UBS's Capital Market Assumptions help us evaluate how several household-specific factors might impact sustainable withdrawal rates while taking market uncertainty into consideration.(UBS)

Beyond the 4% rule: Am I ready for retirement?

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With longer life expectancies—and few opportunities to tap into pension programs and other sources of guaranteed income—most households will need to accumulate significant savings to support their spending throughout retirement.

When determining how much wealth is needed, there are several household-specific factors to consider:

1. Years remaining in retirement (expected duration of retirement and life expectancy);
2. Asset allocation (portfolio risk and return characteristics);
3. Spending patterns (how spending changes throughout retirement); and
4. Acceptable rate of failure (how likely you will run out of money).

Retirees are also subject to external factors that they cannot control, such as tax policy and the market environment. Although analyzing historical returns can offer insights toward potentially viable retirement strategies, the market environment of the past 40 years is likely to be very different from what we expect going forward. Stock market valuations, interest rates, and earnings growth expectations are less attractive, while we expect market volatility to be about the same as it was historically. This means that we need to take historical analyses—like those used to originally come up with the so-called “4% rule”—with a grain of salt.

By using UBS's forward-looking Capital Market Assumptions (CMAs) in combination with analysis of thousands of possible market scenarios, we can evaluate how several household-specific factors might impact sustainable withdrawal rates while taking market uncertainty into consideration.

Establishing sustainable withdrawal rates with the UBS Capital Market Assumptions

Let's start by asking, "If you were willing to spend down your entire portfolio over retirement, what might be a sustainable withdrawal rate (as a percentage of the initial portfolio value) where 85 out of 100 times (i.e., 85% probability of success) you don't run out of money?"

Additionally, we'll assume that you will annually grow the first-year dollar amount by a consistent 2.4% inflation rate throughout retirement. For example, if your initial portfolio value is USD 1 million and the withdrawal rate is 4%, then the first-year withdrawal amount would be USD 40,000, the second-year USD 40,960, the third-year USD 41,943 and so on.

Lastly, our analysis is based on the UBS Wealth Way framework, with a Longevity strategy portfolio invested according to UBS's nontaxable strategic asset allocations (SAAs) without nontraditional assets in addition to a three-year Liquidity strategy portfolio containing 50% US cash and 50% US government fixed income.

Looking at the results of our analysis (see **Figure 2 on page 3 of the full report**), we find that even with lower expected investment returns and a 2.4% annual increase in withdrawals, a 30-year retirement would support a 3.8%–4% withdrawal rate. However, with longer life expectancies, many couples may need to plan for a 40-year retirement.

To support withdrawals over 40 years, withdrawal rates drop about 0.7 percentage point, to 3.1–3.3%. Said differently, if you wanted to support an inflation-adjusted USD 100,000 withdrawal each year for 40 years, you would need about USD 2.97 million, nearly USD 500,000 more than for a 30-year horizon.

The results of our analysis are determined by performing Monte Carlo simulations, which tend to be conservative, because they assume you will react and behave the same way regardless of performance or circumstance.

In reality, the evolution of your investments, spending patterns, and plans should be reviewed on an annual basis to make sure the amount you plan to withdraw is viable. Generally, small adjustments can be made along the way to keep you on track as your wealth and consumption patterns materialize.

Even with this in mind, if you wanted to build a larger or smaller buffer, you could target a different probability of success. While a higher success rate can give further peace of mind, it can meaningfully decrease your withdrawal rate or require more assets (e.g., a higher wealth-to-withdrawal multiple) to mitigate the potential of outliving your assets.

Conclusion

As you prepare for or evaluate your retirement, simple guidelines like the 4% rule are too general to apply to any individual family. For instance, it assumes that you'll increase your spending at a constant rate each year.
Although starting with an all-in-one budget and applying a constant spending increase can be a good starting point when forecasting retirement spending, it is unlikely to accurately reflect your family's actual spending. To help you build a more specific forecast for your family's retirement spending, discuss our suggestions below with your financial advisor:

1. Don't automatically assume that expenses will always increase by inflation.
2. Be as specific as possible when developing goals for your financial plan.
3. Think of your retirement in phases to improve estimates of future expenses.
4. As you move into mid-retirement, some drop in spending is normal.
5. Pay attention to the impact of healthcare expenses throughout retirement and potential long-term care costs in the second half of retirement.

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Read the full report **Beyond the 4% rule: Am I ready for retirement?** 22 February 2023.

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