

HOW REAL RETIREMENT
SPENDING PATTERNS CHANGE
TRADITIONAL RETIREMENT
WITHDRAWAL STRATEGIES

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Advancing Knowledge in Financial Planning...

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HOW REAL RETIREMENT SPENDING
PATTERNS CHANGE TRADITIONAL
RETIREMENT WITHDRAWAL STRATEGIES

TRADITIONAL PLANNING
ASSUMPTIONS

- Replacement rate
- Constant real spending
- Straight-line investment growth
- Variation in some spending categories

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HOW REAL RETIREMENT SPENDING PATTERNS CHANGE TRADITIONAL RETIREMENT STRATEGIES

HISTORICAL ANALYSIS

- Safe Withdrawal Rate (SWR) approach
- Captures historical volatility
- Focuses primarily on distribution
- Project retirement saving/spending annually
- Ignores *earning* and *spending* volatility

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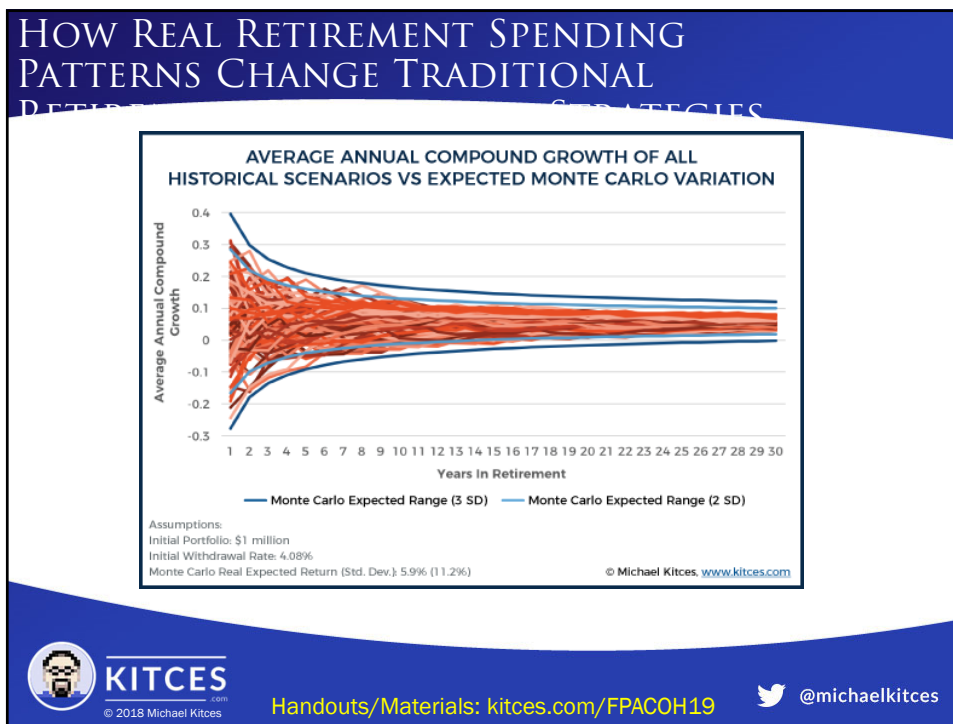
MONTE CARLO SIMULATION

- Incorporates random variables
- Most commonly investment returns
- Probability of success in accumulation and decumulation
- Returns typically assumed to be independent of one another

