Is the 4% Retirement Rule Dead?

Description

Retirement studies, as well as financial gurus, peg the withdrawal rate at 4%. It's the long-standing gold standard for retirees who fear outliving their retirement savings. In Canada, most retirees are still sticking to the 4% retirement rule, although it appears dead in other countries.

The norm might not be useful anymore, and Canadian retirees are facing a big challenge. Usually, a retirement portfolio consists of stocks for money growth and bonds for risk reduction. However, the record low bond yields destroy the formula. Retirees would need more savings and seek higher returns to fund retirement needs.

Deepening concern

Pensions from the retirement system will not provide an adequate financial cushion to retirees. Thus, Canadian seniors might need to be aggressive and make 7% as the withdrawal rate. The super-low interest rate environment is affecting long-term bond yields. As a result, it becomes exceeding challenging for retirement planners.

A new report published by **CIBC** World Markets estimates the market-weighted Canadian bonds (two, five, 10, and 30 years) to produce a compound annual return of only 0.6% over the next decade. If the inflation rate is 2%, the real return for 10 years is negative.

Not a cyclical bump in the road

The reality of low yields will hurt income investors, particularly retirees. It would mean taking on high-risk investments to meet financial objectives over the long-run. For risk-averse investors, it implies saving more money to compensate for lower or weaker returns.

If you were to save cash and not invest, it would compound at a slower pace. Long-term savers require more assets to achieve a reasonable retirement income. The scenario is problematic if you push the numbers. Assuming the long-term bond yield is 1%, you would need $2.2 million in savings to realize

$100,000 annual spending for 25 years.

Most defensive, but a profitable asset

High-risk assets won't cut it for retirees. You have a greater risk of seeing the value of investment dissipate sharply when the market turns. The logical move is to play defensive, earn adequately, and mitigate the risk. **Fortis** (TSX:FTS)(NYSE:FTS) is the hands-down choice if you're seeking a safety net.

The business of this $24.24 billion electric and gas utility company is pandemic-proof and recession-resistant. It could replace bonds because it boasts of the same characteristics, but deliver higher returns. With its 3.65% dividend, you would need only $1,020,500 to grow the money to $2.5 million in 25 years. You achieve your target of $100,000 annual spending.

Bonds don't have much upside potential these days, while Fortis promises to raise dividends by 6.5% annually through 2024. The business model is low-risk as 99% of revenues are regulated. Management will spend $18.3 billion on its regulated assets from now until 2024. Its growing renewable energy assets are the next growth drivers.

A rule is better than none

The 4% retirement rule can work for others and fall short for some. However, it will help to practice withdrawing $4,000 for every $100,000 you hold in your portfolio. At least you have a guide to enable you to estimate the amount of investment you would need as you go along. You have a decent chance at success with a rule rather than not embracing one.

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