In The Flip Side, we presented a risk to following traditional spending guidelines. These traditional guidelines suggest limiting spending to 4% of investment assets.(1) This is a conservative guideline designed to preserve financial security in the future. The flip-side of the traditional advice is that following it is likely to result in under-utilizing your wealth.

The greatest fear of the newly retired is running out of money. Unfortunately, this fear steers some down an excessively safe road that may lead to a life's dream being unfulfilled. Preserving financial security without living life too cautiously is the greatest challenge faced in planning a successful retirement.

The 4% guideline was developed using various analytic models to balance current spending with future financial security. These models typically present failure as running out of money, which is a horrifying thought for the newly retired. Running out of money suggests a life of standing on a street corner begging for change or living in a dingy apartment eating cat food. This is a vision of failure that is completely unacceptable.

However, running totally out of money overstates the risk. Sensible retirees will continuously monitor their resources and will make adjustments along the way to balance spending with wealth. For retirees following a sensible plan, the risk is not running out of money - it is having to reduce spending in the future. This is a risk some are willing to take in exchange for more liberal spending today.

Determining how much risk in future spending one is willing to take in exchange for higher spending today is the art and science of selecting the appropriate retirement budget. Those who are anxious about security should plan conservatively. It is impossible to enjoy wealth without peace of mind. Peace of mind, every day, will provide much more happiness than a trip to Italy.

However, those who can live with a little future uncertainty, without falling into despair every time the stock market blips, may be able to capture the best of both worlds. These people may be able to live a bit more freely without excessive worry about the future. To do so, it is necessary to create a back-up plan, which must be realistic, detailed and followed with discipline. Each plan must be customized to address individual objectives and philosophies. However, all of these plans share one basic dynamic – exchanging higher spending now for the risk of having to reduce spending in the future.

We developed the Six-Three Solution^{SM} for those who would prefer to use their wealth while living. In this plan, total spending, including giving and taxes, is budgeted at 6% rather than the typically recommended 4%. Of this 6%, base spending is limited to 3%. Expenses like taxes, food, mortgage payments, insurance, health care, utilities, club dues, car payments, regular household spending and all other spending that is necessary to support the minimum acceptable standard of living should be no more than 3% of beginning investment assets.

Total spending is budgeted at 6% of investment assets, but it must be possible to stop the extra spending without disrupting the basic structure of the lifestyle. For example, skipping a vacation, dining out less often and cutting back on holiday spending can be accomplished with less disruption to one's lifestyle than selling a home or dropping a country club membership. Extra spending could include dining out, travel, clothing, jewelry, art, hunting, fishing, golf and giving.

Which spending belongs in which category will vary from person to person. Some would consider giving a necessary part of the minimum required spending and club dues as optional. That is a personal choice. The reason giving was categorized as discretionary spending and country club dues as base spending is that giving is easier to skip for a year, whereas it may be impossible to stop paying dues without dropping the membership.

Some clubs permit one to become temporarily inactive and some charities are highly dependent on annual giving. A person for whom this was true might put giving in the base category and club dues in the splurge category. These details will vary from person to person. We are not making any statements about the ethical discretion to give; we are just illustrating the way some might divide spending. The bottom-line is that half of spending is marked as spending you can live without, either temporarily or permanently.

To illustrate how this would work, we will review a plan for a retired person with $3 million in investment assets. In traditional planning, spending $120,000 (4% of $3 million) per year would be considered affordable. The Six-Three Solution℠ would budget spending at $180,000, as long as base spending was no more than $90,000.

A cash flow system would be established transferring $7,500 ($90,000 ÷ 12) per month to an operating account. Annually, the difference between 6% of investment assets and the amount transferred to the operating account would be transferred to a splurge account. In the first year, the splurge account would be funded with $90,000.

If investment performance is good in the first year, the second year deposit to the splurge account is higher; if investment performance is poor, the deposit is less. Regardless of investment performance, the deposit to the operating account would be increased by the inflation rate.

For some people, perfect retirement planning would result in having their wealth expire at the same time they do. Unfortunately, this objective cannot be met in the real world when date of death and investment results are not known. The Six-Three Solution℠ is a way to walk a little closer to the edge without taking too much risk of falling off. For the right people, this plan will allow better matching of wealth to one's objectives.

The Six-Three Solution℠ is not right for everyone. However, if you think it might be right for you, please contact us. We will be happy to explore it with you.

(1) The 4% spending guideline is frequently misunderstood and misused. For a complete explanation of this guideline, see our technical summary titled "Understanding the 4% Withdrawal Guideline".