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TRADITIONAL RETIREMENT SPENDING ASSUMPTIONS

- Fixed rate of annual growth (COLA)
- Ignores spending volatility

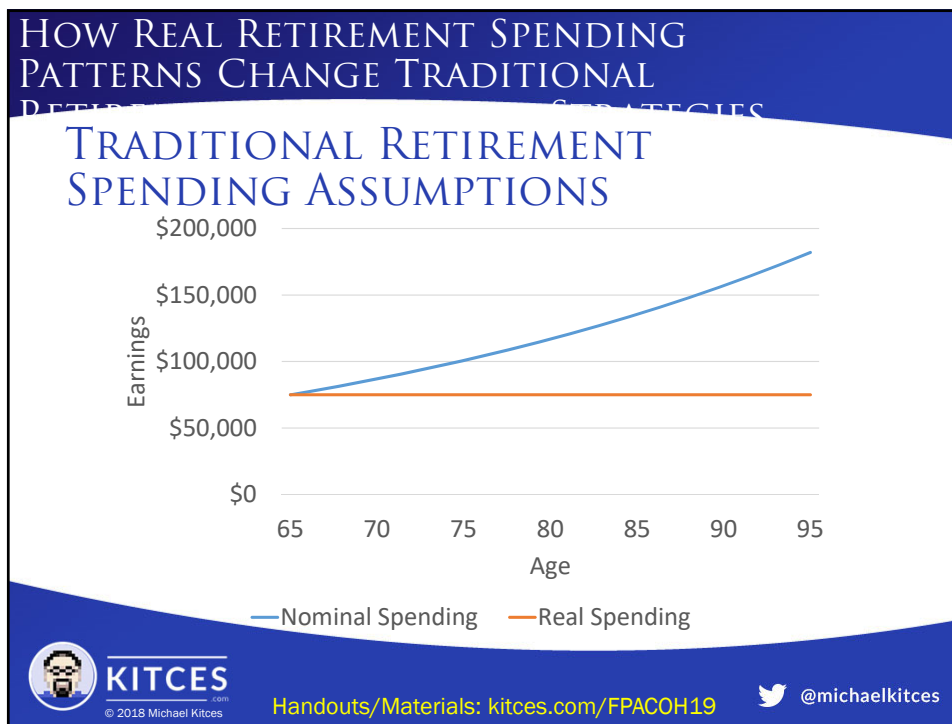


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HISTORICAL RETIREMENT SPENDING

- Ty Bernicke (Bernicke & Associates)
 - 2005 study in the *Journal of Financial Planning*
 - Consumer Expenditure Survey
 - Cross-sectional
 - Real retirement spending declines by 15% every 5-years
 - Retiree in late 70s spending less than ½ of what they were spending in late 50s

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HISTORICAL RETIREMENT SPENDING

- Center for Retirement Research (Boston University)
 - Consumer Expenditure Survey
 - Longitudinal
 - Real retirement spending declines by 1% per year


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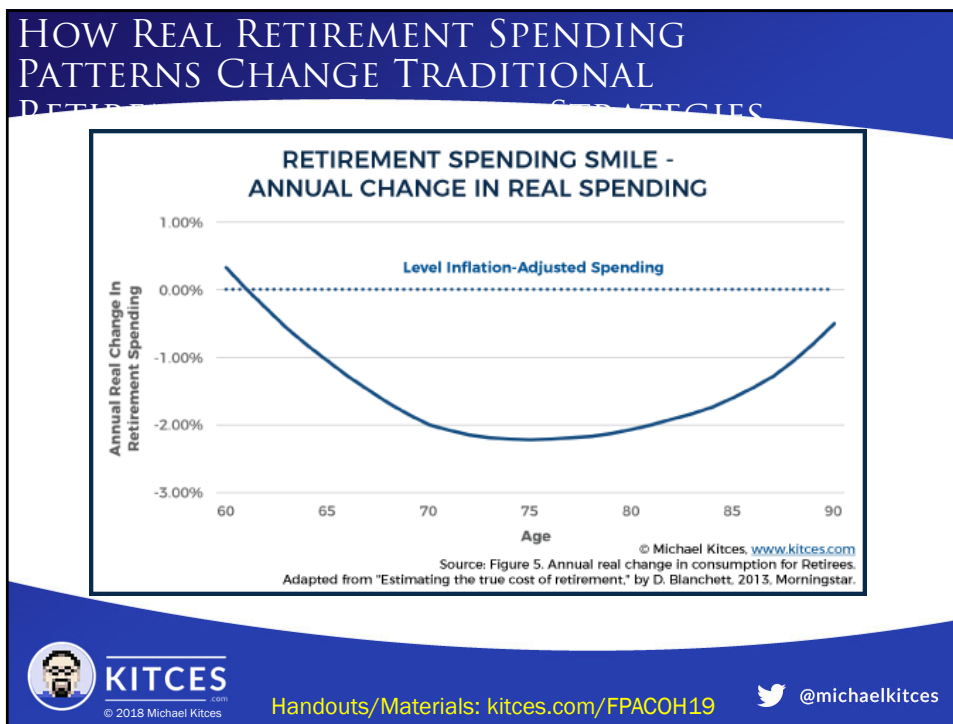
HISTORICAL RETIREMENT SPENDING

- Center for Retirement Research (Boston University)
 - Consumer Expenditure Survey
 - Real retirement spending declines by 1% per year
- David Blanchett (Morningstar)
 - RAND Health and Retirement Study
 - Spending rate changes at various rates throughout retirement

