Quality Asset Management

Grow Your Wealth with Peace of Mind

Preparing for a Long Life

By Gil Hanoch, December 6, 2006

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This article will help you answer the question: when can I retire? In order to retire you need sources of income to support you for the rest of your life. Part of your income needs can be covered using Social Security payments, pensions and any other lifetime guaranteed income you may have. The rest depends on periodic withdrawals from your investment portfolio.

For example, let's say you need $100,000 gross income per year, social security provides you with $30,000 and you have pension payments of $30,000. Your portfolio should supply you with $100,000 - $30,000 - $30,000 = $40,000 per year.

If your portfolio can handle annual withdrawals of $40,000 without depleting, you may be able to retire. If your portfolio is worth $1,600,000, your portfolio should handle a withdrawal rate of: $40,000 / $1,600,000 = 2.5%.

If you have a portfolio that consistently tracks certain asset classes, your investment advisor may be able to determine a conservative withdrawal rate that should allow it to survive the withdrawals every year, including severe recessions, and never deplete. For example, this rate is 4% (growing with inflation) for the portfolio Long-Term Component by QAM. Note that this is a measure based on historic behavior and cannot be guaranteed. Therefore, it is important to choose a conservative percentage.

If you withdraw 4% of Long-Term Component annually, growing with inflation, your portfolio is likely to last forever. You may withdraw a larger percentage of the portfolio, if you want it to support you for the rest of your life and not have any of the principal left. For any given number of years you choose to support, your investment advisor can calculate the withdrawal rate allowed. Here are a few examples:

For a portfolio that can survive 4% annual withdrawals without depleting, what is the withdrawal rate that will deplete it over different time periods?	
Life Expectancy	**Percentage Withdrawal Allowed**
20 years	7.36%
25 years	6.4%
30 years	5.78%
40 years	5.05%
50 years	4.66%
100 years	4.08%
200 years	4.002%
Infinite	4%

Most planners prepare their clients for at least 30 years of retirement (e.g., ages 65 to 95). The total difference between the annual income available for 30 years of retirement and an infinite retirement is 31% (= 1 - 4%/5.78%). If you are preparing for a 30-year retirement, you can delay your retirement by about 2 years (statistically) and be prepared for an infinite retirement.

This low added cost is a reason to always prepare for an infinite retirement.

There are 3 important benefits:

1. As you grow older, instead of seeing your available money deplete, you can see it grow indefinitely. This can increase your financial peace of mind throughout your retirement.
2. This is a conservative approach that provides an extra cushion in case there is an extreme recession that has never been seen before.
3. Your heirs and/or your favorite charities may enjoy the full principal of your retirement savings.

Note that the analysis above was prepared for a specific portfolio, but the general results are the same regardless of the portfolio assumed. In reality, the referenced stock portfolio is likely to grow much faster than 4% per year (even in real terms), but you should keep the withdrawal rate at this level or lower because there may be very bad years in the beginning of the retirement period. A detailed analysis should be performed for the specific portfolio used.

To Summarize

Preparing for an infinite retirement is much cheaper than you might expect and can have huge rewards in terms of added peace of mind and the ability to provide a handsome heritage.