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Morningstar retirement bootcamp

Webinar 1 – Understanding the maths of retirement

Webinar 2 – Estimating how much you will spend in retirement

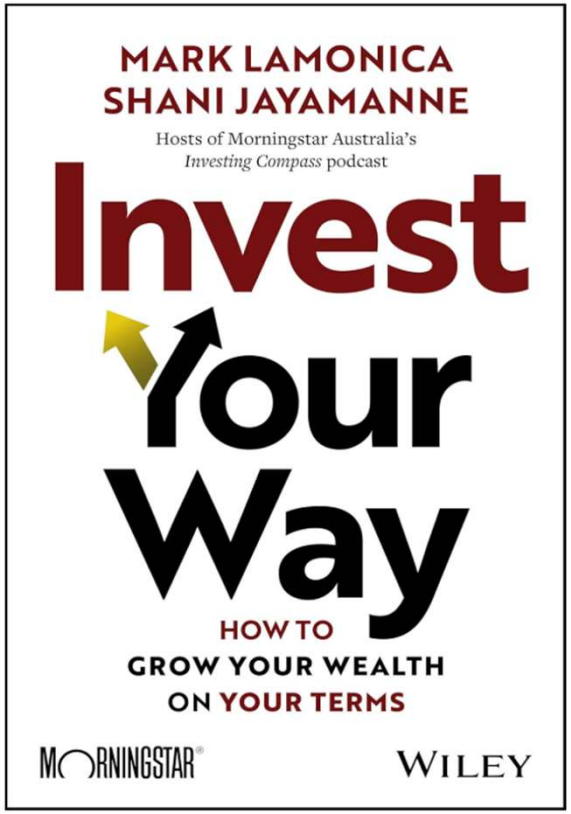
Webinar 3 – How much money you need to retire

Webinar 4 – Figuring out your retirement asset allocation

Learning objectives

Understand the different drivers of spending in retirement so you can estimate a budget which can be used as an input into understanding how much you need for retirement.

Getting the foundations right



- The biggest issue many investors face is undermining their own outcomes by letting emotions influence decision making and making mistakes
- ETFs exacerbate these tendencies given the ease of trading, the proliferation of new ETFs and compelling marketing based on recent performance
- The key is adding structure to decision making by establishing goals, setting an investment strategy and developing a process to guide decision making

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Setting up a personalised retirement plan

There are several steps to set up a personalised retirement plan:

1. Estimating how much you will spend in retirement
2. Calculating the amount you need to retire by setting your personalised withdrawal rate
3. Defining a plan to hit your retirement goal by figuring out your savings target, asset allocation and investment strategy
4. Creating a retirement investment strategy including your asset allocation and spending plan

Estimating how much you will spend in retirement

Estimating how much you will spend annually is the foundation of retirement planning.

How much you need for retirement = **Your annual spending for your first year of retirement** ÷ **Your withdrawal rate**

An evolving goal is better than no goal at all. Even if you are far from retirement, it is worth coming up with an estimate and a plan. The plan can be adjusted as time goes on.

For people closer to retirement your estimate can get more specific.

Estimating after-tax, after-super income

Traditionally a rough estimate of spending needs is approximately 70% of gross salary. This estimate is very dependent on individual circumstances.

Input	Amount	Amount
Gross salary	$100,000	$200,000
Taxes & Medicare	-$22,200	-$59,400
Super	-$12,000	-$24,000
Total	**$65,800** ***(65.80%)***	**$116,600** ***(58.30%)***

There are several considerations to adjust these estimates:

- Other sources of income
- Changes in lifestyle like moving to a cheaper location or downsizing
- Changes in expenses like paying off your mortgage

How much flexibility do you have with your spending?

