

THE TAMRIS REVIEW

In Search Of The Truth

Magic Numbers & Safe Withdrawal Rates

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Introduction

One of the main objectives of building up capital throughout an individual's lifetime is to be able to live off it in retirement. But just how much can an individual take from their assets over their lifetime without running out of capital?

Many have attempted to answer the question. Recently there has been increased interest in the issue, note for example, Lee Eisenberg's book, "The Number", which raised the issue of withdrawal rates and their calculation. The issue will become one of increasing importance with the front end of a

generation of baby boomers now starting to hit retirement.

This newsletter will discuss the fact that there is no magic number and that the management of withdrawals over time requires significantly more than "*a hope and pray*" approach to the management of financial needs and wealth.

Withdrawal rates for individuals

Whether you are 15, 10, 5 years or less from retirement, or whether you are firmly into retirement, there are two important questions you need answers to.

- "What is the most¹ I can safely get out of my investment capital between now and the time I die, given my personal financial and investment objectives and risk preferences?"
- "How will it be done, what risks will I be exposed to and, how will these risks be managed?"

What percentage of your current assets could you safely withdraw from your investments without running out of capital over your lifetime?

Using the past as a guide, some studies have shown that a safe sustainable rate at which you could have withdrawn income and capital from your assets would be in the region of 4%, or \$4 for every \$100 dollars invested. Others show figures as high as 6%.

Such withdrawal rates are fixed to the value of the capital you started with, adjusted over time only for inflation.

While the analysis from the studies is useful, applying a fixed portfolio and a fixed withdrawal rate over time does not help us meet an individual's needs or properly manage risk and return going forward.

¹ In economic jargon, what is the maximum utility?

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As far as the future is concerned, we are in a dilemma.

If we knew what the returns on your assets would be in the future and, if we knew exactly when investments were to rise and fall, then there would be figures that we could use to determine exactly “how much” you could take out every year given your objectives, but otherwise, **no, there is no magic number.**

What determines a safe withdrawal rate?

There is no one number that applies to all and sundry or, that maximises an individual's use of their assets over time. What you can take from your assets over time depends on the following.

- The future returns of the investments in your portfolio and the modelling used to determine the risks to those returns.
- The standard of living you want from your assets, how much capital you are willing to deplete and your preferences regarding risk and return.
- Your life expectancy as well as the risks of living beyond this.
- How the portfolio is constructed to meet your financial needs over time and, how it is structured to manage the safe depletion of capital on which most investors' financial security depends.
- The costs of wealth and asset management; the costs and structures of many products can take away the rationale for longer term equity investment.

As far as the individual investor is concerned, the question is not just what figure can I expect to take from my investments, but is my advisor capable of managing the problem and to what extent can they manage the problem?

Future return and future risks

The returns on all investments vary over time, as do the risks of investment, they are not fixed.

The more expensive an investment becomes and, the more advanced the economic cycle, the lower the future return and the more exposed the investment will be to economic and stock market risks.

Where we are in the stock market and economic cycle determines how much return we will get going forward, how much risk we will be exposed to and, therefore how much we can withdraw over time.

There will be times when buying investments will pose a significant risk to current and future financial security. If we use historical returns to predict what an investor can take from their assets at these times, they will be at risk of running out of money within their lifetimes.

The fact that we cannot use historical average returns and cannot accurately predict the future, has led many to look for a withdrawal rate that could be met from capital whatever the risk or the return.

These studies have looked at the maximum withdrawal rate that could be sustained from a portfolio in the worst case scenario, using historical returns.

The trouble is, we are not always in a worst case scenario and, the worst case scenarios of the future may be different from those of the past. Also, basing what we can take in a worse case scenario does not help us maximise the use of our capital today.

While we cannot accurately predict future return we can use our knowledge of the past, our understanding of the current business and market cycle and, our understanding of the physics of valuation to develop assumptions that reflect the risks and returns of the current moment in time.

In order to safely manage withdrawals and to maximise the use of your capital, the return assumptions that determine what you can take need to reflect the risks that the current market and economic cycle pose to the ability of your assets to meet financial needs over time.