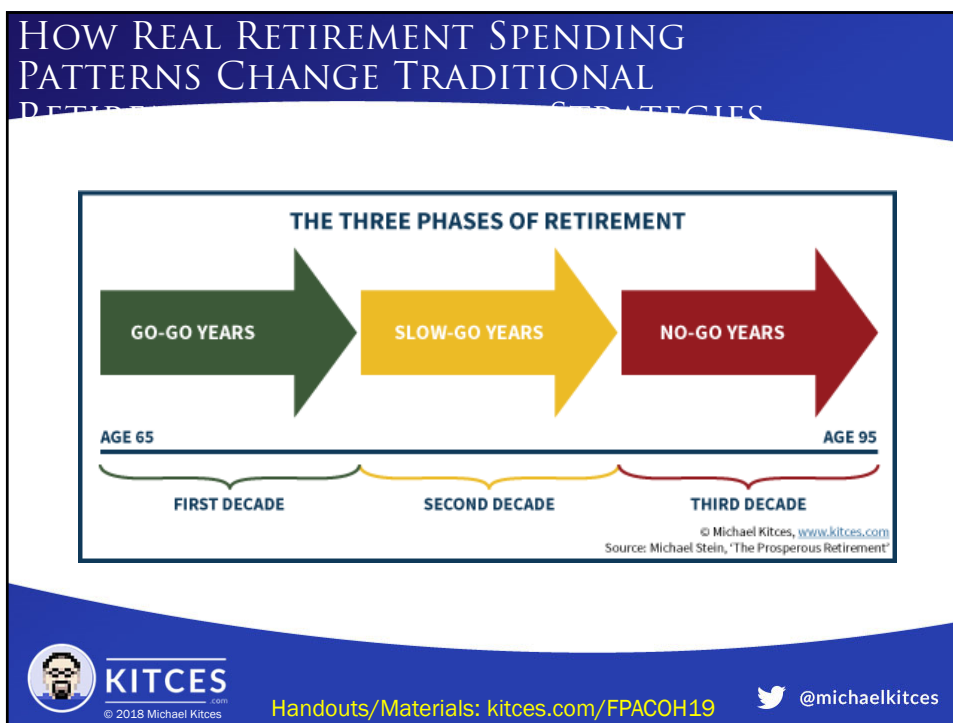

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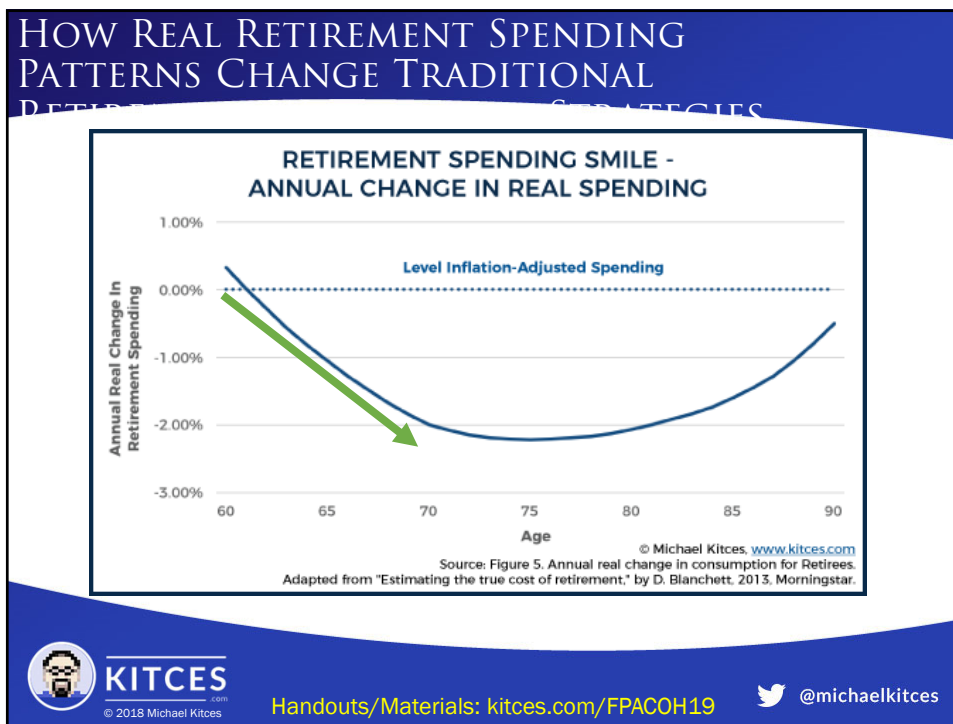
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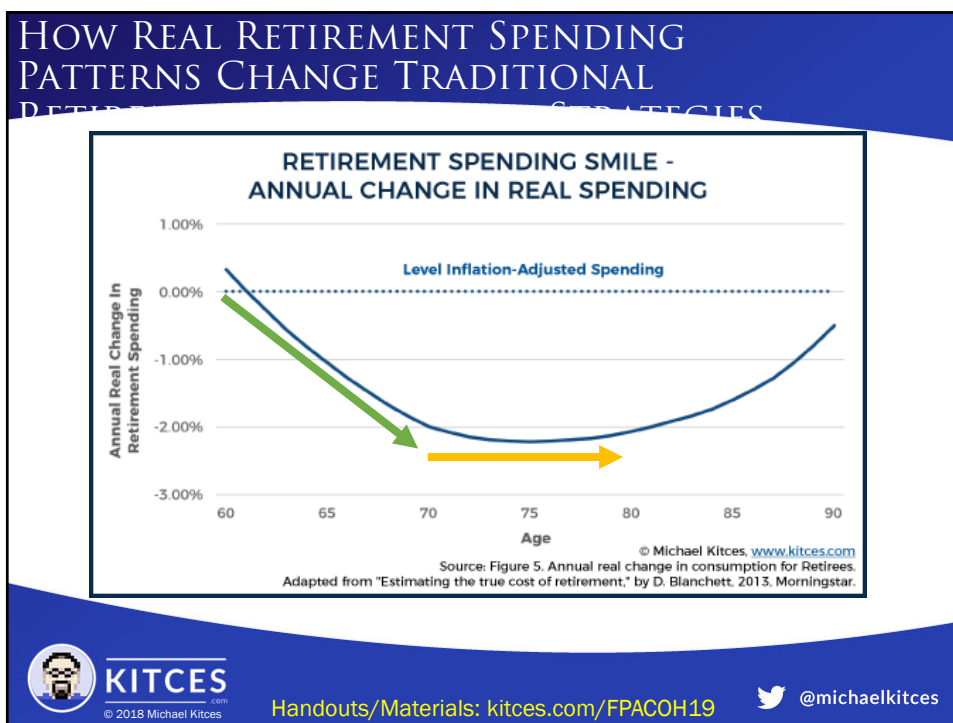
