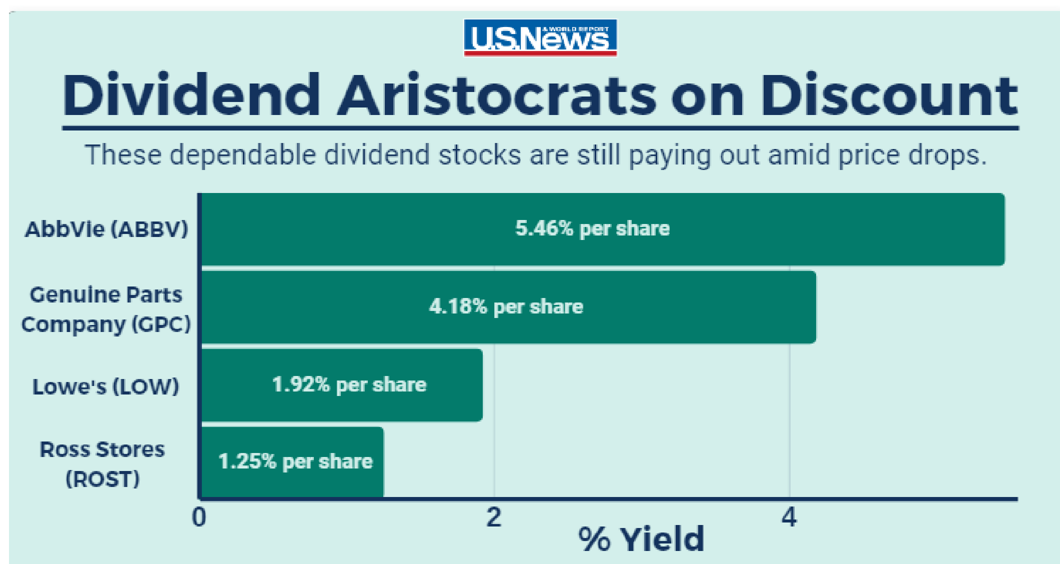
"Not only have preretirees seen a significant hit to retirement plan balances, but some have lost their jobs and, for many, their jobs are in peril," Johnson says.

He adds that companies are suspending 401(k) matches as well, citing Amtrak and Marriott International (ticker: MAR) as examples.

"While 'work longer' is always the first alternative in shoring up a retirement nest egg, that may not be an alternative for many individuals," he says. If you haven't accumulated enough money by retirement age, he explains you're left with two options: "Work longer or settle for a lower standard of living in retirement."

Portfolio Impact: Dividend Cuts

Johnson says another problem for retirees is dividend cuts. "In the low interest rate environment we have been in, many retirees have been moving from bonds to dividend-paying stocks to hit their yield target," he says.



Boeing (BA), Ford (F), General Motors (GM), Las Vegas Sands (LVS) and Schlumberger (SLB) are among the companies that are slashing or eliminating dividends. While many investors focus on price appreciation, dividends play a significant role in total market return. For example, in 2019, S&P 500 companies paid, in aggregate, $485 billion in dividends. But this year's dividend cuts change that calculation.

"In other words, one has to be careful when relying on dividends to supplement income in retirement," Johnson says.

Where does that leave people who hope to retire soon or those who recently retired?

"Working longer is the best way to get a retirement plan back on track. It allows for more savings, more years of investment growth, a shorter subsequent retirement to fund and a larger Social Security benefit," says Wade Pfau, co-director of the New York Life Center for Retirement Income at The American College of Financial Services, headquartered in King of Prussia, Pennsylvania.

"That being said, this can be insensitive advice for many people experiencing an involuntary job loss who may be forced into early retirement," Pfau says.

Historically Low Interest Rates

Pfau believes the traditional 4% withdrawal rate is under more strain than ever, and historically low interest rates are a contributing factor.

Pfau says investors hoping to shore up their retirement might consider an annuity, which provides a guaranteed income stream.

"Annuities pool longevity risk and can also pool market risk. This can allow for a higher spending rate than investments can provide for those who are worried about the possibility of outliving their assets in retirement," he says. "Annuities can support retirement spending goals with less assets than investments, which can help to keep a retirement on track."

Fopiano says investors need to understand exactly what they are buying if they opt for an annuity. She says the current low interest rate environment should be factored into any decision.

"While the guaranteed income of an annuity can seem tempting at times like these, it is important to understand that they are often complex investment vehicles with high fees and lock-up periods," she says. "The environment for fixed annuities, which tend to be the most straightforward, is not attractive right now due to extremely low interest rates. With any type of variable annuity, it's critical to read the fine print and understand all of the terms, riders and costs."

Whether it's purchasing an annuity or pursuing some other strategy, the downturn is causing many investors to change course. That can be either a good or bad idea, depending on how an investor approaches the situation.

Pfau, who writes extensively about retirement strategies for various publications, received a comment from a reader who claimed to be a "buy and hold" investor.

"Then in the next breath, they said that they had moved entirely to cash," he says. "This person is still far from their anticipated retirement date. But I found that to be an interesting juxtaposition. It is hard to stay the course."

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