How to Link Retirement Strategies to Sustainable-Spending Rates Introducing the Retirement Dashboard

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Sustainable-spending rates for retirement depend on many factors: asset- and product-allocation, market valuations at the start of retirement (particularly, current interest rates), the desired spending pattern over retirement, the degree of flexibility to adjust spending in response to market performance and the length of the client's planning horizon.

Last week, my article introduced the Retirement Accumulation and Retirement Affordability indices, which help clients determine if they are retiring at a good time. In this article, I will present my new Retirement Dashboard. More specifically, I will explain the section of the dashboard on "The Cost of Retiring Today – Sustainable Spending Rates for Retirement," with these factors in mind.

This analysis is conducted for a couple who both turn 65 on January 1, 2015. I estimated the sustainable-spending rates for two very different types of retirement-income strategies: those based on dedicated-income sources that can match client spending needs without exposing the client to market volatility, and those based on investment portfolios in which market volatility will play a much larger role in determining retirement sustainability.

Sustainable spending from dedicated-income sources

This section of the dashboard provides an overview of the situation today for funding retirement with dedicated-income sources, using different combinations of income annuities and individual bonds. For a 65-year-old couple, I consider three different retirement-income strategies for three different types of retirement spending goals, producing the nine numbers shown in Table 1.

Table 1

Sustainable Spending from Dedicated-Income Sources

Spending Rates Obtainable for 65-Year Old Couple, January 2015

Income Growth Factor	SPIA	30-Year Bond Ladder	20-Year Bond Ladder + DIA @ 85
Fixed (No Growth)	5.59%	4.51%	4.94%
2% COLA	4.40%	3.48%	3.95%
CPI-U Adjusted	3.75%	3.65%	4.03%

The three strategies shown in the table for a 65-year old couple are:

1. Buy a joint and 100% survivor's life-only single-premium immediate annuity (SPIA).
2. Buy a ladder of bonds maturing over the next 30 years.
3. Buy a ladder of bonds maturing over the next 20 years and purchase a deferred-income annuity (DIA), which will continue the same income level and trend in years 21 and beyond

SPIA & DIA rates are based on the average of the top three quotes from Cannex (except for CPI-U products, since there are only two carriers at present) for life-only benefits using $100,000 of non-qualified funds for a joint and 100% survivor's annuity. Bond ladders for fixed and 2% growth spending are based on Treasury strips, while TIPS are used for CPI-U adjusted spending, using wholesale prices from the *Wall Street Journal*, and assuming a 1.5% mark-up in price for retail investors. For the CPI-U adjusted DIA, a 1.8% inflation rate is assumed to calibrate initial income in 20 years. This is the current breakeven inflation rate predicted over 20 years by the yield differences between TIPS and nominal Treasury bonds.

The SPIA strategy is able to support income much closer to the couple's actual remaining life expectancy based on an underlying portfolio consisting mostly of fixed income. Unlike the traditional 4% rule, this strategy adjusts for current interest rates, which along with increasing longevity explain why SPIA rates are lower today than they have been in the past. The assets used to purchase a SPIA are illiquid, and there would be no further upside potential. The advantage is that the SPIA eliminates market and longevity risk for the client (other than the credit risk of the issuing insurance company).

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