How to Enjoy Retirement Without Going Broke

The problem of decumulation is a tricky one, even for Nobel Prize-winning economists.

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Illustration by Arsh Raziuddin, The New York Times; Photography via Getty

By Peter Coy
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I've been asking readers to suggest ideas, and I got this one last week from Jerry Moskowitz of Croton-on-Hudson, N.Y.: "I teach a class for seniors called Keeping Current in Economics and Finance. An interesting subject may be decumulation — how to successfully spend money in retirement."

Excellent idea, Jerry. Accumulating money for retirement is hard, but decumulating it is tricky, too. Even the experts have trouble saying how to pace your spending so you can enjoy retirement without exhausting your savings before you die. You can't know for sure how long you'll live, whether you'll suffer a costly illness or how markets will perform.

"It's really nasty. It's the nastiest, hardest problem I've ever looked at," William Sharpe, who won a Nobel Memorial Prize in Economic Sciences in 1990 for his work on financial economics theory, told Barry Ritholtz, a Bloomberg View columnist, in a 2017 podcast. Sharpe added, "I can't say I've found some magic solution, because I haven't." (His solution is posted, free, on the Stanford University website. Beware: It's mathy.)

Decumulation isn't just a tough financial problem. It can be an emotional strain to flip a switch from saving to dissaving.

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I can't do this topic justice in one newsletter, but for starters, here are three choices that everyone who's retired or thinking about retiring has to make:

Do you keep your spending steady and allow the assets in your portfolio to fluctuate, or do you do the opposite — keep your portfolio steady and allow your spending to fluctuate?

Both choices have drawbacks. Let's say you want to keep your spending steady to maintain a stable lifestyle but, right when you retire, the market has a few bad years in a row. The spending level that you chose, which seemed reasonable when you retired, will be too much for your shrunken portfolio to sustain. Your assets will shrink far faster than you intended, and you will run out of money.

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Or let's say you choose instead to keep your portfolio steady or shrinking at a slow and steady pace. That means that when the market goes down, you'll have to cut back how much you pull out of the portfolio to avoid draining it too quickly. That could be a problem if you need the money to pay bills.

A good choice is to come down somewhere between the two. Try to keep your lifestyle fairly stable, but bow to reality and cut back at least a bit in years when your portfolio is down.

Do you keep a big nest egg, or do you convert your savings into a stream of monthly checks?

The smart but psychologically difficult choice is to at least partly annuitize — that is, buy a financial product that provides a monthly income. When you buy a life annuity, the seller takes on the risk that you will live to age 110. That's a big load off your mind. What makes it hard on your psyche is that to get a decent-size annuity, you have to turn over a big chunk of your life savings to the seller, usually an insurance company. "The purchaser has to write a big check to get a series of small checks, which may simply look like a bad deal to a naïve consumer," Shlomo Benartzi, Alessandro Previtero and Richard H. Thaler wrote in The Journal of Economic Perspectives in 2011.

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To get over the mental threshold, think about how relieved you'll be to have income for life. Or cut the cost by buying a deferred annuity that kicks in at, say, age 80. Social Security is a fantastic annuity that's provided by the government, and you should try to maximize how much you get from it. One smart strategy is to use up some of your nest egg to cover your costs until age 70 and start drawing Social Security checks only then. By waiting, you will get bigger monthly checks.

Research shows that people who convert their nest eggs into predictable monthly checks have lower levels of the stress hormone cortisol in their bloodstream, says Teresa Ghilarducci, an economist at the New School for Social Research. The rap on annuities is that they have high fees, but competition has benefited consumers. Quality has gone up, and costs have come down.

How much risk do you take?

Keeping your money in stocks gives you more potential but also more risk. For most people, especially younger retirees, some exposure to stocks makes sense. But grasping for high returns to compensate for years of undersaving is unwise. Do you lose sleep when the market plunges — or, worse, sell your shares and lock in big losses? Then you'd be better off in something safer. Also, adjust your asset allocation as you age. "As people get older, security is much more important to them than almost anything else," says Ghilarducci.

As Sharpe said, these aren't easy decisions. Annamaria Lusardi, an expert on personal finance at George Washington University School of Business, says that in her research, "I kept being surprised by how little people know." For many people, she says, finance is a foreign language. "We have shifted so much of the decision making onto individuals," she told me. "In finance, ignorance is not bliss."

The Readers Write

Inflation expectations mean nothing if they are not accompanied by higher wage expectations. So far, they are not, and that's why inflation is hurting consumer confidence. I watch the Conference Board Survey for this. It's monthly, and the data jibes well with other data series.

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