Incise Insight

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The 4% Rule

In 1994 William Bengen, CFP® developed what is known as the 4% rule. If you are not familiar with it, the rule is the dollar amount you can supposedly safely withdraw on an annually inflation-adjusted basis from a portfolio to support retirement income. This may no longer be applicable. If you are depending on the rule you may be putting your retirement in jeopordy.

Using the rule, a properly balanced porfolio of stocks and bonds will last for 30 years. Hundreds of research articles have been written on this subject alone all from different angles. It incorporates what is known as the "withdrawal" method for retirement income planning.

This method is the most popular but, perhaps as a stand-alone technique, one of the most inefficient methods of planning as it does not allow you to enjoy your wealth or maximize what that weatlh can produce for income. One of the reasons that it is popular is that it is simple and easy to comprehend – just build a portfolio of assets and then live off the income. It is also a favorite of money managers as it allows them to charge a fee annually on your money - money they do now want you to spend.

Here are two problems with the rule. First the original research which produced the rule did not consider investment fees. For every 1% fee you pay a manager, it lowers the safe withdrawal amount by .33%. So if your advisor charges 1% of your portfolio to manage it, and the underlying investments also have expenses of 1% you should adjust the withdrawal amount down by .66%. This would reduce the safe withdrawal amount to 3.34%.

Secondly, more recent research indicates that moving forward, this level of income is likely not sustainable, partly due to the low interest rate environment in which we now are living.

Dr. Wade Pfau, Professor of Retirement Income at the American College of Financial Services, has produced research which supports the idea that when a retiree uses the withdrawal method in combination with annuitizing a portion of the portfolio, it can improve both the amount of income received and the legacy value for the next generation. The key word here: efficiency.

When is a 401(k) match most effective?

Have you ever heard it said: When your employer matches your 401(k) contribution you "**get a 100% return**" on your money?

The only time that could be true is the last year you received a match before retirement. Take a 35 year old male who retires at age 65. If he makes a $5,000 contribution for 30 years and earns 6% each and every year, his account would be worth $419,000. If his employer matched 50% of this contribution ($2,500) his account would be worth $628,500.

Having $628,500 after 30 years having only contributed $5,000 each year equates to an 8.14% rate of return. This means **the employers match earned him 2.14%** (8.14% – 6.00% = 2.14%). This is certainly not a 100% rate of return on his investment.

If, at age 64 this same person contributed $5000 at the end of that year, his $5,000 turned into $7,500 because his company matched his contribution by 50%. This would be a 50% return on his contribution. If they had matched it 100% this would be the only year in which he could earn a 100% return through his company match.

What can we learn from this? The biggest rate of return we can earn from our employer's match is at the end of our career. This is not to say an employer's match is not valuable early in one's career.

What it should teach us is that we should be considering other financial topics when we are early in our careers. Do we have an emergency fund? Having to pull money out of a 401(k) in the event of an emergency is certainly not efficient and the rate of return goes out the window. Do we have adequate protection in place? If something unexpected happens, it is too late to go back and acquire the needed protection and the 401(k) match becomes useless.

Business Owners If you are a sole proprietor, an S corporation (LLC filing as an S corp.) or partnership (LLC filing as a partnership) you may want to pay attention to the new 199A deduction (Tax Cuts & Jobs Act of 2017). The deduction applies to "above-the-line" expenses.

Two above-the-line deductions include contributions to a profit sharing or defined benefit (DB) retirement plan. If you are in a financial position to shelter more than a profit sharing plan will allow, you may want to consider a DB plan. One of the concerns of a DB plan is the annual expense. The solution for this is a fully insured DB plan. Depending on your situation, you may be able to shelter up to $200,000 per year for yourself, as the business owner. The 199A deduction will make the tax benefit look even better.

$1.23 trillion - amount of anticipated borrowing by the U.S. Federal government in 2019

What you will learn from Incisic™ is how to financially…

Be Less Dependent on Rate of Return

Utilize Efficiencies

Improve:
- Liquidity
- Use
- Control

Leverage Longer Compound Interest Curves

Increase Flexibility

Create multiple retirement income choices

Use a Dollar Multiple Times

Economic Based

Consider Lost Opportunity Costs

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The content here is not intended to provide individual, family, or business financial advice. True financial advice cannot be provided without a deep understanding of each individual situation, which can only be accomplished through an in-depth analysis which involves a two-way dialogue. It is important that individuals take steps to meet with qualified professionals who take a macro-economic approach, not merely a "black box" financial planning approach to your finances including, but not limited to, risk, insurance, investments, or tax.