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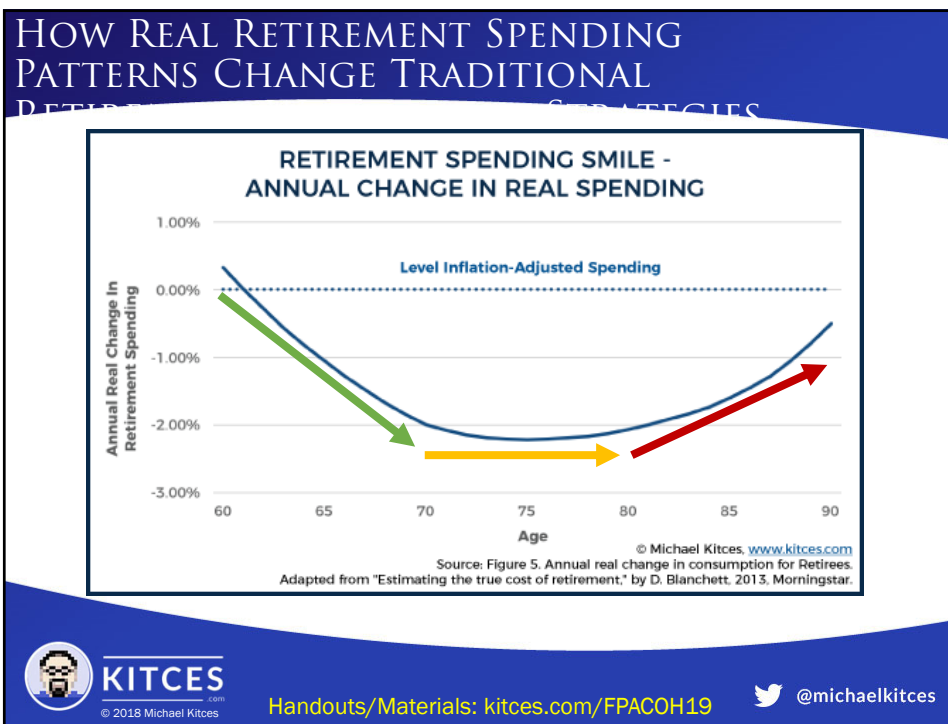
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SPENDING CHANGES IN PRACTICE

- Nominal versus real changes
- Declining real spending does not mean declining spending