The roulette wheel approach

Some investors may have heard of what is called a **Monte Carlo** technique for determining the range of return your portfolio could achieve over your lifetime.

You may have heard your advisor discussing the probabilities of meeting your financial needs; “*there is a 90% probability that you will achieve this objective*”. This type of analysis is derived from a technique called Monte Carlo.

But just what is Monte Carlo?

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Those that use Monte Carlo techniques believe that the movements of stock markets are random and that each market movement is independent of another, which is not the case².

What a Monte Carlo does is select, at random, monthly returns from the past to build up alternative estimates of future returns. They run this process thousands of times until they come up with thousands of different return profiles. They then use the range of returns they have generated to assess the chance of achieving your planned withdrawals.

It is called Monte Carlo because they select the return information just like the roulette table at a casino picks numbers.

The trouble with this type of analysis is that it does not adjust for the current risks of the market and the economic cycle. For example, if markets are highly valued you might find that instead of being 90% certain of meeting your needs, you may only be 50% certain, or less, who knows.

Financial objectives

Every individual's financial needs are different, not just in terms of a "withdrawal rate", but the size and timing of their financial needs.

Who is going to need the same income and capital each year from their assets? No-one!

There will be individuals who want to spend more in the earlier stages of life and less later on and, individuals who will have large outlays one year and less the next.

In fact, what is more important than one figure, one size fits all, is "*can my investments meet my own preferred expenditure profile over time?*" and, if not, "*what do could my investments could cope with over time and what adjustment am I able to make to my planned expenditure?*"

A single rule of thumb figure is not going to be of use to the individual that lives in the real world.

If a portfolio is to be structured to meet your needs over time, it has to be capable of meeting them as and when they arise. Average withdrawal rates are of little

² Market movements are random and dependent given that the long term return on an investment is constrained by its earnings growth and the cost of capital.

to no use in the actual construction, planning or management of a portfolio over your lifetime.

Also the ability of your assets to meet planned financial needs must be continuously reassessed (at least once a year) and the relationship between needs and structure of the portfolio managed at all times.

One of the problems with the so called "magic number" studies is that they relate to withdrawal rates fixed to the initial capital value of your investments.

- You cannot just start off with an annual drawing requirement and a portfolio and, expect the two to still have relevance over time.
- Because the rate is based on a worse case scenario, many investors will not be able to maximise the use of their capital over their lifetimes. This is likely if returns are higher than the worst case scenario.

- It is a bit like being told to drive at 5km an hour, because at 5km an hour you are never going to get hurt in a crash, but if you drive safely, keep your distance, wear a seat belt, make sure your car is well maintained and watch out for other drivers and drive appropriately for the conditions, you should be all right.

If you are being forced to rely on a fixed withdrawal rate then your advisor may not have the necessary systems, software or disciplines needed to construct, plan and manage a portfolio to meet your needs over time.

Capital depletion complicates matters

Depending on how you view your objectives, the figure that you can take from your assets will vary. If you are willing to deplete capital, then your withdrawal rate can be larger. Indeed, if individuals want to maintain a certain standard of living in retirement they may be forced to deplete their capital.

Obviously the more you are willing to deplete capital, the greater the risks you will be exposed to if the wealth management you are receiving does not have the expertise to manage the risks.

How do you maximise both your current and future use of your capital?

Capital depletion should not mean that you will completely deplete your capital within your lifetime. A good wealth manager would project forward at

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conservative rates of return that would allow for significant stock market and economic risks and would support this with a substantive portfolio structure capable of managing all but the most absurd of risks. Indeed, in a perfect world, your wealth manager should be able to manage the risks of capital depletion safely and cost effectively.

Most of the studies that have looked at the maximum withdrawal rate you can take do not provide portfolio solutions that can manage the risks of capital depletion.

One of the major problems with fixed withdrawal rates is that the both the investor and advisor are unable to make any decisions as to what level of capital depletion they are actually accepting³. If they were able to effectively model capital depletion and manage it, they would not be using a rule of thumb.

Life expectancy

The maximum withdrawal rate for a client age sixty is going to be different from a withdrawal rate for a client aged 75 and so on. The shorter the life expectancy the less risk there is of depleting capital within your lifetime.

