Retire or Keep Working

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Most investors are experiencing a bear market for the first time. Many see the value of their portfolios substantially down. In each of my past articles, I emphasized the importance of being conservative, avoiding leverage, having a proper asset allocation, owning only the best mutual funds (if you are investing in mutual funds), last but not least, low cost investments such as DRIPs.

Now that we are in a bear market, those who were planning to retire this year and counting on their investment portfolio for retirement income are in for a rude awakening.

Let's walk through an example. Our fictitious friend, Bob, was planning to retire this fall. He is 60 years old. He had $500,000 at the end of December 2001 in his portfolio. After considering his government benefits and his other income, he was planning to withdraw $20,000 in his first year of retirement. This is the base amount that is adjusted annually for inflation. He wants his portfolio to last at least 30 years until he is 90 years old.

In my earlier articles, I demonstrated that if you want your portfolio to last at least 30 years, then you ought not to withdraw more than 4% of your portfolio during the first year of your retirement. In Bob's case, his *initial withdrawal rate* would be exactly 4%, i.e. $20,000 out of $500,000.

Unfortunately, Bob was too aggressive with his investments: His portfolio is down 20% since the end of last December. Its market value is now only $400,000. Bob wants to know the consequences of this bear market on his retirement plans.

Bob has three choices:

- Reduce his withdrawals
- Ignore the bear market
- Keep working

Reduce Withdrawals:

If Bob retires now, he needs to reduce the amount of his periodic withdrawals. The math is simple: To make his portfolio last for at least 30 years, Bob can withdraw only $16,000, which is 4% of his current portfolio value of $400,000. In each of the following years, Bob will index this base income of $16,000 for inflation. In other words, for the rest of his life, Bob has to take a pay cut of 20% from what he originally planned at the end of 2001.

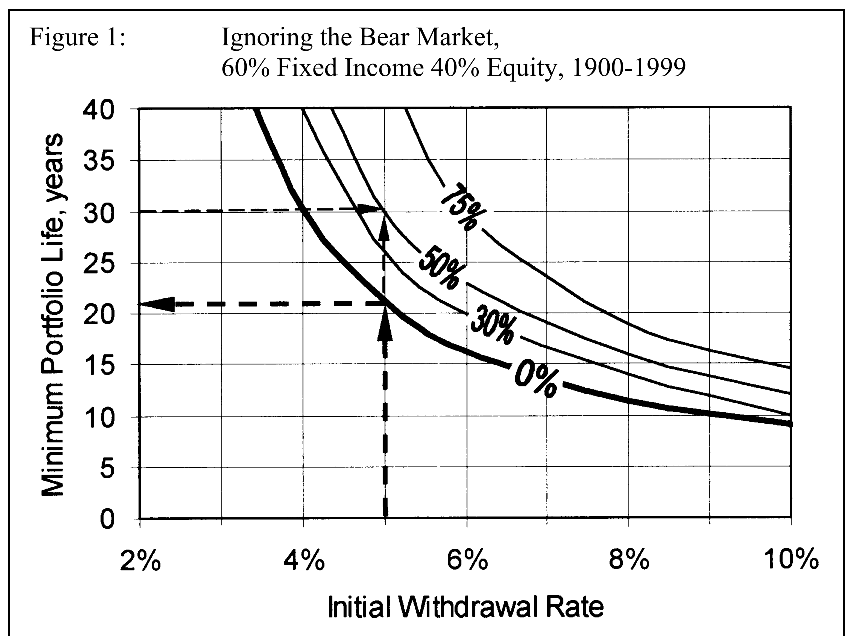
Ignore the bear market:

Bob can just ignore the market and withdraw his original planned amount of $20,000 during the first year of his retirement. He then indexes this base amount for inflation in subsequent years.

In doing so, Bob's portfolio will run out of money sooner. How much sooner? First we calculate Bob's initial withdrawal rate: $20,000 is 5% of his initial capital of $400,000. Then we can read off that –based on one hundred years of stock market history-, instead of 30 years, the minimum portfolio life will be about 21 years. After 30 years, when Bob is 90, there is a 50% chance that he would be broke.

Keep Working:

Figure 1: Ignoring the Bear Market, 60% Fixed Income 40% Equity, 1900-1999



Bob may choose to continue working a few more years. Working longer helps in two ways: Firstly, his portfolio can grow longer without having to sell any investments at a low point in current market conditions to provide him with income. Secondly, the longer he works, the shorter will be the time period during which he needs to draw income from his investments.

Bob wants to know how many more years he has to work so that he can withdraw $20,000 in today's dollars when he finally retires and that his portfolio lasts at least until he is 90 years of age.

Using my “True Market Retirement Simulator” (available for free downloading at our website), I plugged in the numbers and figured out that Bob has to work for an additional three and a half years.

If Bob had lost different amounts, here is a table showing how many years more he would need to work to achieve his sustainable withdrawal rate until he is 90:

Loss of Capital from Bob’s Original Plan	Additional Years Bob needs to Work
0% loss	Retire now
10% loss	1.5 years
20% loss	3.5 years
30% loss	6.5 years
40% loss	9.5 years
50% loss	12.5 years
70% loss	20.0 years
100% loss	Until death

Remember this table applies only to those close to retirement. Each person has unique circumstances and must be evaluated individually.

Be aware that all the figures are based on one hundred years of market history between 1900-1999. The future performance may be different.

How can you avoid future disasters: Avoid leverage, invest conservatively, have a balanced portfolio, own only best mutual funds and dump them when they are underperforming (see my Fingerprinting charting service at the Canadian MoneySaver website), have no debt. The same simple stuff I have been writing about since 1996 in this magazine. Try it; it worked for me so far.

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