

to compensate for inflation. Many retirees underestimate the impact of inflation and make little or no provision for increased withdrawals from their investments. These investors have a false sense of security because the current income from their investments is covering their current spending needs.

Unfortunately, if the future looks anything like the past half century, inflation will steadily erode the buying power of each dollar that you earn. If you don't plan for a steadily rising withdrawal from your investments, you can be certain that your standard of living will gradually decline, as price increases force you to—at the very least—sacrifice some of the extras to which you may have become accustomed, such as

travel, recreation, and dining out. At worst, over an extended period, you may not be able to withdraw enough to meet your most basic living expenses.

The implications of the two withdrawal strategies of level or rising payments are illustrated in Figure 8-1. Each example assumes a +7% annual return on an investment portfolio of \$250,000 over a 30-year retirement period, during which inflation averages +4% annually.

Under these assumptions, you could receive 30 annual payments of \$18,825 (or \$1,570 a month) if you wanted a level stream of payments. However, by year 30, the \$18,825 annual amount would have purchasing power equivalent to only \$5,762 in today's dollars, a shocking reduction in purchasing power of nearly 70%. If you wanted your income to rise +4% per year to offset this inflation effect, you could receive \$12,200 in the first year (or \$1,020 per month), with your annual withdrawal amount gradually rising to \$38,100 (\$3,175 per month) in year 30.

Figure 8-1
Two Withdrawal Methods:
Level and Rising Payments

