What Is the 4% Rule? - Video Transcript

If you are nearing retirement or recently retired, you may wonder how much you can withdraw from your retirement portfolio each year before running out of money.

This is often referred to as a sustainable withdrawal rate.

One common guideline is the 4% rule, which works like this:

Let's say your retirement nest egg is $1 million. You would withdraw $40,000 the first year.
In subsequent years, you would adjust your withdrawal for inflation, to keep up with rising living costs. If inflation is 3% in year 1, you would withdraw $41,200 in year 2. And this would repeat year after year.

Inflation adjustments will lead to higher annual withdrawals over time. However, your retirement portfolio may be earning investment returns at the same time, which would help balance these increases and make your portfolio last longer.

Hypothetically, if inflation is 3% annually, and your annual return is 5%, your savings would last almost 34 years using the 4% rule. For comparison: If you started with an initial withdrawal rate of 5% or 6%, your savings would last about 25 years or 20 years, respectively.

Chart: *This hypothetical example of mathematical principles is used for illustrative purposes only and does not represent the performance of any specific investment. Fees, expenses, and taxes are not considered and would reduce the performance shown if included. Rates of return will vary over time, particularly for long-term investments. Investments with the potential for higher rates of return also carry a greater degree of risk. Actual results will vary.*

Of course, in the real world, no one can predict the rate of inflation or their investment returns. The 4% rule was developed during the 1990s by looking at actual market data for different retirement years. The study found that a 4% inflation-adjusted withdrawal rate was sustainable over 30 years in the *worst-case* market situation.

Subsequent research has found that higher withdrawal rates may be sustainable depending on factors such as asset allocation, inflation, and market valuations at the time of retirement.
On the other hand, some analysts suggest that even 4% could be too high.

Whatever initial withdrawal rate you choose, it can be modified over time. For example, you might not always make full adjustments for inflation. Or you may take higher withdrawals when market returns are high and lower withdrawals when returns are low.

An appropriate strategy will depend on your personal situation — including your portfolio's value, your other income sources, your retirement spending, your timeframe, and your risk tolerance. You may benefit from a professional analysis.

Although there is no assurance that working with a financial professional will improve investment results, a professional can evaluate your objectives and available resources and help you consider appropriate long-term financial strategies, including your withdrawal strategy.

All investments are subject to market fluctuation, risk, and loss of principal. When sold, investments may be worth more or less than their original cost. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. The principal value of Treasury securities fluctuates with market conditions. If not held to maturity, they could be worth more or less than the original amount paid. Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss. Rebalancing involves selling some investments in order to buy others; selling investments in a taxable account could result in a tax liability.