



A More Nuanced 4% Rule?

In December 2022, Morningstar adjusted its recommended starting annual withdrawal rate for balanced retirement portfolios upward from 3.3% to 3.8%. The revision was based on an assessment of factors including recent equity valuations, bond yields and inflation. This new rate, however, is still less than the 4% figure commonly cited in financial planning literature.

The Backstory

The 4% “rule” was designed to provide a high degree of confidence that (with inflation adjustments) a balanced portfolio would last at least 30 years. It was developed in the 1990s by financial planner William Bengen, based on historical market returns and economic conditions, and published in a paper: [Determining Withdrawal Rates Using Historical Data](#) (link below). Since that time, the strategy has come under increased scrutiny with longer lifespans, volatile market returns — and changes in the interest rate environment. It’s also noteworthy that the model didn’t take management fees into account.



A More Individualized Approach

Even with Morningstar’s appreciable .5% increase (and even if the guidance preserves assets over the course of 30 years), retirees may still find themselves under financial pressure due to account balances that have depreciated by more than 20% over the past year in some instances. To illustrate, a first-year withdrawal of 3.3% from a \$500,000 nest egg would provide \$16,500 in income, while 3.8% of \$400,000 (portfolio amount after a 20% loss) reduces that figure to \$15,200 — less income at a time when goods and services cost significantly more than they did 12 months ago.

Back testing has determined the 4% rule would have prevented retirees from exhausting their funds over the course of 30-year periods that included the Great Depression and the Great Recession. Nonetheless, Bengen has on occasion increased and decreased his recommended withdrawal rate (and asset allocation) due to more recent economic conditions. It stands to reason that a more dynamic and individualized approach — accounting for market performance, inflation, asset allocation, sequence of returns risks and investors’ specific circumstances — can help optimize withdrawal strategies to meet retirees’ needs.



How Plan Sponsors Can Help

Employers can provide retirement income planning education in a variety of formats and aimed at varying levels of financial literacy. Additionally, they can host group educational sessions for near-term retirees and encourage them to meet with their advisor during this critical time to tailor their retirement withdrawal strategies to current market conditions and their specific situation.

Even in a changing and often volatile financial landscape, plan sponsors can help participants better prepare for uncertainties that lie in their path. The foundation of this preparedness is robust financial wellness programming that empowers workers to take a more informed and personalized approach to their retirement planning, and recognition that when it comes to cookie-cutter financial advice, some rules are meant to be broken — or at least bent a little.

Sources:

<https://www.retailinvestor.org/pdf/Bengen1.pdf>

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<https://www.forbes.com/advisor/retirement/four-percent-rule-retirement>

<https://www.thinkadvisor.com/2022/05/09/bill-bengen-revises-4-rule-says-to-cut-stock-and-bond-holdings>

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