



Retirement Income Safety

May 9, 2025

One of the thorniest, most complicated issues facing retirees is how much they can take out each year from their retirement portfolio—safely, which means without running out of money somewhere down the road. Why complicated? Nobody knows in advance what the markets will do, and hence the amount the portfolio will grow to (or not) each year and overtime.

Nobody knows the inflation rate, future tax rates or (maybe the most important variable) at what age they're going to die. If you assume you're going to die next year, then you can safely spend all of your retirement money this year and not worry about living under a bridge at some lonely point in the future. If you break the record and live to 126, then your retirement portfolio might need to stretch a bit.

The most sophisticated research on the topic comes from William Bengen, who published an influential article in 1993 that looked at how much retirees could afford to spend each year, inflation-adjusted, if they had retired in each month since 1926, assuming a 30-year retirement. His initial conclusion over thousands of actual retirement trajectories was that in the worst case, you could live off of 4% of the initial portfolio amount in the first year, adjusted for inflation thereafter, and still have a bit of money left over.

But that 4% figure was a worst-case scenario, which befell those unfortunate retirees who left work right at the start of the stagflation period and who experienced the full brunt of the market downturns of the 1970s. (One interesting aspect of the research was that inflation was a bigger threat to retirement portfolio sustainability than bear markets.) In every other time period, people could have been more adventurous with their spending, in some cases up to 10% of that initial portfolio.

Bengen has written a new book that will come out in August, which explains the variables that retirees have to consider, including the aforementioned unknowns, plus the mix of assets in the portfolio, how much of a bequest the retiree wants to leave to heirs, the tax status of the portfolio and the method of withdrawals. For instance, for a portfolio that includes more asset classes

(small cap and international stocks among them) the new worst-case scenario, based on the historical record, now rises to 4.7%.

If all of this sounds a bit mind-boggling, there's a relatively simple solution. You, or the advisor team, can calculate that initial amount that can be withdrawn based on the currently known situation, and then make adjustments each year depending on how circumstances (the markets, inflation, etc.) have changed. Generally, if the initial withdrawal is based on the worst-case scenario, most retirees will be able to take a 'raise' in future years, and as they get older (as the time to death approaches) they achieve more certainty.

Another simple solution is to calculate the amount needed for essentials—food, shelter, gas etc.—and see if Social Security or pensions cover all or most of it. If not, then how much is needed from the portfolio to pay for the remainder? That amount, covering two or three years, can be set aside in cash or short-term bonds, and the retiree knows that no matter what happens in the market, the basics are properly funded for the foreseeable future.

Retirement income planning is undeniably more complicated than accumulating a retirement portfolio during the work years. Bengen's book, and his research, shows that with careful monitoring, it doesn't have to be overwhelming.

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number [\(215\) 325-1595](tel:2153251595) or you can [click here to schedule a meeting](#).

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