

## How long will my money last?

For some investors, portfolio returns exceed withdrawals, their savings 'nest egg' continues to grow, and they need never fear outliving their savings.

For many others, retirement savings can be compared with a rain water tank. Cash flows in from investment income and the sale of assets and cash flows out to fund income streams as well as lump sums. Just like a rain water tank, if the cashflow out is greater than the cashflow in, sooner or later the tank is empty. The critical question then is; "How long before my money runs out?" The answer is typically; "It depends..." It depends on so many uncertainties that many retirees become too cautious.

Rather than simply hoping for the best, the table below gives some guidance. It shows the number of years it takes for a starting amount of savings to reduce to zero if the amount withdrawn is greater than the amount earned.

### Spending more than you earn

Assume Fred has \$400,000 in savings and she needs an annual income of \$40,000 (10%). Assume also these retirement savings are invested and earning 6%. Therefore, Fred needs to liquidate \$16,000 of capital in the first year to pay the shortfall in income and her savings balance progressively declines. According to this table, reading across the rows and down the columns, it will take 15.73 years until those retirement savings are reduced to zero. If Fred could reduce his spending to 8%, his savings will last for 23.79 years.

If Fred spends 8% of his savings annually and earns only 1% per year, from a term deposit for example, his savings will be drained in only 13.42 years. It begs the question why term deposits remain so popular.

Retirement Savings		EARNING													
		1%	2%	3%	4%	5%	6%	7%	8%	9%	10%				
SPENDING	\$800,000														
	\$32,000	4%	28.91	35.00	46.90										
	\$40,000	5%	22.43	25.80	31.00	41.04									
	\$48,000	6%	18.32	20.48	23.45	28.01	36.72								
	\$56,000	7%	15.49	16.99	18.93	21.60	25.68	33.40							
	\$64,000	8%	13.42	14.53	15.90	17.67	20.10	23.79	30.73						
	\$72,000	9%	11.84	12.69	13.72	14.99	16.62	18.85	22.23	28.55					
	\$80,000	10%	10.59	11.27	12.07	13.02	14.21	15.73	17.79	20.91	26.72				
	\$88,000	11%	9.58	10.13	10.77	11.52	12.42	13.53	14.95	16.88	19.78	25.16			
	\$96,000	12%	8.74	9.21	9.73	10.34	11.05	11.90	12.94	14.27	16.09	18.80			
	\$104,000	13%	8.04	8.44	8.88	9.38	9.95	10.62	11.43	12.42	13.68	15.38			
	\$112,000	14%	7.45	7.78	8.16	8.58	9.06	9.60	10.24	11.01	11.95	13.14			
	\$120,000	15%	6.93	7.23	7.55	7.91	8.31	8.77	9.29	9.90	10.63	11.53			
	\$128,000	16%	6.49	6.74	7.02	7.33	7.68	8.07	8.50	9.01	9.59	10.29			
	\$136,000	17%	6.09	6.32	6.57	6.84	7.14	7.47	7.84	8.26	8.75	9.31			
\$144,000	18%	5.74	5.95	6.17	6.41	6.67	6.96	7.28	7.64	8.04	8.51				
\$152,000	19%	5.43	5.62	5.81	6.03	6.26	6.51	6.79	7.10	7.45	7.84				
\$160,000	20%	5.15	5.32	5.50	5.69	5.90	6.12	6.37	6.64	6.94	7.27				

Years to Zero

This table assumes constant withdrawal and earning rates over the whole time period, with no fees, taxes or inflation.

### The real world has fees, taxes and inflation

The table can illustrate the effects of fees and/or taxes. In Fred's example if the fees/taxes equalled 1% the drawdown rate becomes 9% instead of 8%. According to the table, the savings are then exhausted after only 11.84 years, not 13.42 years. The fee of 1 per cent has truncated the income stream by 1.58 years. That is the true cost of an annual fee of just 1 per cent.

With inflation, withdrawals need to progressively increase to maintain spending power. Modelling inflation is not possible because the table assumes uniform withdrawals, but if inflation is a constant 3 per cent (which is near the RBA's preferred rate) prices will double in 24 years. In that scenario, the example savings will be depleted long before that time.

#### For Retirees the Age pension is a safety net

In reality, the balance of capital is unlikely to reach zero for retirees because in Australia we have the safety net of the age pension. A couple who own their home with \$800,000 in financial assets could be entitled to an annual part-pension of \$6,258. Their combined income (investments at 6% + age pension) is \$54,258. If this couple were to decrease their capital by \$100,000, under the current assets test, their combined pension would increase by \$7,800 to \$14,058. The taxpayer has replaced the \$6,000 (6%) formerly earned from that \$100,000 with an increased pension of \$7,800 (7.8%). Their combined income is now \$56,058.

When their assets fall to \$401,500 this couple gain the full age pension of \$37,340 so their combined income is \$61,430. The age pension places a safety net under all retirees, thereby reducing the need to liquidate capital.

#### The challenge of financial independence

For investors who aspire to financial independence, the task is complex. Without careful planning, Australians are likely to outlive their savings. We know that 50 per cent of males currently aged 65 will survive beyond age 84, but around 5 per cent of that group will survive beyond age 97. Similarly, 50 per cent of females currently aged 65, will survive beyond age 88, but around 5 per cent of that group will survive beyond age 100. Some individuals will survive even longer.

Therefore, if independent retirees wish to plan their retirement with a 95 per cent certainty that they will not outlive their money, they need to plan for a retirement of at least 30 years.

There is a direct relationship between risk and investment return, but independent retirees also need to balance market risk against the longevity risk that they will outlive their savings. Therefore, those who adopt low-risk, low-return investments may be sacrificing their long-term financial security due to their short-term concern about market volatility. Yet, such conservative investment portfolios are typically considered normal and appropriate and may explain why so many retirees exhaust their own resources prematurely.

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