NAPLES GLOBAL ADVISORS

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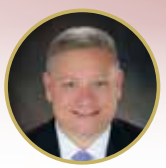

Portfolio Withdrawal Rates: Does an ideal exist?

After several years of above average returns in both stocks and bonds, interest rates are rising and market sentiment (and thus valuation) has been pushed down, driving most equity markets into bear territory. Declining portfolio values coupled with a surge in the cost of living has heightened the need for many to review their finances. This is particularly the case for those who depend on their investment portfolios for retirement cash flow support. As a vital component of the financial planning equation, fresh discussions about appropriate withdrawal rates have proliferated with a recent spate of articles espousing the percentage deemed sustainable for an investment portfolio over the course of an average retirement (typically 25-30 years). At one time or another, most retirees have likely been mired in the various assertions about the ideal withdrawal rate on their investment portfolio.

We are continuously wading through research on withdrawal rates; and to be sure, there has been a lot of good work and a lot of complex math applied to analyzing the issue. Some retirees may have heard of the 4% Rule (attributed to Financial Advisor William Bengen in the 1990s), which, when filtered through a 50%/50% portfolio of stocks to bonds, maintains investment assets over roughly 33 years or more (*Kagan, 2022*). Other articles suggest even a 5% withdrawal rate may be sustainable depending on risk tolerance, inflation, life expectancy, and of course market returns (*Fidelity Viewpoints, 2022*). Another piece of research closely examined the impact of inflation and found that a 3% withdrawal rate is viable over any period even with higher inflation, while a 4% withdrawal rate was successful unless inflation ran at 5% or more. A 5% withdrawal carried substantially more risk of running out of money under heightened inflation (Fisher, 2018).

So, amidst all this conflicting data, what is the answer? What is the ideal withdrawal rate for you? In our view, the answer is simple. If possible, strive to live on **no more** than the income derived from your investment portfolio. NGA's clients are familiar with our philosophy of owning higher credit quality individual bonds and value-oriented, dividend paying stocks. Equally important, we focus on companies with a history of raising their dividends. In aggregate, the top 100 NGA portfolio companies increased their dividends by 9.6% annually over the last 5 years (8/17-8/22). To show the impact of such, we applied some simple math and assumptions to a $1,000,000 portfolio. We assumed a mix of 70% stock to 30% fixed income, a dividend yield of 3%, and bond interest of 4%. The above equates to a portfolio cash flow yield of 3.3%, $33,000 of income

on a $1,000,000 portfolio, with $21,000 deriving from the dividend component and the other $12,000 from bond interest. Finally, we left the bond yield static at 4% over time and applied the 9.6% annualized dividend increase to the stocks.

This table illustrates the impact of increasing dividends over 5, 10 and 15 years.

Year	Dividend	Bond Interest	Total Income
0	$21,000	$12,000	$33,000
5	$33,210	$12,000	$45,210
10	$52,520	$12,000	$64,520
15	$83,057	$12,000	$95,057

The information contained above is for illustrative purposes only.

Presuming all debts are extinguished, living off the income of your portfolio is a simple but powerful budgeting choice. We cannot envision a better inflation hedge than a rising stream of dividends produced by a globally diverse portfolio of high-quality individual stocks. What is more, dividend and interest income is reliable and present even in the tumult of a bear market. We can research and scrutinize appropriate withdrawal rates endlessly, but the simple truth is that living off your portfolio's income (or, better yet - less) is a viable path to retire successfully. And, we would add - with significantly less stress!

Sources:
Kagan, Julie. "The 4% Rule." Investopedia, Updated 20 Jan. 2022, www.investopedia.com/terms/f/four-percent-rule.asp.
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