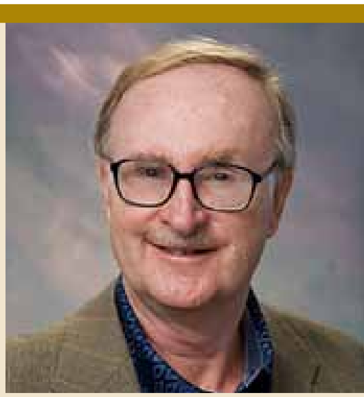
10 *Questions*

WITH NOTEWORTHY PEOPLE

William Bengen on Risk, Volatility, and Safe Withdrawal Rates in Today's Markets

by Lance Ritchlin



WHO: William Bengen, CFP®

WHAT: Financial planner, researcher, and developer of the "4 percent rule"

WHAT'S ON HIS MIND: "Buy and hold in these environments is an invitation to disaster. You need a money manager who is willing to withdraw your funds from the market when there is high risk present—and I believe the risk is very high now—and then be willing to further invest you when values improve and the risk is reduced."

PODCAST: Check out our podcast with William Bengen at www.FPAnet.org/Journal/Home/PodcastPage.

If financial planning has anything analogous to a rock star, William P. Bengen is it. Bengen is an investment manager and fee-only financial adviser based in Chula Vista and La Quinta, California. He received a B.S. in aeronautics and astronautics from MIT, and has an M.S. from the College for Financial Planning.

Bengen's landmark research into "safe" withdrawals from retirement portfolios led to wide acceptance of the "4 percent rule" as standard by the financial planning profession. He literally wrote the book on the subject—it's called *Conserving Client Portfolios During Retirement*, and it was published in 2006 by FPA Press. Bengen has been quoted in numerous publications including *Forbes* magazine, *The Wall Street Journal*, *Bottom Line*, and *Kiplinger's*.

Over the years, other authors have attempted to refine, expand, or challenge Bengen's ideas, but for nearly two decades, the ongoing dialogue regarding "safe" withdrawal rates has been arguably the most dynamic topic in the financial planning profession.

The *Journal* asked Bengen how well his ideas about safe withdrawal rates have stood up in today's volatile markets.

1. *In your book* Conserving Client Portfolios During Retirement *you mention that in the past, recovery from bear markets has been so powerful as to almost forgive taking higher withdrawal rates during them. Do you see recovery from this bear market accommodating higher withdrawal rates now?*

No. The critical thing to permit higher withdrawal rates is the depression in stock prices that occurs at the end of a bear market. I haven't seen anything in the past 20 years that would permit you to withdraw at a higher rate than the 4.5 percent that I recommend. We'd have to go much, much lower than we are now, or we did in 2009 even, to consider a higher withdrawal rate. That's how ridiculously overvalued the stock market has been for 20 years.

When something like this goes on for such a long time, people accept it as normal. This is not normal. This is an outlier that has basically been exacerbated by massive deficit spending and borrowing, which is all now coming to its final conclusion. We'll probably produce some great stock and market values down the road if people are prepared to take advantage of them.

2. *With volatility an everyday reality in the stock markets and interest rates* *with no place to go but up, where are you advising clients focus their investments right now?*

Right now my portfolios are bizarre. That's the only way I can describe them. I have very few investments, less than half a dozen investments, and we're focused almost entirely in the safest bonds I can find, which are U.S. Treasury—which appear to be safe for now, although not in the long term—and gold. I have very little money in the stock market, almost negligible amounts. The funds that I have—actually I don't have short funds but some of them use hedges, so they will go up on a day like this when the market's down a lot.

3. *In FPA's 2011 retirement income survey, one-third of planners say they use dynamic withdrawal policies that can adjust a client's withdrawal amount in extreme market conditions. When clients can accept this flexibility, what's your research shown is the impact of such dynamic withdrawal policies?*

In other words they're reducing withdrawals during times of adverse stock returns. I think that they need to find a money manager who is willing to do something other than buy and hold. I'll be quite frank about it. Buy and hold in these environments is an invitation to disaster. You need a money manager who is willing to withdraw your funds from the market when there is high risk present—and I believe the risk is very high now—and be willing to then further invest you when values improve and the risk is reduced. That's one way you'll be able to conserve capital. You can't depend on the market today to do that for you.

Not in this environment. '80s and '90s for 20 years got away with it. Not now. Not going to happen. So I think rather than putting the burden on the client to scrimp and save, I think the burden falls more on the planner and the money manager to conserve capital.

4. *You've helped shape the dialogue in the financial planning profession for many years. Whose work or research are you following today and why? Is there someone out there who really intrigues you?*

Wade Pfau ... I find [Pfau's ideas] very interesting. Of course, Michael Kitces. Jonathan Guyton has done some excellent stuff. There are other people who have sometimes produced interesting material but those three I think have consistently produced some good stuff.

5. *Before entering the financial planning world you worked for 17 years with your family-owned soft-drink bottling company. Does anything from that experience carry over into your current practice?*

Oh sure. Running a business with, say, 400 employees was of great value to me. I learned a lot about how business operates and how variable profits are in business. That's what makes me so suspicious of these Wall Street earnings games they play. You know: beat (or) meet earnings expectations. Our business earnings varied dramatically from quarter to quarter. I don't know how any of these guys can forecast their earnings like they do, so I think that whole game is a scheme to suck investors in.

I think I learned a lot about investing also. That's where I really started my investing career. I did some investing for the business and cut my teeth there.

I think probably just learning how to deal with a lot of people, different types of people in all walks of life, was very valuable to me. Really opened my eyes.

Running a business will do that to you. I think you learn a lot also about the relationship between government and business.

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6. *Tying in with that, what advice would you have for early-career planners who are in this industry for the long haul and want to build a successful advisory practice?*

I think they probably have the greatest opportunity in the past 20 years to help people, if that's what their goal is, and build a practice, because I believe this decade people are going to need financial planners more than ever. The circumstances are going to be very difficult, the investment environment is going to be tough, saving money is going to be tough. There are going to be lots of concerns. Maybe in the '80s and '90s they'd have been able to throw a dart at the board and pick a couple of good stocks and stick with them and make money. Anyone could have done it.

Not now. You have to be into capital preservation, know when to be in the market and when to be out, how to use your money smartly.

When should you buy a house? When should you rent? A lot of these critical decisions—life insurance—financial planners can help people with, so I think it's a wonderful time to be coming into the financial planning field. They just have to learn the basics, learn the sound stuff, and go out there and do it. It's great.

> "If this situation deteriorates and Europe blows up, the emphasis is going to be more and more on the investment manager ... to preserve capital and not follow a buy-and-hold approach."

7. *You recently stated in* Forbes *magazine that 30 years is still a viable retirement span assumption, even though actuarial tables show that people live longer, because there's almost always a cushion or a stash left, worth at least the initial value of the portfolio. Has recent market volatility given you reason to doubt this stash will hold out?*

Well, there's some periods of heavy volatility … in the past. It's not the volatility that concerns me because it's up and down lately. It's just the overall risk—it's a very risky financial system we've created—and where it could take stocks eventually. It's time to be really careful. I sure hope that 4.5 percent rule holds up. I think, if we're in a deflationary environment, we'll probably be okay. If we get eventually into a hyperinflationary environment, I don't know what will happen at that point. I suspect, late in this decade, we could be headed for something like that, if we continue to print money like there's no tomorrow.

8. *You mentioned some of the other people who've tried to extend your work. In light of that additional research on the impact of valuations and yields, what do you think a safe withdrawal rate is in today's environment? Are you sticking with 4.5 percent?*

I'm still recommending 4.5 percent from a tax-deferred portfolio, if you think you're going to live 30 years. I think that's fair. Of course, it depends on the individual circumstances. When you come down to actually planning with an individual, they've got all kinds of other stuff going into retirement, and they have pension plans and inheritances and big expenses. So, you may have to modify all that. But the basic principle, I think, is sound. I haven't seen anything yet that would invalidate it. But that doesn't mean something can't happen. I don't know where this financial crisis is taking us. This could be very, very bad. It could be unprecedented.

If that happens, then, you're going to have to be really careful. My research is based on a buy-and-hold approach because it was easy to analyze. I think that more and more, if this situation deteriorates and Europe blows up, the emphasis is going to be more and more on the investment manager, as I mentioned before, to preserve capital and not follow a buy-and-hold approach.

9. *What do you see as the next step regarding research into safe withdrawal rates?*

I think that was something … where you vary, now, the investment approach based on some criteria that have yet to be defined, whether it be value or something else. I believe that buy and hold is appropriate under certain circumstances; other circumstances, it's not. And timing, if you need to depart from it….

So, that's where I'm looking at, basically, by varying the investment approach, the variable that really hasn't been explored. I think all the research done has pretty much assumed a portfolio with a pretty constant stock-bond ratio throughout the whole time of the client's retirement. I think that's a big key. That's the one variable you can control. You can't control what the economy does, you can't control what stocks return. But you can control how much you own of them. And when you own them.

10. *Do you see the use of annuities as a complement to the safe withdrawal rate approach or an alternative?*

I think it's an alternative use of capital that may make sense in certain circumstances, particularly if some people feel they need to have a larger sum of money, more than my safe withdrawal rate would dictate. As they get older, that's become perhaps a more and more attractive option for a lot of people.

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