# 9 Guidelines for Retirement Success

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Now that your once-distant dream of retirement is at hand, it can be an unsettling switch from being a saver to being a spender. It means having an entirely new approach to your money. It can be tough regardless of your financial expertise or the size of your portfolio.

Even if you've been successfully managing your money on your own for decades, the transition into retirement is one of those times in your life when a little personal guidance can go a long way, even if means simply confirming what you already know. So you might want to consider consulting with an objective financial planner as you approach the transition.

To help ease your transition into retirement, the Schwab Center for Financial Research has come up with nine straightforward guidelines. They aren't intended to be rigid directives, but can reduce your financial stress and give you the upper hand as you move into retirement.

### #1: Review Your Situation

Make sure you know exactly where you stand. Gather the latest statements from all of your accounts to create a net worth statement (your assets minus your debts). Then take a look at your cash flow (money in, money out) for the last couple of years, and use this information to create a projection for the future.

Tip: Review your budget at least once a year, reassessing whether each expense is discretionary or non-discretionary.

### #2: Maintain at Least a Year's Worth of Cash

Set aside enough cash to cover at least one year of spending. This is the amount that you'll need to supplement the income you can count on—for example, from Social Security, a pension, or real estate investments.

Tip: Before you file for Social Security, crunch the numbers! Far too many people leave money on the table because they haven't done the math. In general, it's best to wait until age 70 to file in order to maximize your lifetime benefit, but every person has to consider their own circumstances.

Where should you keep your cash? Checking and savings accounts, money market funds, Treasury bills and certificates of deposit (CDs) are all options to consider. None will provide a great return, but that's okay. This is about safety and liquidity, not income.

Realize, too, that this is the minimum amount of cash you should have. If possible, you'll also want to have enough cash to cover an additional one to four years in your portfolio. See guideline #4 below for details.

### #3: Consolidate Income in a Single Account

Combine all of your non-portfolio income—which could come from Social Security, a pension, an annuity, whatever—into one account. You can also put portfolio income—for example, interest and dividends—into this account. This account will be your primary source of cash, allowing you to more easily track your income and spending over time.

### #4: Match Your Investments to Your Goals and Needs

As an experienced investor, you understand the importance of selecting a mix of investments in keeping with your personal goals, time frame, and risk tolerance. For most people this means gradually moving away from stocks and toward bonds and other fixed income as well as cash. But it's important not to abandon stocks altogether so that your portfolio can keep up with inflation. Bonds will not only provide you with income but will also act as a buffer against market volatility. Cash investments protect you from having to sell stocks at a bad time. As an example, you might follow the allocation path in the table below.

| | Pre-Retirement | Early Retirement | Late Retirement |
|---|---|---|---|
| Portfolio | Moderate | Moderately Conservative | Conservative |
| **Percentage Allocation** | | | |
| Stocks | 60% | 40% | 20% |
| Fixed income | 35% | 50% | 50% |
| Cash | 5% | 10% | 30% |

### #5: Cover Essentials with Predictable Income

Guideline #1 recommended reviewing your income and expenses. Now divide your expenses according to whether they're essential or discretionary. Ideally, you'll be able to cover all of your essentials with predictable income. That way you can cut back on non-essentials in a lean year.

Tip: Don't have enough predictable income to cover your essentials? Consider purchasing an immediate fixed annuity.

### #6: Don't Be Afraid to Tap Into Your Principal

It's the rare individual whose portfolio is large enough to allow them to live off of the dividends and interest alone. Your goal isn't to avoid tapping into your principal at all, but to do it in a prudent way.

Following the 4% guideline, plan to withdraw no more than 4% of your portfolio's value in the first year of retirement. As an example, if you want to withdraw $40,000 a year from your portfolio (and then increase that amount each year for inflation), you'll need a portfolio of about $1 million. Sticking to this guideline can give you 90% certainty that this cash flow will last for 30 years—provided that at least 20% to 60% of your money is invested in a well-diversified mix of stocks.

Tip: If you have mutual funds in taxable accounts, consider having the distributions automatically swept into a money market fund. You may not have to sell as many shares this way.

### #7: Follow a Smart Portfolio Drawdown Strategy

When it comes to creating a "paycheck" in retirement, tax-efficiency is king. But because you may have a variety of accounts—ranging from your 401(k), your IRA, and your Roth IRA to your brokerage account—and because each account may hold a variety of investments—ranging from individual stocks and bonds to mutual funds and exchange-traded funds (ETFs)—it can be very confusing to know what to take from where.

To help you make the smartest decisions, the Schwab Center for Financial Research recommends the following priority system. The rationale behind this order is that withdrawals from traditional IRAs and 401(k)s are taxed as ordinary income, typically at a higher rate than the long-term capital gains rate that you'd pay when you sell investments held for more than one year from your taxable accounts. Also, leaving more money in your IRA or 401(k) provides more time for tax-deferred compound growth.

- *First, draw down your principal from maturing bonds and CDs.* If you have a short-term ladder of bonds or CDs, your first step can be to tap the principal of each bond as it matures. If this is enough to supplement your other income—congratulations, you're done. Chances are, though, that you'll need to continue on.
- *Second, if you're 70½ or older, take your RMDs.* You likely know that once you reach the age of 70½, the IRS requires you to take a yearly required minimum distribution (RMD) from all of your retirement accounts except a Roth IRA. [Note: A Roth 401(k) and a Roth 403(b) have RMDs that kick in at age 70½ unless you're still working.] Whether you need this money or not, you've still got to take it.

Your strategy should always be to sell the lowest-rated securities in your overweighted asset classes. If your RMD satisfies your income needs, you won't have to tap into your taxable accounts. Nonetheless, your decision on what to sell should be made in the context of all of your accounts. In other words, before you decide what to sell from your IRA, look to where you're overweighted in your entire portfolio.

For example, let's say that your required minimum distribution is $25,000, which covers all the additional income you need. After reviewing the breakdown of all of your accounts, you see that you are overweighted in large-cap domestic stocks and international stocks, and underweighted in bonds. By selling your lower-rated large-cap and international stocks from your IRA, you get your entire portfolio back to your target allocation.

- *Third, sell overweighted and lower-rated assets from your taxable accounts.* If you need to withdraw more than your required minimum distribution, look to your taxable accounts next. Sales within taxable accounts are taxed as capital gains rather than as ordinary income, with a preferential rate for gains on investments you've owned for more than a year. Of course, if you've lost confidence in any of your investments, they are also good sell candidates.

If you do have to sell highly rated securities, you can minimize your tax bill by starting with those that will generate a loss before you sell those that will generate a gain. Also, whenever you're considering selling an investment in a taxable account, think about matching gains to losses as a way to control your taxes.

- *Fourth, sell overweighted and lower-rated assets from your tax-deferred accounts.* Generally, your tax-deferred accounts will be your last place to look for income, starting with outsized asset classes and lower-rated securities. If you're 70½ or older, you know that you have to withdraw your required minimum distribution. But you can take more if you need to. Or, if you're younger than 70½, you may still want to tap your tax-deferred account despite the fact that you will be paying taxes at your ordinary income tax rate.

It’s often smart to tap your Roth IRA last. Not only can it continue to grow without taxes, but you’ll be able to withdraw that money tax-free at a later date. Roth IRAs are also a great way to pass on money tax-free to your heirs.

### #8: Rebalance to Stay Aligned With Your Goals

As you probably know, it’s important to review your portfolio’s asset allocation at least annually. If one asset class has grown beyond your plan, it’s time to pare it back. Once you’re retired, this can be a prime opportunity to sell assets to generate cash.

Example: Let’s say that your target asset allocation is 40% stocks and 60% bonds, but your portfolio has drifted to 45% stocks and 55% bonds. You can sell some stocks to generate income, and reallocate anything that’s left over to bonds until you’re back on target.

It’s often possible to rebalance your portfolio at the same time that you make your annual withdrawals. But keep in mind that rebalancing does not protect against losses, nor does it guarantee your goals will be met.

### #9: Stay Flexible and Reevaluate as Needed

Life doesn’t just stop changing once you’re retired. Let’s say you want to sell your house and travel the world. Perhaps you’ve received an inheritance. Or maybe you’re starting a business or going back to work. As your needs change or your feelings about risk change, your portfolio and the amount you withdraw should reflect your new realities.

### Other Things to Keep in Mind

As an experienced investor, you likely have the drive and knowledge to follow these guidelines and manage your money wisely. However, as you keep an eye on your accounts, don’t forget about the rest of your financial life.

Ask yourself: Do you have the appropriate insurance coverage? Have you thought about when to file for Social Security? Do you understand what Medicare won’t cover and how you’ll cover the difference? Have you created an estate plan? These are all crucial issues and important pieces of your financial life.

And finally, include your spouse or significant other in both your day-to-day and long-term financial planning. Certainly every couple has their own way of divvying up responsibilities according to their skills and preferences. But when it comes to your money, it is essential for both partners to participate fully and have complete knowledge of their accounts and investments.

So don't keep money in the closet. Share your thoughts and concerns and educate each other. If you work as a team, you'll both be better off.

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