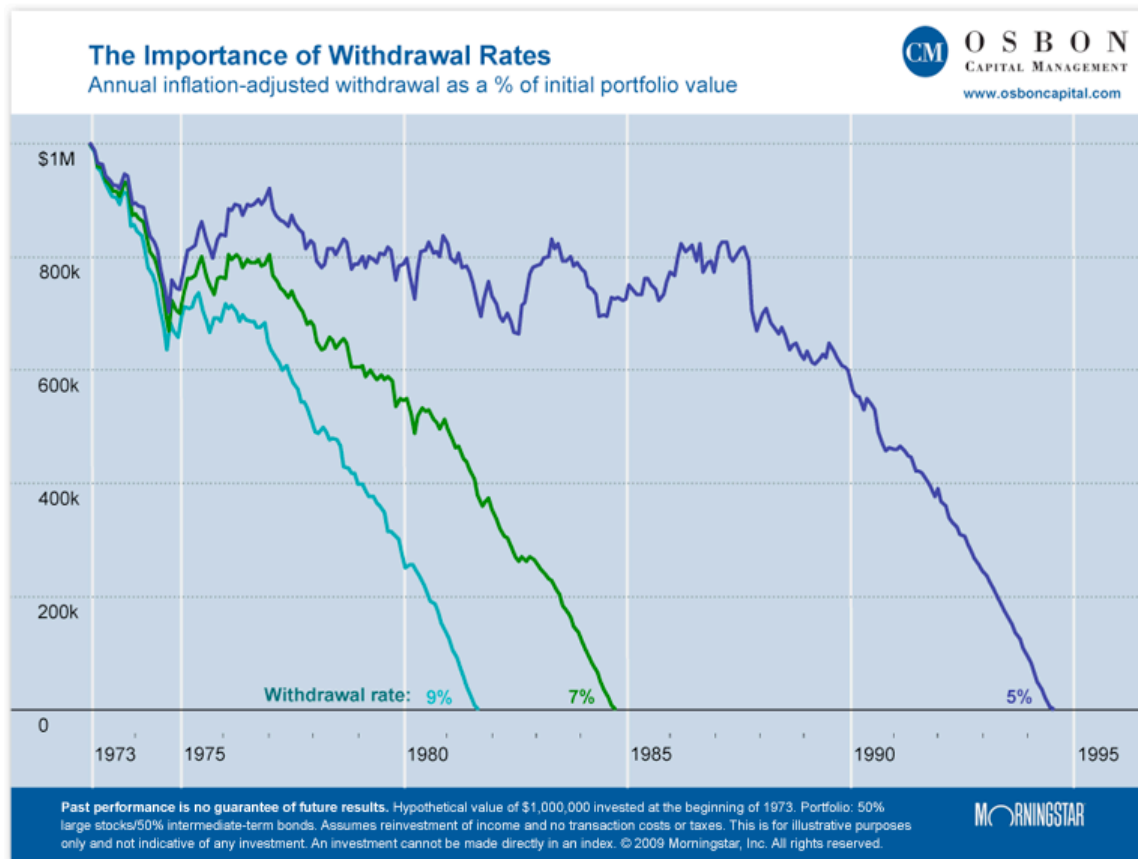




Quick Q & A #16

Q: How long will that nest egg last?



A: That depends on return, inflation, and withdrawal rate.

One of the most critical questions facing many investors is whether the assets set aside for retirement will last as long as they are needed. Because a shortfall in retirement funds can lead to a severely lowered standard of living, or worse, understanding the math is crucial.

Three factors determine how quickly a nest egg depletes – the rate of return that the portfolio earns, the inflation rate, and the withdrawal rate. An investor can only control the third – how much of the portfolio is sold each year to meet cash flow needs.



Small changes in withdrawal rate can have a huge impact. As the chart above demonstrates, an investor with a 50% stock - 50% bond portfolio withdrawing 9 percent of initial portfolio value each year (adjusted for inflation) beginning in 1973 would have run dry during 1981. However, reducing the withdrawal rate to 5 percent keeps the cash flow stream alive to mid-1994 – an extra 13 years.

Prepare for the unpredictable

These timeframes reflect the unpredictable market conditions investors must prepare for. Stiff inflation in the 1970's and early 80's sharply cut portfolio value. By the same token, strong market returns later in the 80's greatly prolonged the cash flow stream, but only in the case of the 5 percent withdrawal rate; it was already too late for the 7 and 9 percent withdrawals.

With increasing life expectancies, retirement now lasts thirty or more years for many. As it impossible to predict what market returns and inflation will do over such an extended period, we recommend building as large an investment nest egg as possible through indexing, and keeping the one controllable variable – withdrawal rate – as low as possible.

Read more: [More Quick Q&As from Osbon Capital Management](#)

Next time: Which business network should investors watch?

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This hypothetical case represents a portfolio of 50% stocks and 50% bonds, with the investor retiring on December 31, 1972. The retiree takes distributions each year equal to 5, 7 or 9% of the initial portfolio value (\$1 million), adjusted for inflation. Each portfolio is rebalanced monthly. Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the five-year U.S. government bond and inflation by the Consumer Price Index. An investment cannot be made directly in an index.



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