If you stick to a fixed rate of withdrawal (a rate fixed at the start of your retirement planning) as recommended by many of the so called magic number studies, you might find that the rate may never match your actual needs. It may also become increasingly irrelevant as time moved on.

What you can take from your assets over time depends on your life expectancy and for those who are not super wealthy (and this includes most high net worth individuals), the withdrawal rate is likely to increase over time, often significantly.

Portfolio construction

How your portfolio is structured, planned and managed to meet your financial needs over time is a major determinant of how much you can withdraw from your assets over your lifetime.

³ Since they make no assumption as to what the current risks to return are, important in modelling the risks going forward.

The good!

- An optimum portfolio is one that can protect your planned short and long term withdrawals against the natural ups and downs of markets and the often [severe and prolonged declines](#) in markets and economies.
- You should never be forced to sell an asset to meet a need and, any sale of assets to meet needs should not be at the mercy of the markets, which means forward planning.
- Transactions should be made years in advance of the actual need, thereby allowing the manager to take advantage of the market and economic cycle to sell assets at high valuations as opposed to low valuations.

Periods of significant stock market and economic risk happen every 10 to 15 years and an inappropriate portfolio structure can make a fool of long term averages. Long term average returns ignore the fact that *over shorter time frames, returns can be much lower and risks much greater.*

The bad and the ugly!

- If you are having to realise assets every year to meet financial needs, your portfolio may not be properly structured.
- If your portfolio withdrawals are affected by movements in markets and investments (i.e. you have to reduce expenditure when markets are falling) your portfolio is most likely not properly structured.
- If your portfolio could not survive a long drawn out bear market without having to reduce expenditure or to sell undervalued assets then, your portfolio may not be properly structured, planned or managed.

Simply withdrawing from a collection of investments will expose you to significant risk in the event of a market downturn, accelerating your withdrawal rate and fully depleting your capital well within your lifetime. Just having the right balance of low risk assets and equities is not enough.

If your portfolio is not properly structured, planned and managed you will incur **additional transaction costs** and **risk selling at a loss** if you have to sell a fixed interest investment before maturity (a permanent risk

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with managed bond funds) or an equity that is undervalued.

A well structured portfolio with forward planning can provide for a higher withdrawal rate because of lower transaction costs and because it forces a discipline of selling highly/over valued assets to meet future financial needs. So you avoid selling at low points.

Portfolio structure is very important. One of the problems with a “magic number” is that it is a withdrawal rate that has been judged to be safe through all historical market conditions. It therefore represents the lowest common denominator. This means that those using these magic numbers may think they need not pay attention to portfolio construction, planning and management. .

Mean variance optimisers

The standard industry tool for constructing portfolios is the mean variance optimiser.

The weakness of mean variance optimisers is discussed more fully in TAMRIS's technical documents and [discussion](#) can also be found on the website. However, the greatest problem of these portfolios as far as the management of financial needs is concerned is that there is no input into the models for financial needs.

If a financial need arises that cannot be met from the interest or dividend yield of a portfolio, an asset has to be sold. If assets have to be sold in declining markets, the investor incurs risks that are both cost and valuation driven.

It is very important to realise that any action which can reduce transactions costs and the costs of misallocation can have a significant impact on the ability to withdraw income and capital from a portfolio over time.

Any system that cannot manage capital depletion, cannot by implication safely manage withdrawal rates over time. Many of the portfolios recommended by these systems have high costs which can severely restrict their ability to provide the returns necessary to meet withdrawals over time.

Costs

It has been said that a 4% withdrawal rate is a safe rate at which you can withdraw. But, is this before tax, after tax and importantly, is this before or after charges?

For someone with a wrap account and annual management expenses of 3%, is the withdrawal rate 7% or 1%?

Whatever the rate, it has to be net of management expenses and tax since individuals spend net, not gross.

If capital is being depleted, this will also affect the net rate (capital withdrawals are part gain part base cost), which means the withdrawal rate also differs from individual to individual.

