Rafferty Annuity Framing LLC

Is 3% the New 4%?

The Problem:

- In October of 1994, financial adviser Bill Bengen published research in Journal of Financial Planning, titled "Determining Withdrawal Rates Using Historical Data."
- This became known as "the 4% rule", which specifies that a portfolio roughly split between stocks and bonds could, with high confidence, sustain an initial withdrawal of 4% of the portfolio value, increased in dollar terms by the rate of inflation each year.
- Central to this 4% rule of thumb is a return assumption in the fixed income piece of the portfolio that is substantially higher than current fixed income yields/returns: it was about 5.5%
- As of this writing, the yield on the ten-year treasury is 1.3%, and the yield on the Barclays Aggregate Bond index is roughly 1.9%.
- Subsequent academic research revisiting this rule indicates that 4% may no longer remain viable given fixed income yields today, and that 3% or lower may be more appropriate.
- While nominally 4% is only 1% more than 3%, on a relative basis it is 33.33% more - meaning you need 1/3 more in financial assets to generate the same cash flow with a 3% withdrawal than with a 4% withdrawal to produce the same level of cashflow.

"What's the difference between 4% and 3%? Hint: Not 1%"

To produce an initial withdrawal amount of $25,000 from a portfolio:

3% withdrawal requires $833,333

4% withdrawal requires $625,000

33% Larger portfolio required at 3% vs 4% withdrawal to produce same dollar cashflow

Vulnerable Prospects:

- Those who's retirement lifestyles will depend heavily on drawing from their accumulated retirement savings, particularly high earners without pension income.
- Look at the HIPPs in your book – these are the *high income, pre-retired, pension-less* clients, and these will be the most vulnerable given that social security will replace a smaller proportion of their income.

Why Act Now?

- The fixed income bull market is forty (40!) in 2021. Yields across the credit spectrum are tiny.
- Research indicates that future fixed income returns are heavily correlated with current yields
- Equity markets are richly priced with forward P/Es north of 20 (as of July 2021)
- Now is the time to examine solutions that provide much higher cash flows than either a safe withdrawal of 3 or 4%.

An annuity when framed properly can be a great solution. Contact me today!

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