



## It's Not How Much You Save for Retirement, It's How Much You Spend While You're Retired

A Nobel Laureate economist has sharply criticized a fundamental savings-and-spending-in-retirement concept that investment professionals have touting for decades as “the rule.”

William Sharpe, a professor of finance at the Stanford Graduate School of Business and recipient of a Nobel Prize in Economics, says that the “4% rule,” which is the most commonly offered spending advice given by investment professionals, may ultimately be harmful to the interests of retirees who follow it.

The 4% rule suggests that retirees spend four percent of their savings while investing in a mix of assets that includes stocks and bonds.

Not so fast, objects Prof. Sharpe. “If a retiree adopts a 4% rule, he will waste money by purchasing surpluses, will overpay for his spending distribution, and may be saddled with an inferior spending plan,” wrote Sharpe and colleagues Jason Scott, managing director of the Retiree Research Center at Financial Engines, and John Watson, a fellow at Financial Engines, Inc., of Palo Alto, Calif.

The 4% rule assumes the retiree adopts a fixed spending plan over 30 years of retirement, and invests in instruments that produce variable returns. Most investment professionals, says Prof. Sharpe, would advise a retiree to spend less if his investments are consistently underperforming.

What if returns are better than an-

anticipated? According to Prof. Sharpe, that means there would be money left over at the end of life—a surplus. That’s a waste, and there’s also additional waste on the front end because the retiree paid for investment surpluses he didn’t need.

Despite variations in investment schemes, the problem, says the Nobel Laureate, is “they all attempt to finance a constant, non-volatile spending plan using a risky, volatile investment strategy.”

Is the solution to adopt a near-risk free investment strategy, such as by investing in U. S. Treasury securities? And retain the 4% rule?

For example, a retiree might invest \$1 million in these assets, be guaranteed a 3 percent return over 30 years, and withdraw \$30,000 a year. Over the retiree’s lifetime, that could result in a complete spend-down.

Maybe that’s enough, says Prof. Sharpe; but what advisors really need to do is to find ways to help retirees make a realistic assessment of their own risk tolerance. Sharpe and his colleagues have learned that the traditional quizzes given by advisors to their clients do not yield much useful information.

If people are going to invest in volatile assets after they retire, they will need to choose a strategy that adjusts their spending as the value of their savings changes.

“That’s quite a leap from the inflexible 4% rule,” concludes Prof. Sharpe