RETIREMENT PLAN
Update

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Because the time is now ...

Is the 4% spending rule still valid?

As you become closer to retirement, you'll want to think about a withdrawal strategy. While a 4% annual withdrawal rate is often used, you may want to consult a financial professional to see if this strategy would work for you.

You may spend the majority of your working years setting money aside in your retirement plan and managing that money through every type of market boom and bust. When you draw close to the finish line, you'll still have a few important decisions to make. Chief among them will be how much to take from your retirement account each year.

You'll want to confirm that you don't withdraw too much from your account in the early years of your retirement and potentially threaten your financial security for your remaining retirement years. Finding an appropriate withdrawal strategy can be difficult, but it is critically important.

Systematic withdrawals

One often-used strategy is to start with a 4% annual withdrawal rate and then adjust the dollar amount annually to keep pace with inflation. The goal of a systematic withdrawal plan is to help prevent depletion of your retirement savings in the early years of retirement. If your portfolio earns at least as much as you withdraw, your principal would remain unchanged or grow over time. Of course, there are likely to be years when the stock and bond markets are down and your portfolio earns less than you withdraw, depleting your principal. Although systematic withdrawals are relatively easy to implement, it's critical to choose your withdrawal rate and investment mix carefully since both factors will impact how long your money will last.

Moving the goalpost

You should be aware that the traditional 4% withdrawal figure has undergone some reevaluation.* Recent research from Morningstar suggests that people retiring now who want to confirm that their savings will last should spend no more than

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3.3% of their savings in the first year of a three-decade retirement and adjust for inflation after that.

According to the researchers, the 4% strategy would have enabled investors holding a portfolio composed of 50% stocks and 50% bonds to make their money last over the vast majority of 30-year retirement periods between 1926–2020. They say that this may no longer be a workable strategy as future returns from stocks and bonds are expected to be lower. The researchers simulated future returns over a 30-year period and found that in 25% of the simulations, a half-stock, half-bond portfolio would run out of money if withdrawals stayed at 4%.

There are alternatives to systematic withdrawals. For example, some retirement experts recommend varying your portfolio withdrawals in response to market moves—taking more out of your retirement savings when the markets are up and less when they are down. This approach is more complex, but might be one you can discuss with your financial professional.

The big picture

Before you decide on an appropriate withdrawal strategy, you may want to take a step back, look at the larger picture and ask yourself these questions:

What do I really want out of retirement?

Take an honest and realistic look at what you want to do during your retirement. If you are leaning toward an active retirement that includes travel, it's likely that you will need more money than someone who does not wish to travel. Where you plan to live in retirement is another important consideration. Whether you intend to remain in your current home, downsize in your current community or move elsewhere will have an impact on how much money you will need in retirement.

What other retirement expenses might I face?

You will still have a range of basic living and discretionary expenses in retirement. Basic living expenses include housing expenses, such as energy, utilities, maintenance, property taxes, condo fees and mortgage and rent payments. They also include transportation expenses, such as car payments, gasoline and repairs. Groceries, insurance premiums and income taxes are also expenses you will have to consider. In addition to travel, discretionary expenses include recreational activities, gifts and entertainment.

When can I afford to retire?

You can do a rough estimate of whether you will have enough income to cover your projected expenses in retirement. If your numbers fall short, you may have to consider working longer than you'd expected or reducing your planned spending when in retirement.

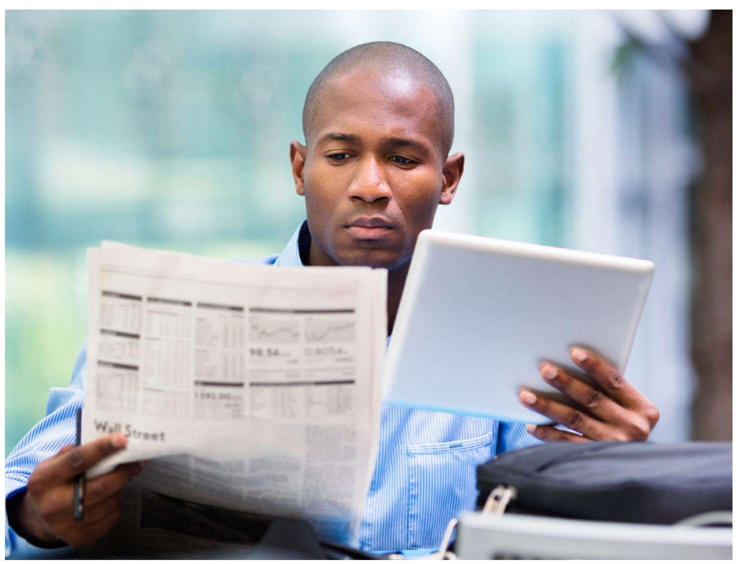
How you approach a retirement income strategy will depend on your personal situation. You may benefit from consulting with a trusted financial professional to help you determine and implement a strategy that suits your needs.

* "The 4% Retirement Rule Is in Doubt. Will Your Nest Egg Last?," The Wall Street Journal, 11/22/2021.

Borrowing from your retirement plan—not always the best option

Before taking a loan from your retirement plan, consider the possible drawbacks to borrowing.

Many retirement plans allow participants to borrow from their plan accounts. You may have taken a loan in the past or may be thinking of doing so soon. On the surface, a plan loan might seem to make financial sense: after all, you are only borrowing from your own retirement account and repaying yourself. However, with the exception of an emergency when you have no other resources, taking a plan loan may not be the wisest thing to do. In fact, there are several drawbacks to borrowing from your retirement plan.



Zero tax advantage

Pretax salary deferrals are tax-advantaged in that they are taken out of your pay before federal income taxes

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are calculated. That's not the case with repayments on your loan, which you make with money that has already been taxed. And when that money is distributed to you at retirement, you'll pay taxes on it once more.

Missed potential earnings

A plan loan reduces the size of your account balance, leaving you with less money that is invested on your behalf for your future. It is true that you will repay the loan with interest, but that interest could possibly be less than the return your plan investments would have earned had you not taken the loan. If you borrow money when the stock market is in a growth period, the missed earnings potentially could be substantial.

Lower contributions

If you cut back on your regular plan contributions while repaying your plan loan, you would reduce your potential earnings even further. The reality is that stopping contributions even for a year or two could have a negative impact on how much money will be available to you for your retirement.

Potential repayment issues

If you leave your employer and you still owe money on your plan loan, you will typically face a choice: repay the entire outstanding amount or allow it to become a distribution. If you can't afford to repay the loan in full and opt for a distribution, you will have to pay regular income taxes on the outstanding balance. In addition, if you are under age 59½, you may owe an early withdrawal penalty equal to 10% of the loan balance.

See plan loans as a last resort

Your retirement plan is intended to provide you with future benefits so that you can enjoy your retirement. That's why it's not good to regard the money in your retirement plan as a funding source that you can turn to whenever you need cash. Instead, look into other alternatives—a short-term loan from your bank or credit union, for example. Or, better yet, consider building an emergency fund so that you will have a financial cushion to fall back on when you are faced with a sudden expense.

If you would like some help with managing your finances, consider working with a financial professional. Together, you can map out a strategy for putting your financial life in order.

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