If your advisor is projecting a withdrawal rate of 4%, they need to take into consideration all charges impacting on the ability of your assets to meet your financial needs over time. If your withdrawal rate is 4% and your annual management expenses are 3%, your actual withdrawal rate is 7%.

We also need to consider all the other charges associated with financial advice. If your portfolio is not properly constructed, planned and managed to meet financial needs you will be incurring other advisory costs in addition to the specific asset management fees.

The bottom line is what you can take from your assets that will go directly towards your expenditure.

Worse, look at the products the industry is selling in place of proper portfolio construction and planning. The high cost, low return, illiquid Principal Protected Note, the segregated fund, the expensive wrap account, the over expensive mutual fund. If your advisor is recommending a 4% withdrawal rate and at the same time selling you any of these products, they have violated the spirit of the 4% withdrawal rate and could place your financial security at risk.

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Components and component costs

Indeed, add up all the components that impact on your withdrawal rate and you have a substantial range of returns and hence withdrawal rates.

Let us say for the sake of simplicity with the objective of illustrating the point, that the following costs apply to two portfolios run to meet financial needs over time.

- 3% annual management expense ratio for a wrap account.
- 0.25% for a self managed Exchange Traded Fund (ETF) account.
- Marginal additional cost of transactions with an inappropriate portfolio structure – (-ve) 1% per annum.
- Liquidity risk of inappropriate transactions – (-ve) 1% per annum.

Let us then assume that historical returns have been say 11%, but markets and the economic cycle are at advanced levels and future return is only going to be 5.5% per annum.,

The range of returns (before tax) for an inappropriately structured portfolio with high costs and an appropriately structured portfolio for low costs could be as follows.

- High cost portfolio - 5.5% less 3% wrap management expenses, 1% a year for inappropriate transactions, 1% liquidity risk for selling assets to meet needs = 0.5% return.
- Appropriately structured, low cost index portfolio - 5.5% less 0.25% = 5.25%.

While the above is not a carefully crafted case study, it does show how the factors discussed can impact on withdrawal rates over time. Indeed, the difference between the above two returns (4.75%) would wipe out any benefit of investing in equities. You could say that some would be better off investing in GICs without the costs of a financial advisor.

Maximum safe withdrawal studies

In 1994 a US financial planner (Bengen) looked at the maximum withdrawal rate an individual could take from their assets over time.

He studied the returns on bonds and the US market since 1926. He looked at various portfolio allocations to bonds and equities and came up the conclusion (after extensive number crunching) that if you wanted to be certain of not running out of capital over your lifetime, the maximum withdrawal rate you could take from your assets was 4% of your initial capital value. He also surmised that in order to be sure of meeting the minimum withdrawals that you could only increase your withdrawals by the rate of inflation.

While the study itself provided valuable insight into the risks of withdrawing capital over an individual's lifetime, there are a number of problems relating to the application of the study to the management of portfolios.

- A 4% withdrawal rate is not going to be efficient at maximising an individual's use of capital because not everyone is going to invest at the worst possible time.
- Individuals need to be able to maximise their use of their capital over their entire lifetime. Having to adhere to a fixed withdrawal rate agreed at the start of their retirement is a serious constraint on their ability to maximise their use of their capital over time.
- It also restricts the ability to manage risk and return at all points in time. In order to be able to effectively manage risk, a portfolio's allocation and planning and management of allocation needs to be sensitive to actual financial needs. .
- The portfolio construction used in the back testing was exposed at all times to both normal and significant short term stock market and economic risk.
- If the withdrawal rate is fixed to the value of the initial portfolio and the asset allocation as a fixed percentage does not vary, there is effectively no management of asset allocation relative to the withdrawal rate.
- The past is not always a good guide to the future, indeed the US market of 2000 was more highly valued and the economic cycle more advanced than at any other time in its history. There is a risk that the 4% maximum withdrawal rate might even be lower for an extreme risk event. Likewise, at the bottom of a market and economic cycle withdrawal rates could also be significantly above the 4% recommended by the study for those investing at such times.

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- Transaction costs and management fees do not appear to have been explicitly taken into consideration⁴. If we include these costs, the net withdrawal rate would be lower.

