

AI-01064 4 Percent Withdrawal Rule

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What is the retirement rule of 4%? What is the basis for the 4%? Explain and derive the origin and validity.

The retirement rule of 4% is a guideline for safe withdrawal rates from your retirement savings. Here's the breakdown:

- **Concept:** In your first year of retirement, you withdraw 4% of your total retirement account balance. In subsequent years, you adjust the withdrawal amount for inflation to maintain purchasing power.
- **Basis for 4%:** This rule is based on historical data analyzed by William Bengen in the 1990s. He studied stock and bond market returns over a 50-year period (1926-1976) and found that a 4% withdrawal rate, with annual inflation adjustments, had a high probability of sustaining a retirement portfolio for 30 years.

Validity and Origin Considerations:

- While the 4% rule provides a starting point, it's not a one-size-fits-all solution. Here's why:
 - **Market Fluctuations:** The rule is based on historical performance, and future market conditions might differ.
 - **Life Expectancy:** The 30-year timeframe may not apply to everyone. Longer retirements might necessitate a lower withdrawal rate.
 - **Risk Tolerance:** The 4% assumes a balanced portfolio (50% stocks, 50% bonds). More aggressive investors might handle a higher rate, while conservative ones might need a lower one.

- **Origin Limitations:** The original study focused on a specific time period. Lower current interest rates might suggest a safer withdrawal rate around 3%.

Overall, the 4% rule offers a helpful framework, but consulting a financial advisor to personalize your withdrawal strategy based on your specific circumstances is recommended.

Explain the 4% rule in an example. I have \$1400000, 57, healthy and active retiree and invested in Nasdaq 100 index.

Let's break down the 4% rule with your example and discuss some considerations:

Scenario: You have a \$1,400,000 retirement nest egg, are a healthy and active 57-year-old retiree, and your investments are solely in the Nasdaq 100 index.

4% Rule Calculation:

1. **Initial Withdrawal:** Using the 4% rule, your first year's withdrawal would be $4\% * \$1,400,000 = \$56,000$.
2. **Inflation Adjustment:** In subsequent years, you'd adjust the withdrawal amount for inflation. For example, if inflation is 3%, you'd increase the withdrawal by 3% to maintain purchasing power. So, in year two, you might withdraw $\$56,000 * (1 + 0.03) = \$57,720$.

Considerations for your situation:

- **Nasdaq 100 Focus:** The 4% rule is typically applied to a diversified portfolio with a mix of stocks and bonds. The Nasdaq 100 is a stock-heavy index, which can be riskier. This might suggest a lower initial withdrawal rate (perhaps 3%) for more stability.
- **Life Expectancy:** You're healthy and active at 57, so you might have a longer retirement than the 30-year timeframe the 4% rule was based on. This could mean needing a more conservative withdrawal rate to ensure your savings last.
- **Risk Tolerance:** It's not mentioned how comfortable you are with risk. If you prefer stability, a lower initial withdrawal might be appropriate.

Recommendation:

While the 4% rule offers a starting point, consulting a financial advisor is highly recommended. They can consider your specific situation (health, risk tolerance, retirement goals, etc.) and the current market climate to create a personalized withdrawal strategy. They can also advise on potentially diversifying your portfolio beyond the Nasdaq 100 to manage risk.

Additional Notes:

- Remember, the 4% rule is a guideline, not a guarantee. Market downturns can impact your portfolio.
- Rebalancing your portfolio periodically may be necessary to maintain your desired asset allocation.

By seeking professional advice and potentially adjusting the withdrawal rate based on your circumstances, you can increase your chances of a secure and comfortable retirement.