What withdrawal rate is safe for retirees? Lessons from after the internet bubble

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I don't envy those on the cusp of retirement today because they're starting out in an era when the U.S. stock market is at lofty levels and the nation is beset with political uncertainty.

The problem is investors who encounter a big downturn shortly after retiring have an increased risk of running out of money prematurely. On the other hand, those who enjoy a strong market in the decade after retirement are lucky and could wind up with much more than expected.

To explore the issue, I've been following an unlucky group of investors who retired at the top of the market just before the internet bubble burst in the summer of 2000. (The idea was sparked by Norbert Schlenker, the president of Libra Investment Management, who's been tracking the same unfortunates at the Financial Wisdom Forum using different market measures.)

Well-seasoned souls will remember that U.S. stocks boomed in the late 1990s as technology companies soared on dreams of what the internet might bring. In many ways, the period resembles today's enthusiasm for all things AI.

The market bust after the internet boom provides an ongoing test of William Bengen's 1994 paper called Determining Withdrawal Rates Using Historical Data. He used prior market gains, and losses, to determine that a balanced portfolio of U.S. stocks and bonds should last for at least 30 years while paying a 4-per-cent initial annual withdrawal rate that was subsequently adjusted for inflation.

Mr. Bergen's "4-per-cent rule" can be adapted to the Canadian market to study a hypothetical investor who began their retirement at the end of August, 2000 when the market peaked. To make the math easy, the investor retired with a $1,000,000 portfolio and 50 per cent of it was invested in the S&P/TSX Composite Index (Canadian stocks) while the other 50 per cent went into the S&P Canada Aggregate Bond Index (Canadian bonds). The investor then took $3,333.33 from the portfolio at the end of each month to live on (a 4-per-cent initial annual withdrawal rate) with the payments being adjusted each month to account for inflation. (The figures herein are based on raw data from Bloomberg and use inflation-adjusted monthly data with reinvested dividends and

distributions. They do not include fund fees, taxes, or other trading costs. The portfolios are rebalanced monthly.)

The simple half-and-half portfolio performed reasonably well despite starting off at the top of the market. It still had about $551,000 at the end of January, 2025 and it will likely pay out for the full 30-year retirement period through to the end of August, 2030. Mind you, retirees who used a 6-per-cent initial withdrawal rate have already gone bust. Those who employed a 5-per-cent rate will likely go under in a little less than four years because they're currently consuming about 28 per cent of their portfolios each year.

However, the idea of loading up on Canadian bonds and stocks in the late 1990s would have struck many investors as being mad. After all, U.S. stocks had been posting double-digit real annual returns for the last half of the 1990s. But Canadians who loaded up on U.S. stocks fared particularly poorly in the following years because they were hit with the double whammy of falling stock prices and a strong Canadian dollar.

The accompanying graph shows how unhedged Canadian retirees fared after putting all of their money in the S&P 500 Index (U.S. stocks) at the end of August, 2000 using various withdrawal rates.

Investors who opted for a 4-per-cent initial real withdrawal rate went bust in early 2018 after suffering from extremely harsh losses in the first 10 years. Those who used a 3.5-per-cent real withdrawal rate are almost out of money today and are likely to go bust in the next year or two.

I hasten to add that many balanced and diversified portfolios avoided calamity over the period. Similarly, the risk of failure can be reduced by choosing a modest withdrawal rate and having the ability to reduce spending, if necessary, in hard times.

More optimistically, those who enjoy unusually good times in their early retirement years will likely be able to spend much more than they had originally anticipated.

While I'm not planning on retiring soon, I have been reducing my exposure to U.S. stocks as a risk management measure due to the situation stateside. For those who are about to retire, hold on to your hats.

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