Withdrawal Strategies for Retirement: The 4% Solution

The key objective of saving for retirement is to save enough so that your money lasts as long as you do. In previous articles, Worth A Look has provided an overview of how to plan for the expenses you'll face and identify the sources of revenue you'll need in retirement; catch-up strategies to employ in case you need to turbo-charge your retirement account balance; and prudent asset allocation decisions.

Now, let's look at how to make your nest egg last. How can you feel confident that you are not withdrawing too much (and risking running out of money) or too little (skimping unnecessarily)?

Various studies have been done. In one study conducted at Trinity University, researchers explored various asset mixes and withdrawal rates based on actual stock and bond market returns from 1926 to 1995. The goal was to determine how much a retiree could withdraw from his or her retirement account and still have some assurance that they would not run out of money over a realistic time period.

An annual withdrawal rate of 4% was considered an effective way to provide income while producing a 100% success rate—or close to it—of having your money last over a period of 25 or 30 years. That's how long retirement could span if you have a life expectancy of 85 or 90. Other studies have reached similar conclusions regarding optimal withdrawal rates.

The study found that an asset mix of 50% stocks and 50% bonds with a withdrawal rate of 4% of the original nest egg at retirement had a 100% success rate over 25 years and a 95% success rate over 30 years. Substituting a 5% withdrawal rate with the same asset mix caused the success rates to drop to 80% for 25 years and 76% for 30 years. A 6% withdrawal rate would result in a 57% success rate for 25 years and 51% for 30 years. These figures factor in the impact of inflation. Other asset mixes produced similar or worse results:

<table>
<thead>
<tr>
<th>Asset Mix</th>
<th>25-Year Success Rate</th>
<th>30-Year Success Rate</th>
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<tbody>
<tr>
<td>100% Stocks</td>
<td>100%</td>
<td>95%</td>
</tr>
<tr>
<td>75% Stocks/25% Bonds</td>
<td>100%</td>
<td>98%</td>
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<tr>
<td>50% Stocks/50% Bonds</td>
<td>100%</td>
<td>95%</td>
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<tr>
<td>25% Stocks/75% Bonds</td>
<td>93%</td>
<td>71%</td>
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<tr>
<td>100% Bonds</td>
<td>46%</td>
<td>20%</td>
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Dear Participant:

The common theme in this issue is the importance of planning and preparation. It’s the key to successful retirement savings. In this issue’s look ahead to your retirement years, we examine the ideal annual withdrawal rate from your retirement account.

You’ll also learn about one of the most vital expenses to plan for—long-term health care. And, in “Money Matters,” preparation is also a key part of preventing identity theft. Here’s to the many benefits of good planning and preparation!

Sincerely,

[Signature]
David Shute
Worth A Look Publisher

www.TA-Retirement.com
As you think ahead to your retirement years, you may be focused on saving for your future living expenses. Don’t forget to include your health care expenses, which will probably increase for two main reasons as you age.

The first reason is obvious—older people tend to require more medical care. Secondly, while the inflation rate—as measured by the Consumer Price Index (CPI)—has been relatively mild the last half dozen years or so, rising each year by between 1.6% and 3.4%¹, health care costs have risen by several times that rate. The Center for Studying Health System Change tracked annual increases in medical costs as follows: an 11.3% rise in 2001, 10.7% in 2002, 8.4% in 2003 and 8.2% in 2004.

If these numbers haven’t caught your attention, perhaps these will:

- A person who reaches 65 faces at least a 40% lifetime risk of entering a nursing home.²
- Total national expenditures for nursing home care are projected to rise to $330 billion by 2030.³
- The annual cost of a semi-private nursing home room is $60,000 on average ($69,400 for a private room), while the average annual cost of a one-bedroom assisted living facility is $30,000.⁴ What will they be in 20 or 30 years?

For many people, Medicaid helps pay for long-term care, but to qualify, you need to pay down your assets to a large degree. With skyrocketing health care costs and rising government deficits, experts warn not to depend on Medicaid to cover your long-term care expenses.

Your decision of whether to buy long-term care insurance could depend in part on your level of income and assets: Can you afford the premiums? Or, can you afford NOT to pay the premiums? (Would you be able to pay the costs—perhaps $300,000 for five years of nursing home care—youself?)

