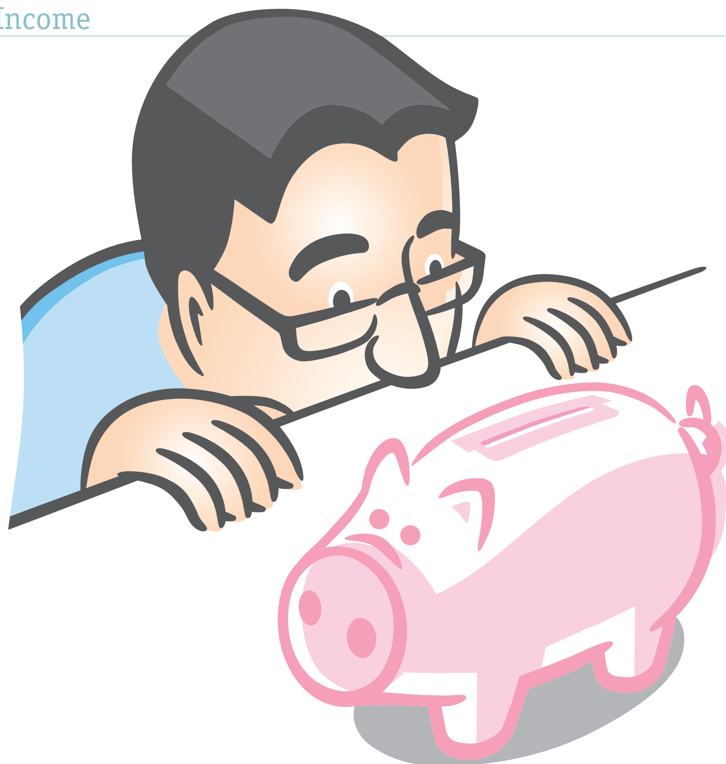

Getting over the psychological hurdle

Spending down your hard-earned retirement savings doesn't always come easy

For years – maybe even decades – you've been diligently saving and investing for retirement. Start to save early, the professionals say, or you may not have enough money to enjoy your retirement years. Continue to save, they urge, particularly if you want to counter the effects of inflation or a potential downturn in the market – and especially if you're worried about outliving what you've saved. And you listened. You did everything right, accumulating what you hope will be a comfortable nest egg.

But what happens when you finally retire and it's time to switch gears from saving to spending? It turns out, many people are so focused on accumulating assets that they never really think about actually withdrawing the money. In fact, recent studies show that many retirees aren't drawing down their retirement portfolios, opting instead to live on Social Security and the minimum required distributions (aka RMDs), so their portfolios can continue to grow. This may lead to unnecessary sacrifices in a retiree's standard of living. After almost two decades in retirement, most current retirees still have 80% of their pre-retirement savings, according to research from BlackRock.

The problem with uncertainty

So why aren't these retirees spending their nest eggs? There are several schools of thought on the topic. Some adhere to the old adage: "You can't take it with you." Some focus on sharing wealth with those they'll leave behind or for philanthropic pursuits, so they spend as little as possible, and still there's a whole subset of retirees who tend to delay spending due to longer lifespans and difficulty in estimating sustainable withdrawal rates. They're worried about the "what ifs" retirement may throw their way, and they want to be prepared – as much as they can be – for the uncertainty. You may be a bit of all three.

The latter group understands that over the course of a long-term retirement, which could last 30 years or more, inflation may erode their savings. They also know that portfolio returns may not always be in their favor, and healthcare costs can quickly escalate. Finally, they may be concerned about outliving their savings. Only 25% of baby boomers believe their savings will last throughout retirement, according to the Insured Retirement Institute. By spending less and allowing their savings to grow in the early years of retirement, they hope to offset some of the uncertainty.

