Living in Retirement:

Why Your Reliance Rate Matters

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When it comes to your retirement, the goal is typically to create a strategy that allows you to do what you want – and not run out of money doing it. This strategy starts with analyzing how much income you need in retirement, your outside sources of income (such as Social Security and a pension) and the role of your investment portfolio to complement these outside income sources. How much you rely on your portfolio for income (versus your outside income sources) is called your reliance rate.

As your reliance on your portfolio for income increases, so does your potential sensitivity to market fluctuations. In other words, if you have a higher reliance rate, market declines could have a greater effect on your strategy. A higher reliance rate may also make other investments, such as income annuities, more appropriate. Here's why.

It Starts with Withdrawals

A successful retirement strategy should start with a reasonable withdrawal rate – or how much of your total portfolio you are withdrawing each year. Withdrawing too much, especially early in retirement, could dramatically affect how long your money lasts. That's why it's critical to start smart with your withdrawals.

In general, we recommend starting with a more modest initial portfolio withdrawal rate of approximately 4%. We call this an "initial" rate, as we assume you will increase the dollar amount of your withdrawals each year by about 3% to account for inflation.

That said, this is a starting point. Your actual expenses and spending will likely fluctuate over time. It's important to review this with your financial advisor each year.

Reliance, Withdrawals and Flexibility

While the withdrawal rate may help determine the *sustainability* of your retirement income strategy, your reliance rate helps determine its *sensitivity*. Your reliance rate is the percentage of your spending goals that must be provided by your portfolio (as opposed to outside sources, such as Social Security).

For example, if you plan to spend $50,000 during your first year of retirement and expect your portfolio to provide $20,000 of this amount, your reliance rate would be 40% ($20,000/$50,000 = 40%).

So how does your reliance rate affect your sensitivity to market fluctuations? Consider this: Individuals relying on their portfolios for 80% of their income are likely to be more sensitive to market declines or "shocks" than individuals relying on their portfolios for only 20% of their needs, regardless of the withdrawal rate. The more conservative your withdrawal rate is, the more you may be able to support a higher reliance rate. However, the higher your withdrawal rate, the more risky a high reliance rate may be. Ultimately, the more you are relying on your portfolio for income, the more a market decline could affect your strategy.

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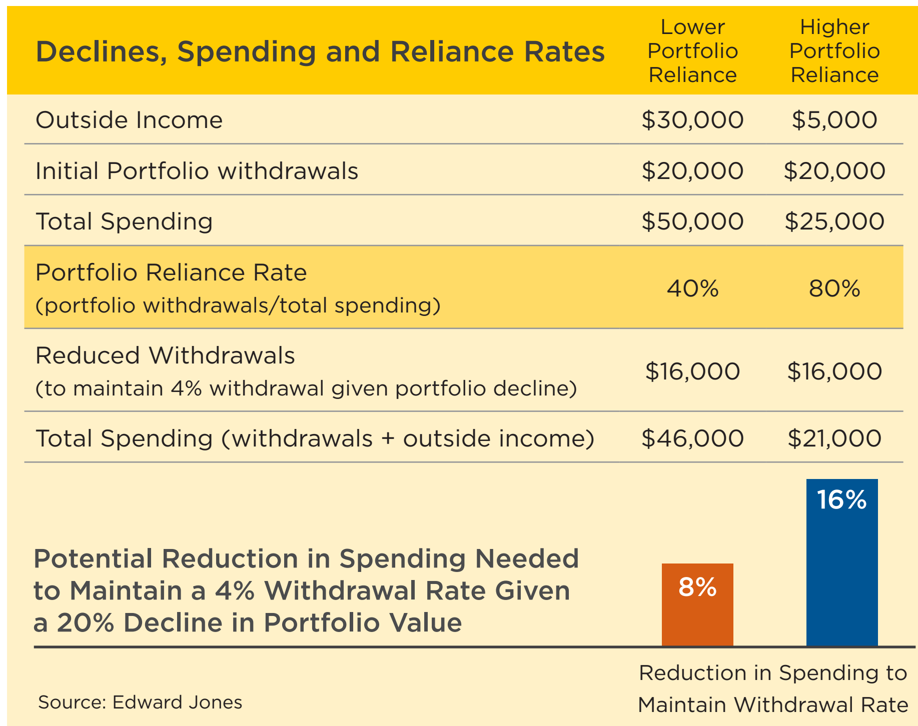
Reliance Rate Illustration

Let's assume you started with a 4% withdrawal rate, withdrawing $20,000 from a $500,000 portfolio. If your portfolio declined by 20% to $400,000, your portfolio withdrawal rate would effectively rise from 4% to 5% if you maintained your $20,000 withdrawal. Remember, your withdrawal rate plays a key role in determining how long your money will last. You are now faced with an important decision: temporarily maintain this higher withdrawal rate or reduce your spending.