Broadly spending falls into two primary categories:

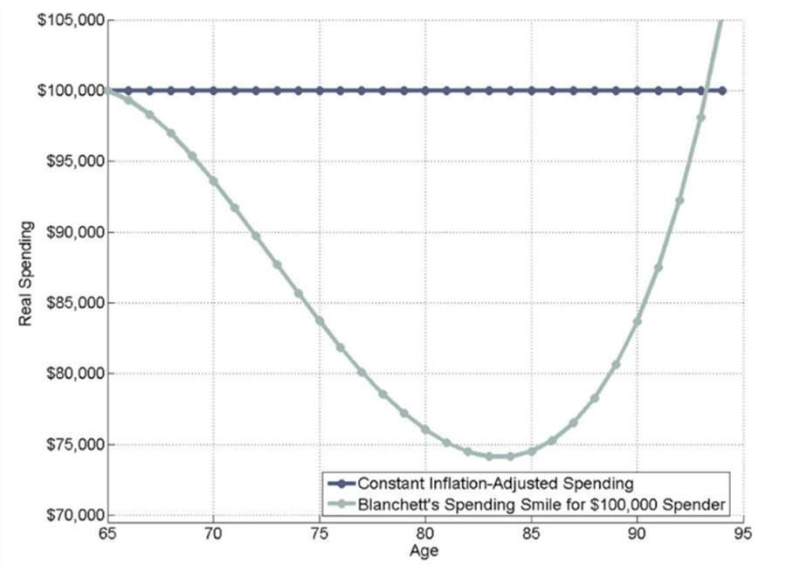
Needs: Spending with little flexibility which includes basics like a place to live, feeding yourself and medical care.

Wants: Spending that may involve more flexibility on items like entertainment, hobbies and travel.

The more flexibility you have in your spending the less likely it is that the strict assumptions of the 4% rule apply to your personal situation.

The retirement spending smile

In theory and empirically, retirees spend a lot early in retirement when they are active and less once they've grown older. Spending can also spike at the end of life as medical and care costs come into play.



For illustration purposes only. The Estimated Path of Real Retirement Spending for a $100,000 Initial Budget at 65 vs. Constant Inflation-Adjusted Spending Strategy. Based on data from Blanchett, David. 2014. "Exploring the Retirement Consumption Puzzle." Journal of Financial Planning 27 (5): 34–42

A study by a former Morningstar researcher found that spending typically drops in real terms by approximately 1% a year for retirees between the ages of 60 and 90.

This may not seem meaningful but it compounds over time. A retiree with $100,000 in spending at age 60 would hit a spending trough around age 84 when spending is $74,146 or 26% lower.

Retirees might have better outcomes if they plan on spending more early in retirement while saving more for later in retirement.

The retirement spending smile

There are several implications from this typical retirement spending pattern which may impact the withdrawal rate for many retirees. The basic assumption of the 4% rule is that the dollar value of spending in the first year of retirement will increase by inflation.

The following scenario demonstrates how different spending patterns impact retirement outcomes. I ran a30 year Monte Carlo simulation using 75% US shares and 25% cash.

- At a 4% withdrawal rate the portfolio had a 91.97% chance of not running out of money when withdrawals are adjusted by inflation.
- At a 4% withdrawal rate the portfolio had a 99.50% of not running out of money when withdrawals were ***not*** adjusted by inflation.
- The withdrawal rate can be increased to 6.50% for a 91.97% chance of not running out of money if withdrawals were ***not*** adjusted by inflation.

Do you have goals other than just not running out of money?

While all retirees have a core goal of not running out of money there are other considerations including bequests to family and charitable organisations.

A few considerations:

- Can you segregate a portion of your assets for bequests? Are you in a position to give them now when the money may be more useful and you can observe the impact of your generosity?
- Does the age pension play a part in your plan even if you don't current qualify?

Are you planning / want to retire early?

People retire early for both voluntary and unvoluntary reasons. There are several considerations if you plan to retire early and believe you may not be able to work as long as you want:

- If you do plan on retiring early, it makes sense to address your post-preservation age retirement first as tax savings from superannuation will compound make it worthwhile to get as many assets as possible into the lower-tax environment as soon as possible.
- There are two techniques for retiring early:
    - Generate enough income from your portfolio to support you prior to preservation age and supplement your super withdrawals.
    - Create a 'bridge to super' with enough assets to pay your expenses up until preservation age.
- In both cases you will need to take tax into account as capital gains / dividends will be taxed at a minimum of 30% or higher based on your marginal tax rate.
- Be wary of early retirement rules like the amassing 25 times your annual spending needs. This is not designed for a retirement longer than 30 years and tax is a consideration.