Looking Beyond the Mailbox

Redefining Income in a Low Yield World with Systematic Withdrawals

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Historically, investors in or near retirement have relied primarily on bonds for “mailbox money” necessary to fund their golden years. Going forward, investors and advisors will need to redefine their concept of “income” and reconsider how they fill their “mailbox”.

For almost 4 decades the bond market provided investors in or near the retirement corridor with meaningful income, as well as, appreciation in the value of their bond holdings as interest rates declined.

However, with the future of bonds looking bleak, this “mailbox money” approach may not be sustainable for the next generation of retirees.

Low yields on Treasuries and safer bond investments have created a thirst for income, leading many to reach for yield while risking principal. Advisors and investors now find themselves between a rock and a hard place when relying on bonds for sustainable retirement income.

But there are other ways to meet income needs.

A systematic withdrawal plan may complement other sources of income for retirees. The key is to avoid large losses while growing capital.

What are Systematic Withdrawals?

A “Systematic Withdrawal Plan” requires that an individual selects a specified rate in which he or she will withdraw funds from their retirement account to last through their projected life expectancy.

Benefits of Systematic Withdrawals

Systematic withdrawals have attractive features that make it a worthy addition to a retirement income plan:

- Control how much is withdrawn and how often
- Seek capital appreciation by remaining invested in equities
- Minimize duration, liquidity, and/or credit risk in bond investments
- Potentially tax-friendly since withdrawals are streamlined and scheduled

Battling Perceived Finiteness – Redefining the Conversation About ‘Income’

Traditionally, bond coupon payments arrived in the mailbox, and the investor never had to sell anything. For some, there is a mental hurdle or fear associated with selling portions, however small, of one’s portfolio in order to generate necessary cash flow. Retirees often feel that they will run out of finite capital too soon, so they rely on what they perceive to be “safer” payout methods.

Systematic withdrawals can also seem risky and unsustainable for investors worried about a bear market swiping away a large chunk of their portfolio. Taking out money during a downturn can be anxiety inducing.

Other risks investors should consider that can directly impact the sustainability of income in retirement: a significant rise in living costs, a surprise large expenditure or health cost, and a longer-than-expected lifespan, all of which potentially result in an individual using up their own funds too soon.

Given the low current yields, the safest categories of bonds provide little income and are forcing many retirees to increase allocations to riskier asset classes, like higher yielding bonds or equities. While investors may have limited control over the rise in their living costs, they can at least try to address the risk to their portfolio.

Sustaining a Systematic Withdrawal Plan

Systematic withdrawals can be a sustainable income strategy, however.

An investing approach that seeks to provide consistent returns in unpredictable market environments may alleviate the risks and concerns surrounding systematic withdrawal plans. A disciplined, risk managed investing approach may help investors endure tough markets before and during retirement so their systematic withdrawal plan can maintain its efficacy.

Historically, the general rule of thumb has been known as the “4% rule” because financial planners calculate that if you invest in a portfolio balanced between stocks and bonds, withdraw 4% percent each year for retirement income, and give yourself an annual raise (to account for inflation)—there's a roughly 90% chance that your money will last for at least 30 years (Source: Morningstar Direct). That rule of thumb worked well as bonds have contributed a hefty 4.28% real return since January 1982 through May 2019, as rates on the 10-year Treasury fell from over 15.15% down to 2.15%. (Source: Morningstar Direct, Swan Global Investments). During that period, bonds could have essentially delivered the “4% rule” on their own.

In today’s low-yield world, bonds provide little or no real return, creating significant pressure on the rest of the portfolio to deliver all of the growth necessary to sustain withdrawals over time. Instead, investors may need to consider other investment strategies to mitigate risk, such as hedged equity strategies that seek to reduce the risk of large portfolio losses through market cycles, so their “income” stream may last throughout retirement.

A hedged equity approach, like the Defined Risk Strategy, that seeks to mitigate the risks of big losses in order to generate consistent returns over time may support a long-term systematic withdrawal plan.

Important Notes and Disclosures: