

4% RULE: ‘NEAT, PLAUSIBLE, AND WRONG’

BY PAUL R. SAMUELSON

The persistent – and futile – debate over the 4% rule for retirement income brings to mind the observation of the American social critic H.L. Mencken:

“There is always a well-known solution to every human problem – neat, plausible, and wrong,” Mencken wrote in 1920.

Retirement wasn’t on Mencken’s mind (the average life expectancy in 1920 was around 54). But I imagine he might have anticipated the 4% rule and the zombie economic theory that tax cuts pay for themselves. Both are neat, plausible, and not *obviously* wrong.

The 4% rule works as a back-of-the-napkin analysis of how much an investor or couple can withdraw annually to stretch those savings to last about 30 years.

However, it fails to provide the nuanced, personalized, tax-aware, and technology-informed approach you take with clients seeking advice on transforming their accumulated savings into a retirement income stream.

When 4% Works – And (More Often) When It Doesn’t

The 4% rule suggests that people retiring between the ages of 60 and 65 can withdraw 4% of their accumulated savings (invested 50/50 in stocks and bonds) to pay expenses in year one. Each year after, they can withdraw the same amount plus a cost-of-living adjustment (COLA) based on the inflation rate.

I can think of one case that supports a “withdrawal rule.” It is a single retired person with safe investments and consistent Social Security, pension and/or annuity payments.

A withdrawal level could be assigned based on the rate available from a single-payment income annuity with a COLA.

The case for a constant withdrawal level falls apart when it comes to married couples. At some point, one member will die, and the other will be widowed.

Suddenly, the survivor will receive smaller payments from Social Security and perhaps pensions. The survivor won’t necessarily be the partner with fewer health concerns or superior financial skills.

Subsequently, the widowed partner will face *higher* tax rates because their deductions and tax brackets are sliced in half when filing as a single person. They may also need to contend with the still-emerging rules on required minimum withdrawals (RMDs).

For married couples, then, an annual withdrawal level when they begin retirement should be reduced to prepare for the time when a survivor will have to increase withdrawals to maintain a home and lifestyle and possibly in-home or facility services as the survivor ages.

Meet Regularly Once Clients Retire

Determining appropriate withdrawal levels is an ongoing process because amounts will vary over the course of retirement, depending on:

- When someone ceases working, or whether they work part-time.
- Unpredictable windfalls from bequests or gifts.
- When they begin collecting Social Security and RMDs.

For example, it can make sense for some 65-ish retirees to take larger withdrawals from brokerage and savings accounts.

This allows them to:

- Defer collecting Social Security until age 70.
- Wait to draw from retirement accounts until mandated.
- Allow those accounts to continue to benefit from interest accruing and investment gains.

It’s worth noting that the economy and the markets can throw a wrench into the best plan for level withdrawals of any percentage. For example, in the past few years, people who committed to a level of withdrawal may have struggled to pay drastically higher costs for food, housing, fuel, and other basic living expenses.

Samuelson’s Formula

I’ve made my point: A tidy solution denies the caprice of life and the inherent complexity of retirement income management.



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Nevertheless, I will defy H.L. Mencken’s warning about neat solutions with a few of mine that have had a high batting average for households that have saved wisely for retirement:

- Healthy individuals should put off filing for Social Security until age 70. Advisors can help them with ideas about how to do this. Delaying will mean they will collect significantly more Social Security benefits over their lifetimes.
- Healthy individuals should also work as long as they can to shore up their savings and capacity to meet the needs of advanced old age.
- As households transition into retirement, they can take higher account withdrawals while they wait for retirement income from Social Security and RMDs to replace earned income partially.
- Households with tax-advantaged retirement accounts—IRAs, 401Ks and the like—and taxable brokerage accounts can reduce their expected lifetime taxes on IRA withdrawals by aiming to achieve a constant *taxable* income (corrected for marital status).
- Households with small investment accounts should buy at least one income annuity with survivor benefits but without a long period of guaranteed payments. This will provide a low-cost, reliable retirement income stream and peace of mind.
- Both couple members should understand their investments and retirement income sources because one or the other will have to carry on alone. As an advisor, you can help see to that. If there is a reliable child or other trustworthy relative, include them in the conversations.

Get ready. This year marks “peak 65,” when more boomers turn 65 than in any past year. Retirement is on their minds: The recent Allianz Life 2023 New Year’s Resolutions Survey found that more than 1 in 5 workers said they would likely retire in 2024. Among boomers still working, 31% said they will likely retire in 2024.

The work of accumulation can seem easy when compared with decumulation. But your advice is as necessary as ever. Please don’t fall victim to the notion that any of it is neat.

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Paul comes from an extended family of prominent economists and advisors to presidents. He carries on the Samuelson tradition, writing the complex algorithms at the core of LifeYield technology that empowers financial advisors and firms to minimize clients’ taxes and maximize their retirement income.

Paul’s career includes roles as chief investment officer at PanAgora Investment Management and before that as a leader, consultant, and partner at investment companies including Hagler, Mastrovita and Hewitt; Colonial Management Associates; and Acadian Financial Management.

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Paul is a Phi Beta Kappa and cum laude graduate of Williams College and holds a Ph.D. in finance and M.S.M. from the Massachusetts Institute of Technology. Paul loves to sail, golf, run, swim, and row. He gets around town (always wearing a helmet) on Boston’s Bluebike shared bikes.



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