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MIXING IT UP

Testing the 4%-a-Year Retirement Rule

The adviser who coined this rule of thumb for withdrawals is watching how it holds up in tough markets

By SHEFALI ANAND

The next five years could determine whether a rule of thumb for retirees' withdrawals from their portfolios remains valid in these turbulent times, says Bill Bengen, a financial planner in Southern California.

Mr. Bengen is the creator of the 4% rule for retirement withdrawals.

In a study published in 1994, he said that if retirees withdrew 4% of their nest egg in the first year, and then increased the dollar amount by the inflation rate every year, their savings would easily last 30 years. He assumed that the portfolio was held in a tax-deferred account and was evenly split between large-company stocks and U.S. Treasury bonds.

In a subsequent study, Mr. Bengen added U.S. small-company stocks to the mix, which increased the portfolio's volatility and potential return. To adjust for this, he revised the withdrawal rule to 4.5%.

In recent years, as stocks have become more volatile, many observers have wondered whether Mr. Bengen's rule still holds. So far, he thinks it does.

However, he says the next five years could be crucial, particularly for individuals

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Stan Lawrence

who retired in 2000 and have experienced two major stock-market downturns since then. He expects stock returns to be low for a while; if that is coupled with high inflation rates, "then retirees have a big problem," he says.

He doesn't think a sharply higher inflation rate is likely in the near future, "but you never know," he says.

In this column, we feature model portfolios from prominent financial advisers who invest primarily in mutual funds and exchange-traded funds. Mr. Bengen has been a practicing financial planner since 1989 and currently runs a solo practice from his home offices in Eastlake and La Quinta, Calif. He manages $50 million for around 80 clients.

Mr. Bengen says that retirees whose withdrawals lately have gone up to 5.5% or 6% of the current value of their account should consider taking steps to protect their nest egg.

One option is to put 10% of their savings into an immediate annuity now, to guarantee an income stream for life, and consider buying another annuity in a couple of years. "You don't have to go whole hog," he says, addressing the concern of some retirees that annuitizing all their savings would leave no money for their heirs. If the markets zoom up in the next couple of years, the second annuity might not be needed, he says.

Alternatively, he says, retirees can look at taking a reverse mortgage, which basically converts a portion of the equity in their home into cash. "Both tools do very similar jobs—they just give you extra cash" to augment investment income, says Mr. Bengen.

Here, he shares the portfolio of a 60-year-old client, which is representative of his choices for many clients.

STOCKS: The portfolio has just 32% in stocks, partly because Mr. Bengen has been holding a lot of cash in recent years.

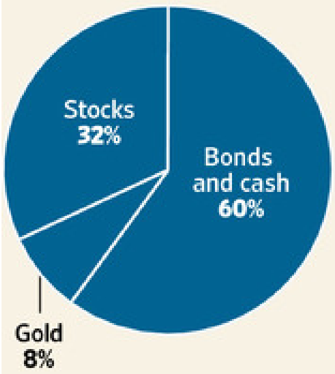
"The most important thing right now is capital preservation," he says. He is concerned that large movements of money globally are distorting the stock market.

"It's a very uncomfortable time," he says. To deal with this, he has been very active in recent years in moving in and out of investments as market conditions change.

He expects stocks to extend their recent gains in the next few months, because he believes central banks will continue to pump money into the global financial system and much of that will find its way into stocks.

Dividing Up the Money

A model portfolio of Bengen Financial Services



Stocks	32%
SPDR Dow Jones Industrial Average (DIA)	9
iShares Dow Jones Select Dividend Index (DVY)	5
Utilities Select Sector SPDR (XLU)	2
Marketfield Fund (MFLDX)	3
Hussman Strategic Growth (HSGFX)	2
FPA Crescent (FPACX)	1
Archer Daniels Midland Co. (ADM)	2
Vanguard MSCI Emerging Markets (VWO)	8

Bonds and cash	60%
Vanguard Intermediate-Term Bond ETF (BIV)	28
Vanguard Short-Term Bond ETF (BSV)	7
DoubleLine Total Return Bond (DLTNX)	7
SPDR Barclays Capital High Yield Bond (JNK)	5
Cash	13

Gold	8%
iShares Gold Trust (IAU)	8

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He invests 24% of the portfolio in U.S. stocks, with more than a third of that in the SPDR Dow Jones Industrial Average ETF, at 9% of the portfolio.

To provide a cushion for the portfolio, Mr. Bengen buys some funds that invest in dividend-paying stocks. He puts 5% in iShares Dow Jones Select Dividend Index and 2% in Utilities Select Sector SPDR .

He also uses two funds that can bet against stocks— Marketfield Fund , which can own stocks, bonds, commodities and derivatives, at 3% of the portfolio, and Hussman Strategic Growth , which primarily invests in stocks and derivatives, at 2%.

One percent of the portfolio is in FPA Crescent , whose manager can buy stocks and bonds or hold cash with the goal of "equity-like return with less risk than the stock market," according to the fund's website.

Mr. Bengen recently made a 2% investment in the stock of Archer Daniels Midland Co., a grain trading and processing company based in Decatur, Ill. He expects strong growth in the food and agriculture industry, plus the shares have a dividend yield of about 2.2%.

For his foreign-stock allocation, Mr. Bengen invests 8% in the Vanguard MSCI Emerging Markets ETF. "The developing world offers much greater growth opportunity" than developed economies, he says.

BONDS AND CASH: The portfolio has 47% in bonds and 13% in cash.

The majority of the bond allocation is in two ETFs from Vanguard Group that invest in high-quality government and corporate bonds. Twenty eight percent of the portfolio is in Vanguard Intermediate-Term Bond ETF , which owns bonds with an average maturity of seven years, and 7% is in Vanguard Short-Term Bond ETF , whose typical bond matures in less than three years.

Mr. Bengen invests 7% in DoubleLine Total Return Bond , which invests in government-agency and mortgage bonds, including higher-yielding, low-quality bonds.

He also owns a fund that solely buys low-quality, or junk, bonds, the SPDR Barclays Capital High Yield Bond ETF, at 5%. He likes the fund's high yield, at 7.3%, and potential price appreciation.

GOLD: Mr. Bengen has owned a gold fund since 2008. He currently allocates 8% of the portfolio to iShares Gold Trust . He says that in this uncertain environment, with many central banks printing money, gold helps preserve value. Gold also is very valuable as a hedge against the U.S. dollar, he adds.

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