



Facing Retirement in a Down Market

A conservative withdrawal approach is part of a sustainable retirement spending plan.

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KEY INSIGHTS

- A severe market downturn at the onset and in retirement can cause concern for investors.
- We analyzed two scenarios, starting with bear markets, to gain insight on portfolio sustainability.
- An initial 4% withdrawal approach, and small spending adjustments, can help retirees extend the life of their portfolio.

The longest-running bull market in U.S. history ended in February 2020 with the official arrival of a bear market. Fears surrounding COVID-19, the disease caused by the coronavirus, and the resulting global economic shutdown represented a one-two punch that investors could not ignore. Individuals nearing retirement—or just entering retirement—may be concerned about what this market downturn may mean for their withdrawal strategy and the ability of their savings to support them throughout a retirement that could last decades.

The sequence of returns (the order in which markets rise and fall) is important when it comes to your retirement withdrawal strategy. Market declines within the first five years of drawing down retirement assets can significantly impact the chance of the portfolio lasting, especially when planning for a retirement horizon that could span decades. To better understand the long-term impacts

of this kind of early decline, we analyzed retirees from two different time periods to gain insight on portfolio sustainability:

- Someone who retired January 1, 1973, the most recent 30-year period that started with a bear market.
- Someone who retired January 1, 2000, who is 20 years into their retirement and already living through two bear markets.

Scenario 1: A 1973 Retirement Date

In 1973, the onset of the oil embargo and an energy crisis sparked a recession. The early 1970s was also one of the highest inflationary periods in history, as prices more than doubled in 10 years. Our analysis assumed a starting portfolio of \$500,000 with an asset allocation of 60% stocks and 40% bonds throughout the entire horizon using the S&P 500 Index and the Bloomberg Barclays U.S. Aggregate Bond Index.¹

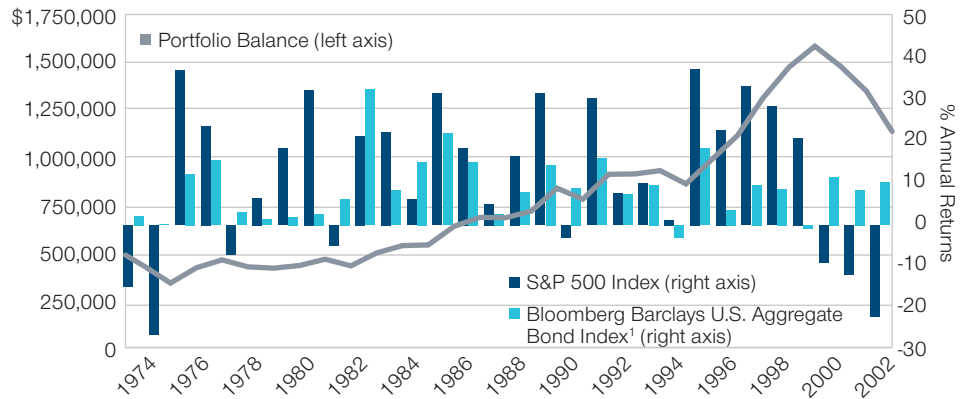


Judith Ward, CFP®
Senior Financial Planner

¹ Benchmark reflects the Bloomberg Barclays Government/Credit U.S. Bond Index for the period 1973–1975 and the Bloomberg Barclays U.S. Aggregate Bond Index from 1975 to the present.

(Fig. 1) Scenario 1: Retiring in 1973

A conservative withdrawal strategy may have helped a retiree weather a large market decline early in their 30-year retirement.



We tested the “4% rule,” assuming the investor started with an initial withdrawal amount that was 4% of the starting portfolio balance (\$20,000 the first year). This amount was adjusted each year based on actual inflation² in order to maintain purchasing power over the 30-year spending horizon. Many experts consider the 4% rule a safe starting point that helps investors navigate an uncertain market environment, especially at the onset of retirement.

The beginning monthly withdrawal for this investor was \$1,667. But retirement would get off to a rocky start as they entered a bear market that would see the S&P 500 Index decline 48% within the next two years. (See Figure 1, Scenario 1: Retiring in 1973.) Not only did the investor have to cope with watching their portfolio shrink to nearly \$328,000 by September 1974, but inflation was also a huge factor. Inflation ended 1972 at 3.4% and soared to over 12% by the end of 1974.² Money at that time didn’t go as far as it used to when it came to paying for everyday expenses like gas and food.