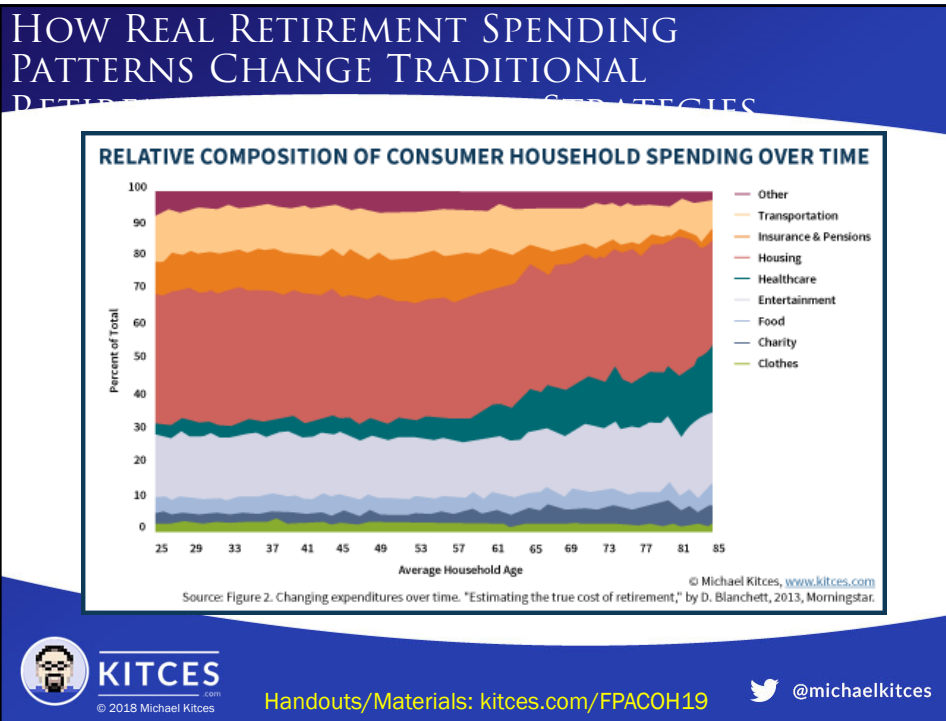


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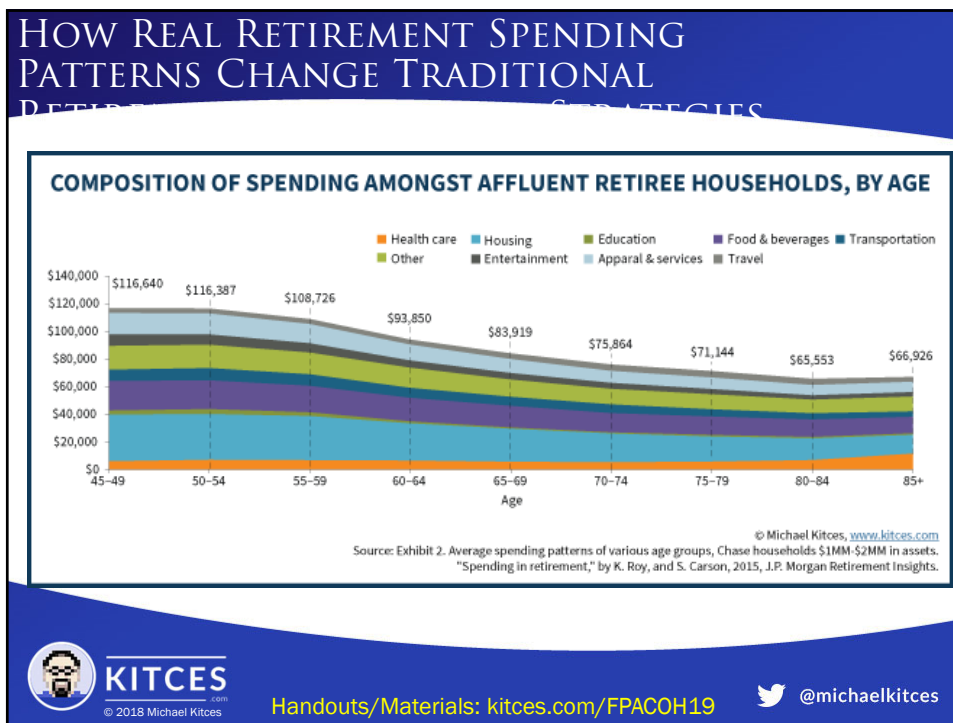
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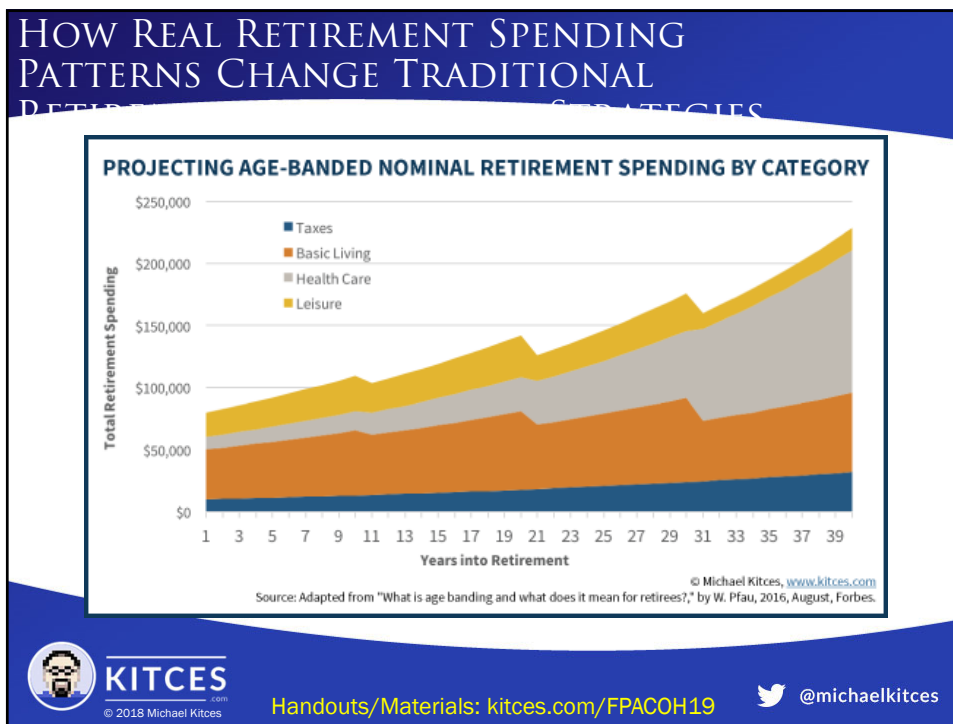
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RETIREE SPECIFIC ADJUSTMENTS