What are your long-term financial goals? Is preserving an inheritance an important factor? If so, even though you may be able to pay for long-term medical costs yourself, you might prefer the protection that insurance offers.
5% Annual Withdrawal Strategy
Success Rates

<table>
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<th>Asset Mix</th>
<th>25-Year Period</th>
<th>30-Year Period</th>
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<tbody>
<tr>
<td>100% Stocks</td>
<td>87%</td>
<td>85%</td>
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<tr>
<td>75% Stocks/25% Bonds</td>
<td>85%</td>
<td>83%</td>
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<tr>
<td>50% Stocks/50% Bonds</td>
<td>80%</td>
<td>76%</td>
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<tr>
<td>25% Stocks/75% Bonds</td>
<td>48%</td>
<td>27%</td>
</tr>
<tr>
<td>100% Bonds</td>
<td>17%</td>
<td>17%</td>
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Based on these results, a 4% withdrawal rate along with an asset mix of 50% stocks/50% bonds can be an effective option for keeping your assets going over the long term. To quickly see if you're on track to have enough retirement income, divide your projected retirement savings by 25 (or multiply by .04).

For example, a $250,000 total divided by 25 equals $10,000. Factor in what you expect in Social Security benefits. Let's assume it's $20,000 a year. That totals $30,000 annually in our example. Perhaps you are confident that you can live on that amount in retirement. If not, you might have to supplement your income with a part-time job. If you have 10 or 20 years before you retire, you have some time to build up your nest egg. It may be easier to motivate yourself once you see what's at stake in dollar terms.

Similarly, what if the market slumps substantially early in your retirement, reducing the size of your nest egg? You'll have to adapt. One solution would be to keep your withdrawal percentage steady (which, because your nest egg has shrunk, would mean withdrawing less money each year) and either trim your expenses or consider other alternatives.

Retirement planning is a long-term process. By planning well in advance and monitoring your withdrawals, you'll have a better chance of outliving your money.

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* “Who Will Pay for the Baby Boomers’ Long-Term Care Needs?” American Council of Life Insurers, 2001
* Long-Term Care Costs, by Marlene S. Stum, Ph.D. University of Minnesota; [http://www.financinglongtermcare.umn.edu/basics/prepared/mythsandfacts/LTCost/LTCost1.htm](http://www.financinglongtermcare.umn.edu/basics/prepared/mythsandfacts/LTCost/LTCost1.htm)

Each person’s situation is unique. You may wish to consult a legal/tax advisor. Also, since your circumstances will likely change over time, you should periodically review your investment strategy to make sure it continues to reflect your current situation.
Don't Let Someone Steal Your Identity

Identity theft has been reported on a great deal recently. But do you know how to protect yourself from it?

By stealing your personal identification information, a thief may fraudulently obtain goods, services or money. Identity theft can occur in a number of ways—lost or stolen identification cards, a deliberate telephone or e-mail scam involving a phony offer that leads to fraudulent use of your Social Security number, bank account or credit card numbers. It could also involve someone lifting information from a laptop computer, obtaining a personal password or rummaging through trash for personal data.

What can you do to prevent identity theft?

Identity theft can happen to anyone. But there are some safety measures you can take to reduce your risks:

• Don’t give out personal information on the phone, through mail or e-mail or on the Internet unless you have initiated the contact or know who you are dealing with.

• Give your Social Security number only when necessary. Use other forms of identification when possible. Ask to substitute another number if your state uses your SSN as your driver’s license number or if your health insurance company uses your SSN as your account number.

• Keep your purse or wallet in a safe place at all times.

• If in doubt, shred it. Don’t just recycle old statements and financial receipts. Tear or shred credit card receipts, insurance forms, bank statements, checks and expired credit or debit cards.

• Delete all personal information when disposing of a computer. Don’t just delete files with your keyboard or mouse. Even reformating your hard drive may not be enough. Use a “wipe” software program to overwrite your hard drive.

• Don’t store financial information on your laptop computer or personal digital assistant (PDA) unless absolutely necessary. And if you do, use a password that is difficult to decipher, using a combination of letters and numbers.

What if you are a victim?

If you think someone has stolen or scammed your personal identification or identification documents, take quick action. Close credit card or bank accounts immediately. Call any one of the three major credit bureaus—Equifax, Experian, TransUnion—and place an initial fraud alert on your credit reports. A single call will suffice as they share information.

To replace your SSN card, call the Social Security Administration at 1-800-772-1213.

To replace your driver’s license or other identification documents, contact the issuing agency and follow their procedures to place fraud flags and get replacements.

Pay attention to your billing cycles. A missing bill could indicate that an identity thief has your account information and has changed your billing address.

In the information age, we all share in the benefits, risks and responsibilities of easy access to and use of information. A few careful steps can make a big difference.

For more information, call the Federal Trade Commission’s ID Theft Hotline: 1-877-ID THEFT or go to: http://www.consumer.gov/idtheft/.

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