The study did implicitly highlight a number of important issues.

- The fact that you cannot rely on historical average returns to determine what you can safely withdraw over time.
- The fact that high market valuations and advanced economic cycles expose individuals financial needs to significant financial risk and that your portfolio structure and your withdrawals needed to be able to cope with this.

The problem with this study (and many since) is that its conclusion **allowed the problem to constrain the wealth management solution** as opposed to looking at a structure to manage and solve the problem.

- It did not look at portfolio construction as a method of managing the risks to the ability of assets to meet financial needs over time during periods of significant stock market and economic risk.
- It did not look at developing forward looking return assumptions which would manage uncertainty of and risk to withdrawal rates.
- It did not look at the management of excess risk and return during periods of high to extreme market valuations and failed to address the central issue of the validity of an equity withdrawal strategy during high markets as well as the impact of industry product charging structures on the differential return on equities.

There have been many more studies into this area since then. While a number have started to look at portfolio construction, planning and management as part of the solution, they still suffer from their fixation on fixed withdrawal rates, have yet to develop forward looking assumptions that manage risks to return and still do not address the issues of valuation and costs on the equity return differential.

This is important because the validity of a withdrawal strategy with a high equity component is questionable when costs are high and/or future returns are low relative to low risk alternatives.

⁴ The original article did not make a reference to these costs.

Maximum withdrawals, versus naïve withdrawal strategies & traditional portfolio constructs

Please note that compared to the naïve strategies used by the industry to withdraw capital from portfolios to meet financial needs, the maximum withdrawal rate approach will protect individuals from the excessive risks that naïve strategies pose.

Naïve strategies involve advisors projecting future returns, often based on historical averages, and then deducting planned withdrawals from these projections. This means that withdrawals will be higher than the maximum withdrawal rates which use more conservative return assumptions.

Naïve approaches quite often rely on you having to sell investments whatever the economic and stock market conditions. Regularly selling investments that have fallen in value and worse, investments purchased at the top of a market, only to fall in value for years, can decimate a portfolio's value and an individual's financial security.

At high market valuations and advanced economic cycles the risk of naïve withdrawal strategies are of particular concern.

Simple Asset Dedication models

We have started to see the introduction of "asset dedication" solutions as a structure for the management of financial withdrawals over time.

Essentially, these models allocate enough of your capital to a specific asset class; say bonds, to meet your financial needs over the short term.

The interest and the capital from the bonds are used to fund expenditure over a certain time period, with the bonds being designed to mature regularly to provide capital to meet financial needs. Equities are sold every year to rebuild the portfolio and some defer equity sales during declining markets.

The following points relate to a number of weaknesses in the simple structures being used.

- Too small a low risk allocation to manage significant stock market and economic risk. For example some appear to take an allocation to bonds to cover only 5 years of financial needs. Running down the bonds and having to sell

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equities each year does not protect the individual's financial needs from significant risks.

- If you have to sell equities every year to rebuild the 5 year low risk cover, you are effectively taking the same risk as if you were 100% invested in the stock market.
- If you defer taking equities because of low market valuations for any length of time, the security offered by such structures become even more perilous.
- The low risk allocation strategy does not take account of high to extreme market valuations when low risk allocation should actually be increasing.
- With a five year cover some capital will only be invested for a year before it is sold back into low risk, meaning the initial investment time frame is too short. Indeed, if you were covering a five year risk period and believed that equity investment should be made with a minimum 5 year period, you would need 10 years of cover.

- Many of the asset dedication models do not allow the individual to adjust their asset allocation stance in response to their risk preferences. This could lead to unsuitable solutions for many investors.
- Many cannot take into consideration future inflows to the portfolio and future outflows from the portfolio in the construction, planning and management of assets to meet financial needs and appear able to deal only with fixed withdrawals and simple financial needs.
- Many cannot take into consideration the distribution of your existing investments within their frameworks.
- They rely on maximum fixed withdrawal rates calculated by other studies, the weaknesses of which are noted earlier. If you cannot model the future risks to the ability of assets to meet financial needs you can neither mitigate the risks nor can you fully maximise your use (maximise utility) of your assets.
- They do not appear to take into consideration current risk/return relationships when making the security allocations. As such they are limited in

their ability to manage periods of extreme risk, especially the risks of initial investment. .