- JP Morgan Study
 - 40% of affluent retirees are “foodies”
 - 30% are “homebodies”
 - 5% are globetrotters



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IMPACT OF REALISTIC ASSUMPTIONS ON SAFE WITHDRAWAL RATES

- 30-year retirement horizon
- 60/40 portfolio rebalanced annually


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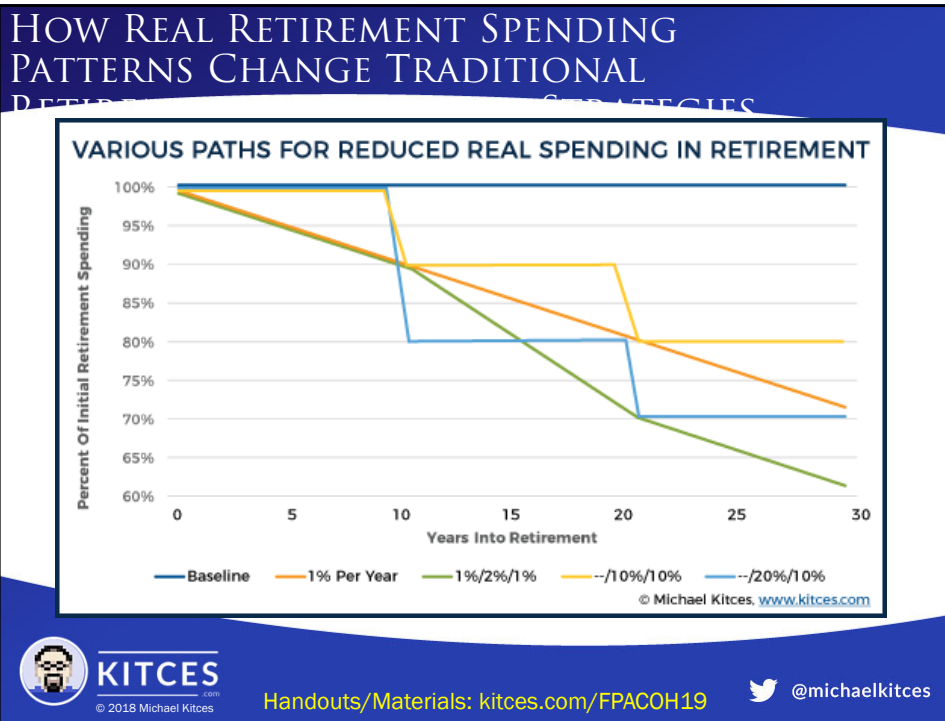
IMPACT OF REALISTIC ASSUMPTIONS ON SAFE WITHDRAWAL RATES