Recovery was around the corner, however, and the investor’s balance began to grow again with the help of two subsequent bull markets. The account balance recovered to over \$500,000 about 10 years into retirement in December 1982 and reached \$1 million by the end of 1995. Those gains helped the investor weather the significant bear market in March 2000. And at the end of 30 years, the portfolio balance in this scenario was well above \$1 million despite all the market volatility during those decades.

Spending Adjustments Along the Way

Hindsight is 20/20, and our analysis shows that a retiree starting with a conservative withdrawal amount was able to maintain their purchasing power and not run out of money.

But this scenario assumes the investor didn’t adjust their behavior due to the inevitable anxiety those steep market losses likely caused. It’s human nature to adapt and adjust, and retirees would likely feel the need to modify their plans in some way.

² Consumer price index, seasonally adjusted.

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If an investor in the throes of a bear market wanted to preserve their account balance by spending less, how would that affect their circumstances over time? In short: Being prepared to make spending adjustments after a market decline gives investors an even larger margin of safety in the long term.

More specifically, we assumed that once the investor, who retired in 1973, experienced a drop in their portfolio of 30%—from \$500,000 to below \$350,000—they would temporarily adjust their spending to help offset the steep loss. So, instead of a monthly withdrawal of \$2,035 starting in 1975 that kept pace with inflation, the investor would maintain their withdrawal amount of \$1,816 per month until the end of 1976. Forgoing inflation adjustments may sound tame, but this shift would have translated into a significant spending cut because of the higher inflationary environment at that time.

This retiree would never have to take another cut in income for the remainder of their 30-year retirement, and by the end of 2002, their portfolio would have grown to over \$2 million. That's great news—but remember that the delayed spending increases meant a real loss of spending power over the rest of their retirement. So consider what would happen if the same investor decided after two years of flat spending to increase annual withdrawals to the same level they would have been if no cuts had been made.

The verdict: The investor still ends up ahead of the baseline scenario, with almost \$1.3 million after 30 years, and would have been able to keep pace with inflation with the added flexibility to spend more later in retirement.

Scenario 2: A 2000 Retirement Date

Now let's consider a more recent case: an investor retiring in 2000 using the same assumptions from our first scenario, although there are only data to cover part of a 30-year retirement. Assuming the same starting balance and use of the 4% rule, this retiree would start withdrawing \$1,667 per month in the first year of retirement and adjust each year based on actual inflation to maintain purchasing power.

In this scenario, the investor encounters the bear market that started in March 2000 as well as the financial crisis of 2008. The S&P 500 lost 49% between March 2000 and October 2002 and just over 56% between October 2007 and March 2009. However, working in the investor's favor during this period was a benign inflationary environment.

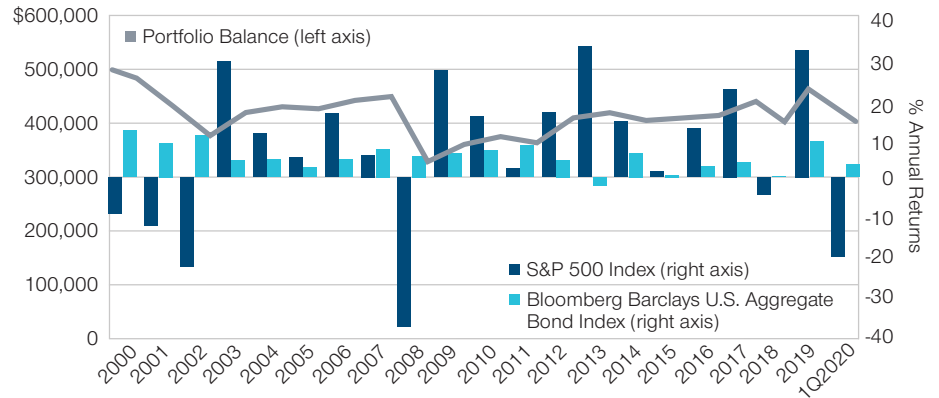
The portfolio in this scenario declines to nearly \$300,000 in February 2009, but a subsequent period of strong market growth helps it rebound—in this case, to over \$460,000 as of year-end 2019. (See Figure 2, Scenario 2: Retiring in 2000.) If spending adjustments were needed, it wouldn't have been until 2009, at which point spending could have remained flat for the next four years until the portfolio rebounded to \$400,000 in 2013. With such a low inflationary environment, however, this spending change may have been an easier adjustment than the 1973 scenario.

This rebound coupled with a conservative withdrawal approach has helped this investor prepare to weather this most recent bear market as their portfolio balance dropped to about \$403,000 by March 31, 2020. Although this investor is about two-thirds into a 30-year retirement horizon, they appear to be on a sustainable path so far. Using the T. Rowe Price Retirement

History has shown that bear markets have typically been followed by healthy market recoveries.

(Fig. 2) Scenario 2: Retiring in 2000

Retirees in 2000 faced two massive market declines in the first 10 years of their retirement.



Income Calculator to assess the next 10 years of retirement,³ we find the portfolio will accommodate continued spending, resulting in a simulation success rate of more than 90%. That means that of the 1,000 market scenarios, the investor had at least \$1 remaining in more than 900 of them. The investor could still sustain withdrawals if the portfolio balance dropped another 20%. (These results are not predictions, but they should be viewed as reasonable estimates.) It is important to reassess the situation each year. For example, if the market drop is sharper or spans over years, or the investor needs to plan beyond 10 more years, then small spending adjustments may be warranted, but the approach can be a measured rather than a panicked response.

Approaching Retirement and the Unknown

The idea of retirement itself may be overwhelming for many investors. And for those nearing or in retirement, it can be unsettling to see the market tumble. History has shown that bear markets

have typically been followed by healthy market recoveries. While investors are in the thick of market downturns, it may be difficult to stay the course and believe things will turn around. Try to resist the urge to make drastic changes in portfolio strategy when markets become more volatile, especially early in your retirement horizon.

If investors feel the need to make changes, systematic adjustments to spending can help sustain portfolio balances throughout retirement, and they seem like actions most retirees expect to make. By following a conservative withdrawal approach early in retirement and planning for temporary adjustments along the way (if needed), retirees can weather the markets and have a truly fulfilling and enjoyable next phase of life.

³We used the T. Rowe Price Retirement Income Calculator and assumed the following: an 85-year-old living with no spouse/partner in retirement with a balance of \$403,475 as of 3/31/20 and a hypothetical portfolio composed of 60% stocks and 40% bonds and ongoing monthly withdrawals from the portfolio starting at \$2,570 and increasing 3% annually to account for inflation. This resulted in a simulation success rate of 99% (i.e., the investor has at least \$1 remaining in the portfolio at the end of retirement) for the investor based on 1,000 market scenarios. No Social Security or other income was considered as we were only assessing the impact of withdrawals on personal savings. To assess a further decline of 20%, we decreased the starting portfolio balance to \$322,780, which resulted in a simulation success rate of 92%.

ASSUMPTIONS

The hypothetical examples presented are based on the performance of the S&P 500 Index, which tracks the performance of 500 large-company stocks, and the Bloomberg Barclays U.S. Aggregate Bond Index, which tracks domestic investment-grade bonds, including corporate, government, and mortgage-backed securities, for the time periods represented. Indexes are unmanaged, and it is not possible to invest directly in an index. These hypothetical examples are meant for illustrative purposes only and do not reflect an actual investment, nor do they account for the effects of taxes or any investment expenses. Investment returns are not guaranteed, cannot be predicted, and will fluctuate. All investments are subject to risk, including the possible loss of the money invested.

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Additional information about the Retirement Income Calculator is available under “Retirement Income Calculator Methodology and Assumptions” at troweprice.com/ric. This document is also available upon request.

T. Rowe Price Retirement Income Calculator is a T. Rowe Price investment tool that allows retirement savers to estimate the durability of their current savings across 1,000 randomly generated market scenarios and to assess the impact of different savings rates, time horizons, and asset allocations on the projection of retirement income. The results generated are hypothetical and are not guaranteed. See the “IMPORTANT” section above.

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