Dynamic Withdrawal Strategies Made Easy

By Kerry Pechter   *Fri, Oct 18, 2013*

Research from Morningstar's David M. Blanchett introduces two equations for implementing an efficient dynamic withdrawal strategy based on different expected time periods, portfolio equity allocations, the likelihood of achieving the goal, and fees (or alpha).

In a new [article](#) in the *Journal of Financial Planning*, Morningstar researcher David M. Blanchett proposes two relatively simple ways for advisers to adjust their clients' withdrawal rates during retirement to maximize long-term safety and income levels.

As he explains in the paper entitled "Simple Formulas to Implement Complex Withdrawal Strategies":

"A growing body of research has noted that updating a retirement portfolio withdrawal strategy on a regular basis improves outcomes. Financial planners call this a 'dynamic' technique to retirement income, because the portfolio withdrawal amount adapts to ongoing expectations and actual experiences during retirement.

"This dynamic approach is in contrast to the static approach used in much of the existing literature on sustainable withdrawal rates. The static approach assumes that a retiree selects a withdrawal rate at retirement and subsequently increases the portfolio withdrawal amount to maintain a real level of consumption, regardless of portfolio performance, expected mortality, or the retiree's changing needs.

"While the ability to account for new information makes dynamic withdrawal strategies theoretically superior, many financial planners and engaged retirees may find a dynamic withdrawal strategy difficult or impossible to implement given the sometimes complex software, tools, or processes that are needed to adjust portfolio withdrawal amounts at some regular interval.

Blanchett's paper introduces two equations for implementing an efficient dynamic withdrawal strategy based on different expected time periods, portfolio equity allocations, the likelihood of achieving the goal, and fees (or alpha). As he puts it the paper:

- The first formula, which is called the dynamic formula, determines the withdrawal percentage for a given target probability of success, portfolio equity allocation, expected retirement period, and fees (or alpha).
- The second approach, which is called the RMD approach, is based on the IRS' required

minimum distribution (RMD) rule. This approach requires only an estimate of the expected retirement period.

"A measure called the 'withdrawal efficiency rate' is used to determine the optimal inputs for distribution equations, as well as the relative efficiency of the formula approach," the paper says. "Results indicated that life expectancy (median mortality) plus two years is a relatively efficient estimate for the expected retirement period and that 80% is a reasonable input for the probability of success. [Our] equations capture 99.9% of the relative efficiency of a far more complex methodology and represent a significant improvement over a static approach."