- Four spending patterns:
 - 1% annual real reduction for 30-years
 - 1% annual real reduction (1st decade), 2% annual real reduction (2nd decade), 1% annual real reduction (3rd decade)
 - 10% real reduction after each decade
 - 20% real reduction after first decade, 10% real reduction after the second


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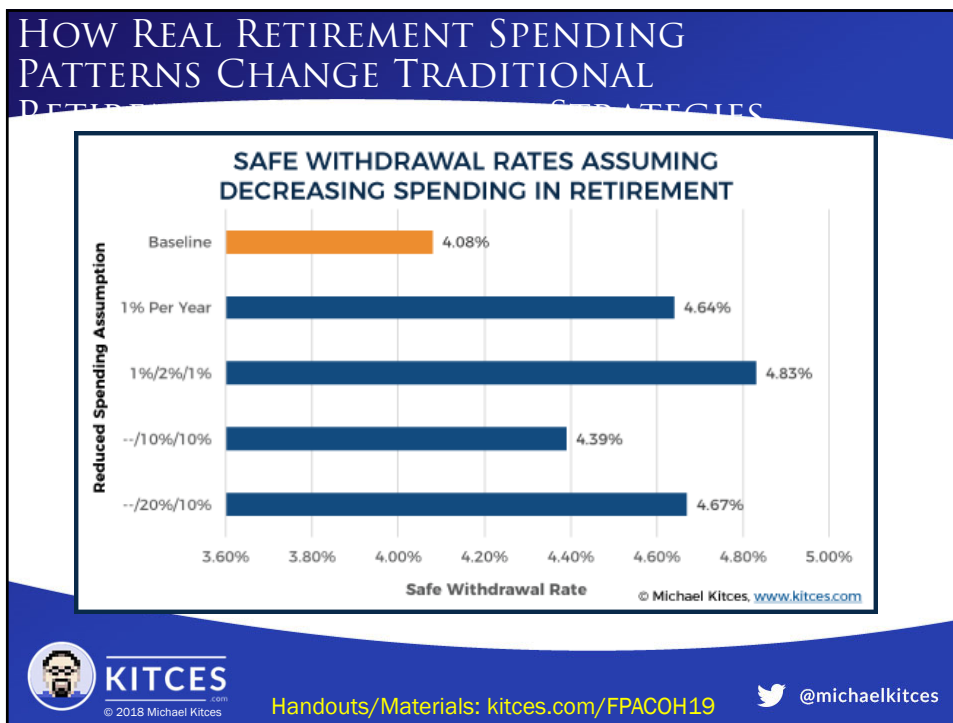


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OVERALL IMPACT

- SWR increase of 0.32 percentage points to 0.75 percentage points
- SWR increase of 8% to 18%
- \$4,008 per \$100k of retirement assets to \$4,390 - \$4,830 per \$100k



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ALTERNATIVE APPROACH

- Market driven spending reduction triggers
- Small-but-permanent cuts vs. large-but-temporary



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SPECTRUM OF DYNAMIC WITHDRAWAL RATE SPENDING STRATEGIES




Fixed [Inflation-Adjusted] Dollar Withdrawals

Low Initial Withdrawal Rate

High Spending Stability

←—————→

Dynamic Spending Decision Rules




Fixed Percentage Withdrawals

High Initial Withdrawal Rate


Low Spending Stability

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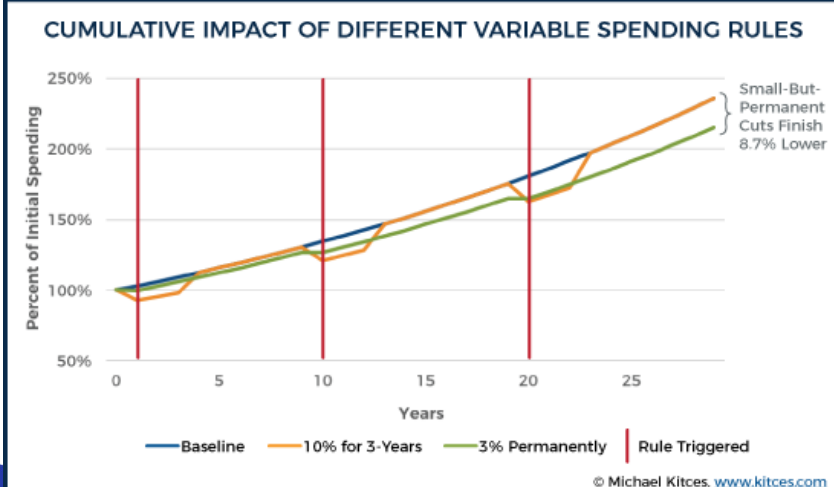
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CUMULATIVE IMPACT OF DIFFERENT VARIABLE SPENDING RULES