Collaborating with your financial advisor can help alleviate some of your concerns and increase your confidence

The 4% rule

Developed more than 40 years ago by financial advisor William Bengen, the 4% rule is often cited as a rule of thumb when discussing possible withdrawal strategies. The idea is that you'd withdraw 4% of your portfolio in the first year of retirement and then adjust the amount to account for inflation in subsequent years. If you start with $100,000 in your portfolio, for instance, you would withdraw $4,000 the first year. That amount would increase to $4,120 the following year to account for a 3% rate of inflation. This is just one withdrawal strategy. Many others exist and your advisor can help you find the one that works best for your situation.

about having enough money to live comfortably in retirement. Just like in your working years, you can establish a safety net – a just-in-case cash cushion or line of credit that helps put you at ease. Whether it's the 4% rule or other distribution strategy, work with your advisor to develop a sound financial plan so that you may enjoy the retirement lifestyle you envisioned. There's a reason you worked hard all those years. Now it's time to let your money work for you.

Withdrawing your money

When it comes to withdrawing your retirement savings, you might say this is where the rubber meets the road. You may think that withdrawing too much from your nest egg could lead to a shortage later on, while spending too little could lower your standard of living and squelch some of your retirement dreams. But chances are, you and your advisor have planned for just about every scenario. If it helps, here are a couple things to consider:

Organize your expenses: Three typical categories include essential expenses such as food, housing and insurance; lifestyle expenses, which might include vacations and hobbies; and unexpected expenses like healthcare costs or pricey auto repairs. Consider paying for your essential expenses with guaranteed income sources such as Social Security or annuities. Use growth or income investments to pay for lifestyle expenses, and maintain a cash reserve for any unexpected costs that might occur.

Be flexible. For instance, a downturn in the market is a good time to tighten the reins on your spending. But if you experience some unexpected investment gains, the timing might be right for that dream vacation. There's little doubt your income needs will fluctuate during retirement. The early years may be filled with travel and other big-ticket items that require more substantial withdrawals. As time goes on, you'll likely travel less, but your healthcare expenses may increase. Studies show that spending tends to decline in the later years of retirement, most likely the result of less travel and similar pursuits. People ages 55 to 64 spend on average $60,076 per year, while people ages 65 and over spend $45,221, according to the Bureau of Labor Statistics. Building in flexibility allows you to go with the flow, so to

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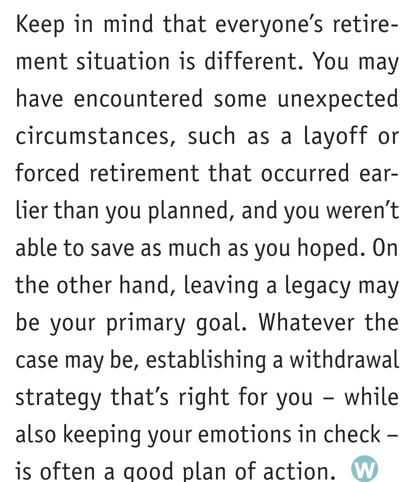
speak. Just be sure to regularly touch base with your advisor so your budget can stay on track.

Review your plan. Work with your advisor to develop and review your retirement income and distribution strategies. By developing a plan of action together, you can run hypothetical simulations based on different withdrawal rates, how many years you will live in retirement or any other contingencies, which will allow you to develop a better idea of how much you can comfortably and confidently spend in retirement to help achieve your goals. Review your plan at least annually or as unexpected life events happen.



Keep in mind that everyone's retirement situation is different. You may have encountered some unexpected circumstances, such as a layoff or forced retirement that occurred earlier than you planned, and you weren't able to save as much as you hoped. On the other hand, leaving a legacy may be your primary goal. Whatever the case may be, establishing a withdrawal strategy that's right for you – while also keeping your emotions in check – is often a good plan of action.

The sequence of your withdrawals

When drawing down from your retirement savings to supplement Social Security and your RMDs, you'll likely want to start with taxable savings. Although this money will be subject to capital gains taxes, the tax rate could be lower than your ordinary income tax rate, plus your cost-basis portion is not taxed. Tax-free investments, such as municipal bonds and muni bond accounts, are next in line because the earnings are free from state and federal income taxes. It may be a good idea to hold off on withdrawing from tax-deferred retirement accounts, such as a traditional IRA, 401(k) or 403(b), as long as you can to avoid paying taxes on the money. And finally, any tax-free savings, such as assets you've accumulated in a Roth account, should be the last to go. These funds can continue to grow without any tax consequences.

Sources: kitces.com; forbes.com; cnbc.com; ournextlife.com; smartaboutmoney.org; thestreet.com; kiplinger.com; myirionline.org

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