

Right Road.

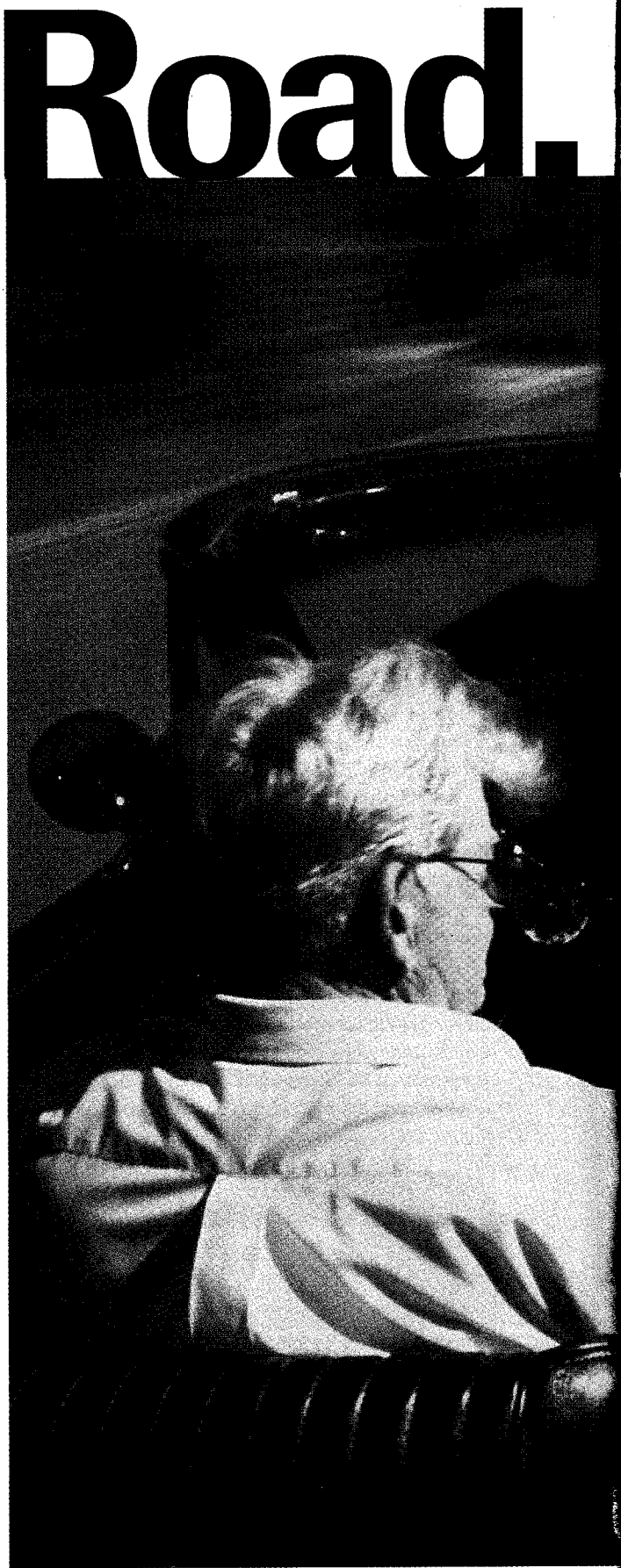
The vast majority of retirement plan projections are overly optimistic because they're based on incorrect or outdated assumptions. By Jim Otar

As financial planners, our goal is to provide clients with realistic retirement projections. However, my research shows that current models with straight-line growth do not achieve this goal. Adding some randomness to the model, such as the Monte Carlo simulation, is a step in the right direction, but it's still far short of what historic evidence suggests.

Retirement planning software helps us to prepare a projection of asset values into future years. In doing so, we input several assumptions, such as investing a certain amount periodically, retiring at a certain age, withdrawing a certain amount of income from this portfolio after retirement, and so on. Similar retirement calculators are available from financial institutions. For the do-it-yourselfers, there are plenty of Web sites that offer such calculators as well.

These calculators produce a report outlining a financial plan, including a graph showing projected asset growth over time. Typically, it may look similar to the graph shown in Figure 1. Note: For this article, I made the following assumptions: 1) the initial withdrawal rate is 6% during the first year of retirement; 2) the withdrawal amount is adjusted each year for inflation. The average inflation between 1900 and 1999 was 3.5%, and that is what I used in this projection; and 3) the portfolio grows at 8% each year. I am assuming a conservative asset mix of 60% fixed-income and 40% equities. The portfolio is re-balanced each year.

First in a Three-Part Series



Wrong Map

