

VERSION BEFORE EDITING

Executive Summary

Americans are retiring in their early 60s and living long lives in retirement. Many of these Americans lack the luxury of an old-style retirement plan providing guaranteed income in retirement. They might have accumulated wealth to carry them through the retirement years, but many do not understand how to invest that wealth and how to make sure that it “lasts a lifetime”.

This paper investigates “spending rules” for retirees, the rate of spending that can be sustained in retirement. The spending rule has to be low enough so as not to exhaust wealth in the event of lower asset returns than expected. The paper shows that spending rules have to be based on real, not nominal, returns, and must be set at rates lower than the average real returns expected in the future. The asset allocation of the portfolio must be chosen along with the spending rule, since the two are very much related to one another. In general, the lower the allocation to stocks in the portfolio, the lower must the spending rule be. The paper will not settle on a specific spending rule in retirement, but it will show that the rule depends on the portfolio chosen, the expected real returns of each asset in the portfolio and the volatility of those returns, and the target level of wealth.

VERSION AFTER EDITING

Executive Summary

Americans are living longer lives in retirement than their grandparents. Many lack the luxury of an old-style retirement plan guaranteeing income in retirement. They might have accumulated wealth for retirement, but many do not understand how to invest that wealth to ensure that it lasts a lifetime.

Retiree spending rules -- the rate of spending that can be sustained in retirement -- can help Americans enjoy a more secure retirement. The spending rule has to be low enough that it won't exhaust wealth if asset returns are lower than expected. It must be based on real, inflation-adjusted returns, rather than nominal returns, and must be lower than the average real returns expected in the future. Because the two are interrelated, the asset allocation of the portfolio must be chosen along with the spending rule. In general, the lower the allocation to stocks in the portfolio, the lower the spending rule. The rule depends on the portfolio's asset allocation, the expected real returns and volatility of each asset in the portfolio, and the target level of wealth.