

# The guardrails approach is a flexible retirement withdrawal strategy: Here's how it works

Select explores a new retirement withdrawal strategy known as the guardrails approach.

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Many experts recommend that people withdraw 4% from their [retirement portfolio](#) each year in order to make their retirement savings last. This much touted advice, however, may not hold true for today's retirees. While personal finance experts have relied on the 4% rule for years, [a recent Morningstar report](#) predicted that future retirees might have a higher chance of making their retirement savings last if they use a lower withdrawal rate.

Financial planner William Bengen first developed the 4% rule in 1994 by using historical returns of the stock market and a 30-year retirement horizon. [The 4% rule dictates](#) that people should withdraw 4% of their retirement portfolios in the first year, only adjusting for inflation each subsequent year. By using a portfolio of 50% stocks and 50% bonds, Bengen found that people with a 4% withdrawal rate had a 90% chance of success (which meant not running out of money during retirement).

Yet today's retiree's are facing an entirely different financial market.

While current retirees have experienced higher than expected stock market and bond returns over the past 30 years, researchers at Morningstar predict that future retirees might find themselves facing lower returns on bonds and stocks after the market's recent stellar performance.

This could mean a future decline in the value of people's retirement portfolios. The report recommends that retirees consider a lower withdrawal rate of 3.3% to ensure they don't run out of money in retirement.

Though researchers suggest a lower withdrawal rate with adjustments for inflation, retirees might also consider trying a more dynamic withdrawal approach. The guardrail approach is one such method. Below, [Select](#) explains what the guardrails approach is and how it works.

## What is the guardrails approach to retirement?

The guardrails approach, which was developed by financial planner Jonathan Guyton and professor William Klinger, requires that retirees change their withdrawal rate based on the performance of the market. This approach is designed to account for changes in the value of your portfolio. Your withdrawal rate will fall when the market is doing poorly or increase when it is doing well.

With the guardrails approach, people set a high guardrail and a low guardrail based on their target withdrawal rate. Therefore, when your withdrawal rate is above or below guardrails, you reduce or

increase your withdrawal amount so you end up within the target withdrawal range.

“And if you think about driving your car down a road, you hit a guardrail, it does two things. It puts a ding in your car, and it changes your momentum so that instead of the momentum pushing you toward the edge of the road, it now starts to shift you back toward the middle where it’s safe,” said Guyton in a [Morningstar interview](#).

Your guardrails are set at 20% above and below your withdrawal rate. For a target withdrawal rate of 5%, the lower guardrail is 4% and the upper guardrail is 6%. The target withdrawal range would be between 4 and 6%.

If your withdrawal rate falls outside your guardrails (after adjusting for inflation) you would take a 10% increase or reduction in your withdrawal amount. After taking the 10% adjustment, your withdrawal rate should be between the upper and lower guardrails. For example, if your retirement withdrawal rate is above 6% next year, you take the inflation-adjusted withdrawal amount and reduce it by 10% so your withdrawal rate is below 6%.

Consider what would happen in a market downturn:

- Year 1: If your portfolio is worth \$1 million and your withdrawal rate is 5%, you withdraw \$50,000.
- Year 2: The value of your portfolio decreases to \$800,000 and your normal withdrawal of \$50,000, with an adjustment for inflation, would be more than 6% of your portfolio. This means you’ve hit a guardrail. You would then take the inflation-adjusted withdrawal amount (assuming 4% inflation) of \$52,000 and reduce it by 10% so you would withdraw \$46,800 which would be less than 6% of your portfolio.

It’s important to note that the guardrails approach does not require that retirees cut their spending by 10% in a market downturn. Retirees often have different sources of income, such as a 401(k) or a traditional IRA. With a pre-tax retirement account like a traditional IRA and a 401(k), you do not pay taxes on your upfront contributions, but you pay taxes on the money when you withdraw it in retirement.

If you had to decrease your withdrawal amount by 10%, part of that reduction could come from the reduced amount of income tax you owe on your retirement withdrawals.

When coming up with your retirement strategy it could be prudent to consult a [financial planner](#) to help find the optimal withdrawal rate and come up with what your guardrails would be.

## Bottom line

While the 4% rule has been the preferred withdrawal retirement strategy for many years, it might be time to consider an approach that addresses the impact that market volatility can have on people’s retirement strategies. The guardrails approach is meant to do that.

By setting your guardrails 20% above and below your target withdrawal rate, you can increase or reduce your retirement withdrawal any time you find yourself spending outside of the range set by your guardrails. Though this withdrawal strategy requires more thought and effort than the 4% rule, it could make your retirement savings last longer.