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THE 10-30-60 RULE: Consider Maintaining or Increasing Equity Exposure in Retirement

The 10-30-60 Rule describes sources of income during retirement. Understanding this rule may help investors recognize a potential need to maintain or increase exposure to stocks <u>after</u> they retire.

As described in the book *The Retirement Plan Solution*,[1] many investors may not realize the greatest source of retirement income may be income earned *in* retirement. Consider this hypothetical example: After working for 40 years and retiring at 65, someone may have accumulated a retirement "nest egg." When she stops working, she may draw on these assets to help fund daily living expenses. But what are the sources of those withdrawals? In other words, where does the money she takes in retirement actually come from? The authors have estimated the following breakdown:

10% = is a return of principal or money she invested while working

30% = comes from money earned on her investments *while* working

60% = comes from money earned in her account *during* retirement

Of course, there are some assumptions with this hypothetical example:

- She started investing at age 25 and her starting salary was $25,000.
- 4% of her pre-tax salary was contributed into a tax-deferred vehicle such as a 401k plan.
- She earned a raise each year of 4.75%.
- She worked 40 years and retired at 65.
- She spent a proportion of her assets each year that would take her account balance to zero by age 90, matching her assumed life expectancy.

The biggest assumption: she earned an average annual 7.5% return on her investments while working and *while in retirement*.

Sometimes, investors may retire and seek greater safety; for example, they may reduce exposure to stocks and increase exposure to bonds and cash. But, in today's stubbornly low interest-rate environment, increasing exposure to low-yielding bonds may reduce the annual rate of return and increase the risk of running out of money in retirement.

Going back to our hypothetical example, if she "played it safe" with a higher proportion of lower-earning cash and short-term fixed income assets and earned 2.0% annually in retirement, a greater percentage of distributions would have come from a return of capital and money earned while working; that 10-30-60 mix would change to roughly 20-55-25. The near-doubling of the proportion earned during her working career was not because she contributed or earned more during those years. It would be entirely due to the fall in her investment earnings after retirement.

Importantly, that 2.0% return would mean almost $800,000 *less* in total withdrawals during her retirement years, a reduction of 45% from what she would have earned with a 7.5% assumption. Conversely, if she earned 10% in retirement, she would have about $425,000 in *additional* distributions to save or share during retirement. See the hypothetical results shown in the table below.

"…maintaining or even increasing exposure to potentially higher-return assets such as equities could make a big difference…."

Of course, equity investing involves risk and possible loss of principal. These hypothetical illustrations are demonstrations of mathematical concepts only and do not represent any specific investment. At the same time, these examples show how maintaining or even *increasing* exposure to potentially higher-return assets such as equities could make a big difference in the amount of money investors have available to spend in their retirement years.

Seeking "Safety" in Retirement May Reduce the Amount of Money Available to Spend

Annual Rate of Return in Retirement	Total Distributions in Retirement	Difference in Total Distributions vs. Earning 7.5% Each Year
Conservative: 2.0%	$942,352	**(-$786,184)**
Central assumption: 7.5%	$1,728,536	---
More aggressive: 10.0%	$2,153,187	**$424,651**

All illustrations are hypothetical. Actual results may vary. Does not represent the performance of any specific investment.

[1]Ezra, Don, Bob Collie and Matthew X. Smith. *The Retirement Plan Solution*. New York: Wiley. 2009

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