Simple asset dedication systems, in certain instances could pose an extreme risk to the ability of assets to meet financial needs over time.

The financial planner's dilemma

Much of the work that has gone into researching withdrawal rates has been expended by financial planning professionals. They are the ones that have had the responsibility of making sure that a client's assets are capable of meeting their financial needs over time. However, their lack of key investment, asset liability modelling and management and, economic expertise is one reason why their research has not moved towards asset management integration. It is time the asset management industry woke up to the possibilities afforded by integrated systems as well the responsibility it has towards the Individual investor.

The Investment Advisor's Responsibility

If the individual's objective is to find out what they can and cannot take from their assets over time, it is their advisors' job to safely manage the problem.

An organisation that is properly managing the problem would not rely on rules of thumb to determine how much you can take from your assets over time. In your initial meeting they may use such guesstimates to give you an idea, but the actual work should not rely on this.

And this is the rub, managing the problem is complex and, without the expertise and systems to do the job properly, using a rule of thumb may make much more sense and, is definitely simpler and more practical.

Anybody looking to effectively manage withdrawals over time needs to be able to do the following.

- Value current risk and return. That is they need investment expertise.
- Must be able to relate the way they value and allocate investments to the management of financial needs over time.

If your advisor cannot value, they cannot allocate, and if they cannot relate asset allocation to financial needs

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they cannot manage risk and return necessary to effectively manage withdrawals over time.

The Two Relationships

There are two relationships that need to be managed by your advisor.

- One looks at the relationship between asset allocation and financial needs over time. This is the structural aspect that makes sure that your assets can meet needs and are not exposed to unnecessary risk.
- The other deals with the management of risk and return at a point in time for all investments within the portfolio.

In order to be able to manage a safe withdrawal rate for an individual over time, your advisor needs to be able to manage these two relationships concurrently.

While the number of different relationships involved may appear too complex to manage, it is actually one which has a natural symmetry and this symmetry is more than capable of managing the dynamics of integration.

In point of fact while the problem is complex, it is easily solved by understanding the physical properties of the asset and liability management relationship and, deriving rules to manage the relationship. Indeed, a small team of economists, analysts and portfolio construction, planning and management experts could run every portfolio in the country with the right system.

What your advisor needs to do

If your advisor is not managing the relationship between your financial needs and your portfolio, all they need to do is the following.

- Make sure that the management of risk and return of the portfolio is in keeping with the risk preferences and return objectives that were agreed for the portfolio.

But, if your advisor is to be able to manage your withdrawals over time, they need to be able to do the following.

- Optimise the balance of your portfolio between low risk shorter term assets (cash and bonds) and

higher risk longer term assets (equities⁵) given your short and long term financial needs and risk preferences and, manage this relationship throughout the stock market and economic cycle.

- This means that at all times, withdrawals are directly related to what you need and what your assets can provide at a point in time.
- Your withdrawal rate should not be based on what your advisor said you could take 10 years ago.
- Ensure that the portfolio is capable of meeting planned short term and long term financial needs irrespective of stock market and economic risk.
 - This means that structure of the portfolio and risk and return assumptions used to model return must cope with even the most severe of economic and stock market conditions.
- Be able to take advantage of future capital inflows to and future expenditure from the portfolio when rebalancing within the portfolio.
 - If the management of assets and financial needs are integrated, this means that planning of the future structure of the portfolio will take these factors into consideration. Why sell an equity now to meet a financial need next year, when capital is coming into the portfolio in six months? Why sell a low risk asset to build up the equity allocation if equities are overvalued and capital is due to be added to the portfolio later in the year?
- To have structures in place that can interpret and adjust portfolio relationships instantly to movements in the prices of markets and securities.
 - One market falls 10%, another rises 15%, another falls 25%, your financial needs change, what do you do? If asset management expertise is directly related to the management of financial needs you will find that the systems that manage your money will be able to automatically

⁵ Note that long dated fixed interest securities are effectively high risk longer term assets since they are extremely sensitive to market and economic risks and are used as alternatives to equities.

