A Key to a Lasting Retirement Portfolio

Fidelity Viewpoints

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If you're retired -- or nearing it -- ensuring that your retirement investment portfolio lasts your lifetime is critical. And that's not easy when a market downturn takes a bite out of your investment portfolio -- as it most likely did over the past year.

While you cannot completely control the market's impact on your portfolio, there are things you can control that can also make a significant difference in how long your portfolio may last. One of the factors you can control is your portfolio's withdrawal rate. The amount you take can directly impact how long your assets could last in retirement.

But what about in a difficult market environment? We still believe in inflation-adjusted withdrawal rates of no more than 4-5% a year for individuals who retiree at age 65. We did analysis using our Retirement Income Planner[1] and an inflation-adjusted withdrawal rate of more than 5% steeply increased the risk of depleting retirement savings during an investor's lifetime. We also ran some further analysis, and here's what we found:

Extended down markets

Since the market correction and volatility is still fresh in everyone's mind, we looked at various withdrawal rates during a hypothetical extended down market. We used the Retirement Income Planner to see how a portfolio might have held up. We used a hypothetical balanced $500,000 portfolio of 50% stocks, 40% bonds, and 10% short-term investments -- an asset mix used by many retirees.

Chart 1 below illustrates how long this balanced portfolio might last with inflation-adjusted withdrawal rates between 4% and 10%.

Source: Fidelity Investments. Hypothetical value of assets held in an untaxed balanced portfolio of 50% stocks, 40% bonds, and 10% short-term investments and inflation-adjusted withdrawal rates as specified. Average rates of return for stocks, bonds, short-term investments and inflation are based on the risk premium approach. Actual rates of return may be more or less. The chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. Please refer to Methodology and Information for further details about the indexes and methodology used to produce the chart. IMPORTANT: The projections or other information generated by Fidelity's Retirement Income Planner regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Results may vary with each use and over time.

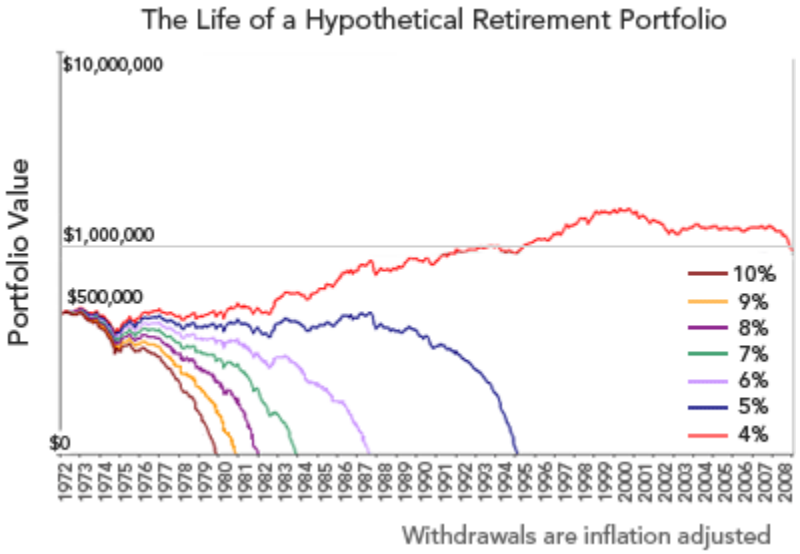
As expected, the higher the withdrawal rate, the lower the number of years our hypothetical portfolio lasted. For instance, at a 10% withdrawal rate, the balanced portfolio only lasted 10 years. At a 4% withdrawal rate, however, the balanced portfolio lasted for 36 years -- long enough to provide a 65-

year-old with an income stream potentially lasting well into his or her nineties. That's important because for a healthy 65-year-old couple, there is a 50% chance that at least one of them will survive to age 92½.[2]

Up and down markets

We also looked at withdrawal rates another way -- how they affected the value of a hypothetical portfolio through up and down markets and periods with very high inflation. We used a hypothetical $500,000 balanced portfolio (50% stocks, 40% bonds, 10% short term) for a person who retired in 1972 and tracked it through 2008, using actual historic index returns. This period includes the great bull market of the late 20th century -- roughly 1982 to 2000. But it also encompasses two of the worst bear markets in Wall Street history, five recessions, two major wars, and the rabid inflation and painfully tight monetary policy of the late 1970s -- one of the worst inflationary outbreaks in U.S. history.

As the chart below shows, the initial $500,000 would have been exhausted by the late 1980s if funds were drawn down at a 6% rate. (All rates are adjusted annually for inflation). A 5% withdrawal rate could have extended income from the portfolio for nearly 25 years, but it still would have run out at a time when there would be more than a 50% chance that one member of the couple would need those assets. In this extreme case, only a 4% withdrawal rate would have left enough total assets intact to catch the full tailwind of the long bull market that ran from 1982 to 2000.



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000 invested in a portfolio of 50% stocks, 40% bonds, and 10% short-term investments with inflation-adjusted withdrawal rates as specified. This chart's hypothetical illustration uses historical monthly performance from January 1972 through December 2008 from Ibbotson Associates: stocks, bonds, and short-term investments are represented by S&P 500, U.S. Intermediate-Term Government Bonds, and U.S. 30-day T-Bills. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. Please refer to Methodology and Information for further details about the indexes and methodology used to produce the chart.

Our analysis clearly shows that the amount of the annual withdrawal rate dramatically raised or lowered the chances of a portfolio lasting for a longer period of time. And the risk of running out of money is a real one. Americans are living longer these days, so it's entirely possible that your retirement could last for 30 or more years.

This chart also illustrates how the combined risks of inflation, market volatility, and withdrawal rates run parallel with the risk of longevity itself, which is so easy to underestimate. Additionally, it further illustrates the power of potential stock returns -- given enough time -- and the critical importance of withdrawal rates.

This isn't to say that a 4% to 5% withdrawal rate offers magical security or assures infinite asset sustainability. Those outcomes depend on market performance. But it is clear that rates much above 5% begin -- fairly quickly -- to increase depletion risk of a retirement income plan.

Conclusion

Unlike the performance of your investments, your withdrawal rate is one of the variables that you can control and adjust as needed to take into account your age, health, availability of other assets, and

desire to leave money for your heirs (your asset allocation and actual retirement age are a couple of other key variables that you can influence). Staying within or below a 4% to 5% range (adjusted annually for inflation) will decrease the risk of depleting your retirement savings too soon. A more conservative withdrawal rate may also put you in a better position if a severe market downturn -- like the one we've just experienced -- takes place. For this reason, Fidelity believes that most retirees should consider using conservative withdrawal rates -- particularly if your assets need to support essential expenses. Retirees may feel comfortable taking a higher withdrawal percentage (with greater chances of depleting assets) when running out of money has no severe consequences.

What to do

It's important to learn more about the five key retirement savings risks and complete a full retirement income planning analysis that captures your specific financial circumstances, taxes, and other goals. We also believe that retirement income plans should be flexible, so that they can be changed as your circumstances change, and reviewed regularly, so that you can stay on track.

Although past performance does not guarantee future results, it may be useful in comparing alternate investment strategies over the long term. Performance returns for actual investments will generally be reduced by fees or expenses not reflected in these hypothetical illustrations.

Investing involves risk, including risk of loss. Generally, among asset classes stocks are more volatile than bonds or short-term instruments.

1. Fidelity Retirement Income Planner, an educational tool developed and offered for use by Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company.

2. Annuity 2000 Mortality Table, