Retirement Daily

Saving/Investing for Retirement

Ask Bob: Have We Saved Enough?

By Robert Powell | Apr 15, 2019 7:38 AM EDT

Question: My wife and I are 71 years old and retired. We spend around $115,000 a year. This dollar amount covers everything. My question is: How much money should we have saved/invested at this point in our life?

Answer: Lynn Dunston, CFP®, EA, founder and senior wealth planner at Dunston Financial Group in Denver, CO, offered this response:

While some suggest general rules of thumb designed to tell one how much one should have saved or invested at a given stage of life, those rules of thumb all fall short. If only financial planning were so simple. The problem with such guidelines is that they fail to consider the many key assumptions that are critical to doing thoughtful retirement income planning.

Even the so-called 4% rule is not designed to be a general catchall to fit every situation.

William P. Bengen, a retired financial adviser, first described the 4% withdrawal rate in 1994 as a guide for withdrawal rates from retirement savings.

Bengen advocated thoughtful retirement planning that takes into account important key assumptions. His work on the 4% safe withdrawal rate was also deeply reliant on assumptions, namely an assumed 50% stock/50% bond allocation, a 30-year time horizon, inflation-adjusted withdrawals, and a willingness to spend down principal, all back-tested over terrible market conditions.

To give your question a thoughtful answer, one would need to know a lot more about your circumstances. I've outlined, below, the areas in which key assumptions need to be made for one to arrive at recommended savings rates. After discussing these, I will make some assumptions of my own, and conclude with an answer to your question.

If you want to explore general rules of thumb about how much you should save, here's one from Investopedia, from Fidelity.com, and from TRowePrice.com.

Income Sources

First, are you collecting income from your or your wife's Social Security, a pension, a rental property, or some other source of income, or are you spending down your portfolio at a rate of $115,000 per year? If there are other income sources, it would be important to know how reliable they are, and how much of the total $115,000 need they could provide. Any other income sources would reduce the amount of capital you need to have saved in your portfolio.

Inflation

One would also need to know if you want or need your $115,000 withdrawal to be inflation-adjusted each year. Most people need and want their purchasing power to keep pace with inflation; therefore, one needs to make a reasonable forward-looking assumption about inflation rates. Inflating the $115,000 to maintain purchasing power also increases the amount needed in the portfolio.

Life Expectancy

Another key assumption is the planning time horizon. Does the portfolio need to last 10 years, 20 years, 30 years, or longer? The longer the money needs to last, the more money you'll need to have saved. Related to this, do you want to spend at the same $115,000 rate for the entire planning horizon or do you anticipate a lower spending rate later in life when you might not be as active? I often assume a lower spending rate for the later retirement years.

Health Considerations

Health assumptions are also critical. Higher than average healthcare costs in retirement or a stay in a long-term care facility can have a dramatic effect on one's savings. Most retirees want to have enough resources saved that would give them flexibility to be able to cover some or all of those costs if needed.

Other Assets

It's often helpful to know if there are other sources of assets, such as home equity that might become available at some point during the planning horizon. It might not be as concerning for a retiree to spend down a portfolio if there is an infusion of capital that can come from another source, such as home equity or an inheritance.

Investment Allocation and Location

To give a thoughtful answer to this question, one would also need to know what the composition of the investment assets is. For example, are they invested in bonds, cash, stocks, or a combination of all three? Where the assets are located also matters. If the assets are in taxable brokerage accounts, Roth IRAs, or traditional IRAs, that will have an influence on the tax treatment and longevity of the portfolio. These answers will also determine assumed rates of return, projected tax rates, and the availability of the assets.

Growth Rates

The assumed rate of the return on the portfolio can make a dramatic difference on the portfolio's longevity. A portfolio that earns an average 8% return will last longer than one earning 2%. A retiree who is highly risk averse and likes to keep money in CDs will need to have more money saved than a retiree who has portfolio with a heavy weighting toward stocks.

Withdrawal Strategy

Finally, several questions related to one's overall retirement withdrawal strategy will influence how much needs to be saved. Do you want to leave anything to your heirs, or are you willing to spend down all of your resources? Are you willing to spend down principal, or do you want to solely live on gains? Will you be withdrawing assets directly out of the investments and thereby liquidating the investments and, if so, will this be done monthly, quarterly, or annually?

It's also important to know how you define retirement withdrawal success. In other words, is a successful retirement plan one where the portfolio lasts to the end of the planning horizon? Is success defined by leaving a legacy to heirs or charity? Or, is success being able to spend as much of the portfolio as possible? Success can also be defined by a desire to maintain liquidity and reduce volatility. The answers to these questions will influence how much one needs to have saved, and a slight variation to any one of these key assumptions can have a large impact on the results.

In your case, I will make the assumption that there is no additional retirement income from Social Security or any other sources, that inflation averages 2.56% and that you want inflation-adjusted withdrawals, and that you and your wife will live to age 90. I will also assume that you are both healthy and will not have healthcare expenses that exceed what you're currently paying in your budget. I will further assume that there are no other available assets besides what you have saved, that all of your savings are held in a taxable brokerage account, and that you are invested in a 60% stock and 40% bond portfolio that earns a projected average annual rate of return of 5.56%.

With these assumptions in mind, and after stress-testing this hypothetical scenario with 1,000 Monte Carlo simulations, you would need $1,925,000. According to these assumptions, you would have a 79% probability of achieving your goal, and your projected median end-of-life portfolio assets would be $494,723.

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Got questions about the new tax law, Social Security, Medicare, retirement, investments, or money in general? Email Robert.Powell@TheStreet.com. Kim McSheridan assisted with this report.

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