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recalculate the relationship between your needs and your assets and provide recommended transactions if necessary. Without this integration your advisor will have to personally rework each individual portfolio.

Needless to say there are thousands of calculations here and numerous relationships. If the advisor did not have a systemised approach to the management of withdrawals, it would take days just to work out the dynamics for one client, instead of seconds it would take with a proper system for all clients.

The lowest common denominator!

Without the integration of asset management, all the financial advisor can do is come to their best assessment of what their client can take from their assets over time.

If they can neither model the interaction of portfolio structure and financial needs, nor can they value and allocate, all they can only do is one of the following.

- A simple compound interest calculation and determine the planned withdrawals that can be taken over time without running out of capital.
- Determine a maximum safe withdrawal rate from assets over time so that they are not affected by market and economic risk and do not have to manage the point in time relationships needed to manage these risks..

In this context, the magic number or maximum initial withdrawal rate is a symptom of the separation of asset and liability management and the simple asset dedication models the first step towards integrating the management of assets and financial needs.

Trawling historical returns and looking for the **lowest common denominator** underpinning a safe withdrawal rate is at best, a second best alternative.

Asset and liability management

We know that an investor wants to maximise their use of their capital over their lifetime, which for many means choosing when and by how much they will be consuming their capital.

We know that an individual's ability to draw from their capital over time is affected by a number of factors;

future risk and return; financial needs; life expectancy; portfolio structure; costs.

We know that we can enhance the ability of assets to meet financial needs by constructing portfolios personalised to financial needs that manage short and long term risks to the ability of assets to meet financial needs.

We know that these structures combined with forward looking return assumptions that manage risks to return allow us to provide greater stability to the management of needs over time and to provide better planning and management of financial needs and assets.

We know that costs eat into withdrawal rates and that without the integration of the management of assets with the management of financial needs, the industry is unable to cost effectively manage withdrawals over time through personalised portfolio construction, planning and management.

We know that if we cannot value investments and relate that valuation to the management of asset allocation relative to financial needs over time that we cannot personalise the automation of asset allocation to financial needs.

The separation of asset and liability management has resulted in the inefficient management of assets to meet financial needs over time.

Current structures cannot efficiently manage risks to return, cannot personalise portfolios to personal financial needs over time and are costly and risky.

To say that the future of the wealth management industry lies in its ability to integrate the management of financial needs with the management of assets is an understatement

Asset & Liability Management frameworks

They manage the dynamic relationship between valuation and asset allocation and financial needs over time. They are by far the most efficient managers of withdrawals and simplify the personalisation of complex financial situations, key to managing withdrawals over time.

Smaller centralised asset management operations will be able to deliver asset management expertise to hundreds of thousands of portfolios personalised to personal financial needs over time. The costs of asset management will fall, the costs of financial planning

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will fall and, the needs of the client will be foremost in portfolio construction, planning and management.

The ability to integrate all business process components into one central service process has ramifications for cost, service, asset management distribution and the future structure of the financial services market place.

Conclusion

The amount an individual can take from their investments over time depends on a number of factors.

The only way in which withdrawals can be safely managed is via a portfolio structure capable of managing the relationship between asset allocation and financial needs and by forward planning assumptions that take into consideration risks to return.

Studies that have determined maximum withdrawal rates that individuals can take over time do not provide either a portfolio structure that can manage risks nor a way of modelling future risks to return.

Far from being solutions to a problem these studies highlight the inadequacies of current solutions and reinforce the need for the proper integration of the management of assets and the management of financial needs.

Safely managing withdrawals over time requires the expertise, the systems and the business and service processes to do the job properly.

There is a tendency in the financial services industry to sell the simple message. This is fine if the basics and fundamentals have been understood by those responsible for central decision making. As it is, the simple messages we see are more short term fixes to the problems created by industry's existing solutions.

The solution provided by maximum withdrawal rates is not a panacea and, while they acknowledge the problems, they represent a step backward in terms of the final solution.

Rules of thumb have arisen as result of a lack of attention to the central issue of the management of assets to meet financial needs over time.