Money and You: Spending in retirement

by Lynn_O'Shaughnessy

One question uppermost in the minds of many retirees and those eyeing that milestone is how they can prevent some destructive force from rolling over their nest eggs and leaving nothing behind but tread marks.

Perhaps the best answer to this question didn't originate at a brokerage house with a Wall Street address or a hoaried economics professor at a place like the Wharton School. Rather, the words of wisdom come from an unassuming certified financial planner who works out of his home office in El Cajon, Calif.

Back in 1994, William P. Bengen published a study in the Journal of Financial Planning that pinpointed how much you or I should be able to safely withdraw each year from our retirement accounts for 30 years without busting the bank. Bengen's landmark research elevated the fee-only planner's standing in the financial community from "Who's he?" to Paul Bunyan status.

Not long ago, Bengen decided to revisit his calculations to see if they still stood up. He discovered that they had. He included his findings, with updated figures, into his book, "Conserving Client Portfolios During Retirement." In the book, you'll discover his magic number: 4.15 percent. That's the percentage of your portfolio that you should be able to withdraw from your accounts when you first retire.

After this initial calculation, however, you can discard that percentage forever. Instead, each year you take the amount of the previous year's withdrawal and increase it by the inflation rate. For instance, if you calculated your first yearly withdrawal at $40,000 and inflation during the next 12 months was 3 percent, you could safely pull out up to $41,200 during the second year. For the third year, you'd take $41,200 and adjust that by inflation and so on.

The book is pricey, but you can read a free 2006 article in the Journal of Financial Planning that discusses the approach. Just type "Bengen" into the search engine of the journal at www.fpanet.org/journal.

SAVING FOR COLLEGE

The 529 college savings plan, which gets its name from a section of the federal tax code, has a lot going for it. These plans allow you to stash away cash for college without worrying about any tax consequence. There aren't any, as long as you keep the money tucked inside a 529 plan. When you need to raid the account as your child starts college, you won't owe federal taxes on the withdrawals.

Peer inside the 529 plans offered by many states, however, and you'll discover that the fees are packed in tighter than a mule team's saddlebags. There could be an enrollment fee, annual maintenance fee, plan management fee, investment fees, commissions and who knows what else. It's easy to conclude that Darwin's survival of the fittest rule doesn't apply to the 529 world. Some truly hideous plans are happily sucking up cash.

Parents overwhelmingly rely upon brokers and commissioned planners to pick a 529 for them. These professionals typically steer their clients to plans that include a built-in commission, which is often 5.75 percent. Advisers deserve to be compensated, but you should look closely at just what they're recommending and why. Stick with a broker, and chances are you will never hear about many excellent low-cost plans because they don't pay commissions.

What's an alternative? Pick your own 529. Stick with low-cost plans containing inexpensive mutual funds and bare-bone fees. It's no coincidence that many of the 529 plans that have been feted by the financial press are also the cheapest. The 529 plans that I've used for my children are Utah's (800-418-2551, www.uesp.org) and Nevada's (866-734-4530, www.vanguard.com), which both use Vanguard index funds. An equally excellent choice, which came along more recently, is West Virginia's plan, which uses Dimensional Fund Advisors mutual funds (866-574-3542, www.smart529select.com).

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