Years	Baseline (%)	10% for 3-Years (%)	3% Permanently (%)
0	100	100	100
5	110	110	110
10	125	125	125
10 (Rule Triggered)	125	145	125
15	145	155	145
20	165	175	165
20 (Rule Triggered)	165	175	145
25	195	215	145


Small-But-Permanent Cuts Finish 8.7% Lower

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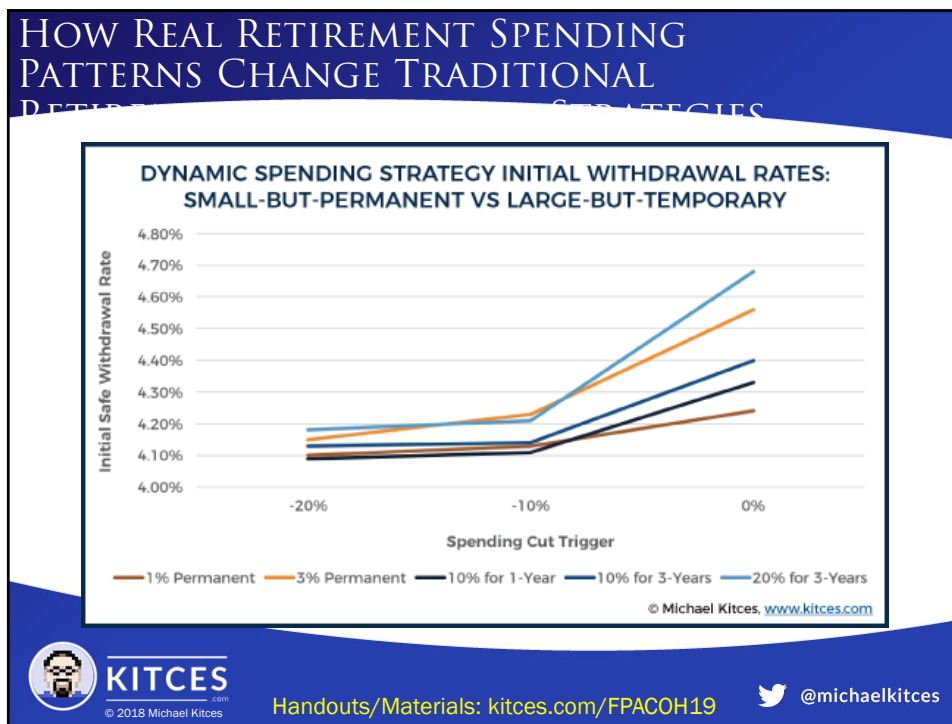


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DYNAMIC SPENDING STRATEGIES

- Guyton-Klinger Decision Rules
- Kitces' Ratcheting SWR
- Finke, Pfau, and Williams (2012): Risk tolerant individual may prefer 5-7% withdrawal rate with a guaranteed income of \$20k



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KEY TAKEAWAYS AND PLANNING IMPLICATIONS

- Important to consider retirement spending trajectory in any type of analysis
 - Constant real spending is often *not* accurate
 - For affluent clients, tends to overstate retirement income need

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KEY TAKEAWAYS AND PLANNING IMPLICATIONS

- Opportunity to incorporate client-specific risk preferences
 - Willingness to accept/tolerate some uncertainty:
 - Can lead to higher withdrawal rates
 - Influences ideal allocation

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KEY TAKEAWAYS AND PLANNING IMPLICATIONS

- Financial planning tools can be lacking
 - Don't just accept the default assumption
 - Can inflate spending at rate lower than inflation
 - Can decrease spending in "chunks"


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KEY TAKEAWAYS AND PLANNING IMPLICATIONS

- Realistic assumptions can be limiting in many other areas
 - Savings assumptions
 - Income-growth over the lifecycle
 - Allocation
 - Taxes
 - Life expectancy
 - Good example, see Blanchett, Finke, Pfau (2017)


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KEY TAKEAWAYS AND PLANNING IMPLICATIONS

- Best assumptions are realistic to your client
 - To the extent your client's unique dynamics can be captured, that is often the best route

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SUMMARY

- Real spending through retirement is not flat
- Vary at age/stage of life (and by category)
- Can substantially impact safe withdrawal rates
- Declining spending throughout retirement means that typical assumptions often overstate retirement savings need

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