



Financial Independence

Scaled Finance Welcome Course: Episode 6

Part Two: Net Worth

Financial Independence: the 4% Guideline

Welcome back!

Last episode, you forecasted your net worth.

Today, we'll discuss a framework which may help determine when work could become optional.

Someone reaches financial independence when their investments fund their living expenses for the rest of their life.

These funds come from:

1. Growth of investment assets
2. Interest, dividends, and other portfolio income
3. Drawing down assets (decumulation)

Bengen's 4%

4% Guideline

Financial advisor William Bengen set out to answer the question:
"How much does someone need to retire?"

He analyzed historical inflation as well as the returns for stocks and bonds. His classic article was published in [Journal of Financial Planning in October 1994](#).

Using a 50% stock / 50% bond portfolio, Bengen found that portfolios lasted 30 years for each year someone retired 1926 through 1976.

He concluded: "Assuming a minimum requirement of 30 years of portfolio length, a first-year withdrawal rate of 4 percent... followed by inflation-adjusted withdrawals in subsequent years, should be safe."

Trinity Study Confirmed 4%

Trinity Study

A later study by Philip Cooley, Carl Hubbard, and Daniel Walz published in the [American Association of Individual Investors AAI Journal in February 1998](#) confirmed Bengen's study.

Since all three were professors at Trinity University, the study is now referred to as the Trinity Study.

They studied inflation as well as the returns of stocks and bonds from 1926 to 1996.

They found that with a 75% stock / 25% bond portfolio, a 4% withdrawal was supported by the portfolio in:

- All years for 15, 20, and 25-year retirements
- 98% for 30-year retirements

They concluded:

"For stock-dominated portfolios, withdrawal rates of 3% and 4% represented exceedingly conservative behavior. At these rates, retirees who wish to bequeath large estates to their heirs will likely be successful."

More Like a Guideline Than a Rule

I view 4% more like a guideline than an actual rule.

Everyone's situations, goals, and dreams are different.

That's what makes personal finance *personal*!

Not Universally Applicable

Negative

Early retirees could have a much longer retirement, pushing beyond the 30 years reviewed in both studies

Additional activities such as travel, or purchase of another home could drive up expenses

Substantial medical or long-term care needs could significantly raise expenses

Taking on additional responsibilities, such as fostering children or raising grandchildren, could drive up costs for decades

Positive

The studies ignored other income such as Social Security, pensions, deferred compensation, royalties, and part-time employment

The studies also excluded impacts like inheritance, debt forgiveness, and moving to a less expensive location

Studies suggest people adjust spending based on circumstances

Studies also suggest expenses tend to fall beyond age 55

Growing Into Lower Expenses

Let's dive into that last point.

Studies suggest expenses fall beyond 55 years old.

Lower Spending with Age

Ann C. Foster [analyzed the U.S. Bureau of Labor Statistics' 2014 Consumer Expenditure Survey](#) and found total expenditure fell by age:

Every Category Fell Except Healthcare

	Age 55-64	Age 65-74	Age 75+
Total Annual Expenditures	\$56,267	\$48,885	\$36,673
Food	\$6,800	\$6,303	\$4,349
Housing	\$18,006	\$15,838	\$13,375
Clothing	\$1,789	\$1,417	\$683
Transportation	\$9,321	\$8,338	\$5,091
Healthcare	\$4,958	\$5,956	\$5,708
Entertainment	\$2,852	\$2,988	\$1,626
Pensions and Social Security	\$6,578	\$2,788	\$800
Other	\$5,963	\$5,257	\$5,041

EBRI Study Confirmed Falling Expenses with Age

Lower Spending with Age 2005-2017

Zahra Emrahmi's [research with the Employee Benefit Research Institute \(EBRI\)](#) suggests lower spending with age is no fluke.

Her article published in 2019 leverages data for 2005-2017 from the:

- Health and Research Study (HERS)
- Consumption and Activities Mail Survey (CAMS)

She similarly found lower spending with advancing age for each year studied.

Go-Go Slow-Go No-Go

Three Stages of Retirement

Dan Keady, a CFP® Board Ambassador refers to [three stages of retirement](#):

- Go-Go years (age 65 to 75)
- Slow-Go years (age 76 to 85)
- No-Go years (age 86 to 100)

"Many people spend more money in their Go-Go years (age 65 to 75) than when they reach the Slow-Go years (age 76 to 85) and No-Go years (age 86 to 100)."

Taxes Part of Spending

Not Adjusted for Taxes

It's important to note that neither Bengen's nor the Trinity Study adjusted withdrawal rates to account for the impact of withdrawing from taxable accounts.

If the assets come from Roth accounts, taxes may not be an issue.

Also, low levels of spending may not generate many taxes.

Just beware that withdrawals may need to be adjusted based on your situation.

Estimating Potential Spending

Incorporating Withdrawal Rates

Let's look at how withdrawals might play out.

The eagle eyed of you may have noticed some holes in the Google Sheets document from the last episode. Now, we'll fill in those sections.

Again, this does not represent advice.

Your situation and market conditions will vary.

Past performance does not guarantee future results.

I suggest you discuss your situation with a financial professional.

As a starting point, I added the 4% withdrawal rate [to the file](#).

Multiplying the beginning net worth by the withdrawal rate approximates potential spending for that year.

This estimate excludes all other sources of income such as part-time employment, pensions, and Social Security.

Action!

Please estimate potential future spending levels based on your forecast.

You can:

1. adapt [this week's Google Sheets file](#) (view at 90% zoom) to your situation,
2. add a withdrawal rate to your net worth forecast file from last week, or
3. estimate it some other way!

Your Turn!

Does anything in your personal spending forecast surprise you?

How might your spending change with any projected part-time income, pension, and Social Security benefits?

By the way, you can look up your latest Social Security benefit statement by creating and/or logging into your account: ssa.gov/myaccount

One exercise some have found helpful is to use their Social Security statement to compare their lifetime income with their net worth.

Next Steps

Great job working through this nuanced topic!

I hope this discussion has given you a fresh perspective.

If someone you know could benefit from this episode, feel free to send them the course link! scaledfinance.com/welcome-course

Part Three of this course will frame expenses in ways my partner and I found enlightening.

Be on the lookout for the next episode in about a week.
That session will focus on long-term ownership.

If you'd prefer to work ahead, navigate to the course link.

See you soon!

**Thank You,
Next!**

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