Four Retirement-Portfolio Withdrawal Mistakes to Avoid

- This article refers to the "4% rule" and how this rule-of-thumb should not be followed blindly.
- The "4% rule" reflects research that found a portfolio should not be fully exhausted during retirement as long as no more than 4% of its value is withdrawn annually (adjusted for inflation).
- Though rules-of-thumb may be helpful, COMPASS provides clients with detailed retirement planning analyses that incorporate their particular circumstances.

Some errors in retirement-portfolio planning fall into the category of minor infractions rather than major missteps. Did you downplay foreign stocks versus standard asset-allocation advice? It's probably not going to have a big impact on whether your money lasts throughout your retirement years.

But withdrawal rate errors can have more serious repercussions for retirement-portfolios. If you take too much out of your portfolio at the outset of retirement, and that coincides with a difficult market environment --you can deal your portfolio a blow from which it may never recover. Other retirees may take far less than they actually could, all in the name of safety. The risk is that they didn't fully enjoy enough of their money during their lifetimes.

Mistake 1: Not Adjusting With Your Portfolio's Value and Market Conditions. Even though the popular "4% rule" assumes a static annual-dollar-withdrawal amount, adjusted for inflation, retirees would be better off staying flexible with their withdrawals.

What to Do Instead: The simplest way to tether your withdrawal rate to your portfolio's performance is to withdraw a fixed percentage, versus a fixed dollar amount adjusted for inflation, year in and year out. That's intuitively appealing, but this approach may lead to more radical swings in spending than is desirable for many retirees. It's possible to find a more comfortable middle ground by using a fixed percentage rate as a baseline but bounding those withdrawals with a "ceiling" and "floor."

Mistake 2: Not Adjusting With Your Time Horizon. Taking a fixed amount from a portfolio also neglects the fact that, as you age, you can safely take more from your portfolio than you could when you were younger. The original "4%" research assumed a 30-year time horizon, but retirees with shorter time horizons (life expectancies) of 10 to 15 years can reasonably take higher amounts.

What to Do Instead: To help factor in the role of life expectancy retirees can use the IRS' tables for required minimum distributions as a starting point to inform their withdrawal rates. That said, those distribution rates may be too high for people who believe their life expectancy will be longer than average.

Mistake 3: Not Adjusting Based on Your Portfolio Mix. Many retirees take withdrawal-rate guidance, such as the 4% guideline, and run with it, without stopping to assess whether their situations fit with the profile underpinning that guidance. The 4% guideline assumed a retiree had a balanced stock/bond portfolio. But retirees with more-conservative portfolios should use a more-conservative (lower) figure, whereas those with more-aggressive asset allocations might reasonably take a higher amount.

What to Do Instead: Be sure to customize your withdrawal rate based on your own factors, including your portfolio mix.

Mistake 4: Not Factoring In the Role of Taxes. The money you've saved in tax-deferred retirement-savings vehicles might look comfortingly plump. However, it's important to factor in taxes when determining your take-home withdrawals from those accounts. A 4% withdrawal from an $800,000 portfolio is $32,000, but that amount shrivels to just $24,000, assuming a 25% tax hit.

What to Do Instead: It pays to be conservative in your planning assumptions. To be safe it's valuable to assume a higher tax rate than you might actually end up paying.

Disclosure: This is for informational purposes only and should not be considered tax or financial planning advice. Please consult with a financial or tax professional for advice specific to your situation.

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