If you wanted to maintain a 4% withdrawal rate, you would now only be withdrawing $16,000 from your portfolio (4% of $400,000). Depending on your reliance rate, this could have a much bigger percentage impact on your overall spending, as shown below:



Declines, Spending and Reliance Rates	Lower Portfolio Reliance	Higher Portfolio Reliance
Outside Income	$30,000	$5,000
Initial Portfolio withdrawals	$20,000	$20,000
Total Spending	$50,000	$25,000
Portfolio Reliance Rate (portfolio withdrawals/total spending)	40%	80%
Reduced Withdrawals (to maintain 4% withdrawal given portfolio decline)	$16,000	$16,000
Total Spending (withdrawals + outside income)	$46,000	$21,000

Source: Edward Jones

In the first scenario, since you're relying on your portfolio for a lower percentage of your overall spending, you may decide not to reduce spending, instead maintaining a higher short-term withdrawal rate. However, in the second scenario, it may be more risky to maintain a higher withdrawal rate given your portfolio's importance in providing for your income, both today and many years from now. Additionally, since you are relying on your portfolio for more of your income, you would need to reduce your overall spending by a larger percentage to maintain your withdrawal rate. Ultimately, the higher your reliance rate, the more flexible you may need to be with your spending – especially if you have a higher withdrawal rate.

Notably, one reason we recommend starting modestly with withdrawals is to help account for potential portfolio declines in advance and to avoid being forced to make dramatic adjustments in spending. Thus, you may decide to temporarily maintain a higher withdrawal rate in the short term and not reduce spending. That said, this example helps illustrate the effect that reliance can have on spending during the inevitable periods of market volatility if you decided to adjust your spending.

The Role of Social Security

One of the most valuable sources of outside income in retirement is Social Security. Social Security is a benefit that provides lifetime income for you and potentially your surviving spouse, as well as a potential cost-of-living increase for inflation. Since benefits are reduced if you claim early but increase if you delay, it's important to understand your options before claiming Social Security. Delaying Social Security (and therefore increasing your benefit) could be one way to increase your income from outside sources, provide a source of rising income and reduce the reliance on your portfolio.

While the Social Security program faces challenges, many potential solutions are being considered that could keep the program on solid footing for years to come.* That's why we believe your decision should not be made based on the political environment. Instead, we recommend that you examine your personal situation – including your life expectancy, your need for the income, spousal considerations, and your intention to continue, reduce or stop working – to help make your decision.

*Congressional Budget Office

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Building Balance with Outside and Insured Income

Given the potential income and emotional effects of a higher reliance rate, we believe it's important to build a foundation of outside and insured income. This income – from items such as Social Security, pensions, and income annuities – is unaffected by market fluctuations and can serve as a base for your income, potentially being used for your necessary expenses. While there's no single appropriate rate for all investors, once your reliance rate rises above 50%, market fluctuations can begin to have a greater impact as you are now relying on your portfolio for the majority of your income. The "Balancing Your Reliance Rate" table highlights characteristics that can help you determine what level of reliance may be suitable for your situation.

Balancing Your Reliance Rate

A lower reliance rate may be more appropriate if you have:	A higher reliance rate may still be acceptable if you have:
• A higher withdrawal rate	• A lower withdrawal rate
• Lower expense flexibility	• Higher expense flexibility
• Lower risk tolerance	• Higher risk tolerance
• Above average health/ life expectancy	• Below average health/ life expectancy

Source: Edward Jones

Depending on your individual situation and the characteristics outlined in the table, you may be looking for ways to increase your outside income and lower your reliance rate. Your decision on when to start Social Security may play a role (see "The Role of Social Security"). As previously mentioned, if you have a pension, it will also factor into your strategy.

However, fewer individuals have access to pensions than in the past. One way to replicate this type of income is through the use of income annuities. Certain annuities can offer guaranteed payments for life and can be used as income insurance by adding to your predictable income base. Income annuities can provide a lifetime income stream, regardless of market performance or how long you live.* This insurance can not only help hedge against risks – such as unexpected market declines or living longer than you expect – but also reduce the reliance on your portfolio.

Reliance and Your Emotions

Your reliance rate could also influence your emotions and investment behavior. A higher reliance rate may tempt you to make emotional decisions during a market decline, since your portfolio is supplying more of your needs. However, making dramatic changes to your portfolio in response to a decline could actually increase the likelihood that your money may not last. This is especially true if you move a large portion of your portfolio to cash, as cash does not typically provide growth potential to help keep up with inflation. Since your strategy needs to address your income needs today as well as potentially 25 to 30 years into the future, it's important to understand in advance how you might be more emotionally sensitive to declines when your reliance rate is higher. That way, when declines inevitably occur, you will be better prepared to stick with your long-term strategy.

Retirement Reliability

Each investor has different goals for retirement. But all investors have one retirement goal in common: ensuring their income provides for their needs as long as they need it. Seeking balance between your sources of income can help provide more stability and "reliability" to your income strategy. This strategy also can help prepare you for short-term market fluctuations that could otherwise cause you to veer off track. Contact your financial advisor to help you review your retirement income strategy today.

*Withdrawals taken prior to age 59½ may be subject to a 10% federal tax penalty. Surrender penalties are usually assessed if you withdraw all or a portion of your principal during the guarantee period. Such withdrawals may also be subject to a market value adjustment. Some fixed annuities provide waivers for surrender charges under special circumstances, such as a nursing home stay. Ask your Edward Jones financial advisor which fixed annuity may be right for you. Guarantees are based on the claims-paying ability of the issuing company.

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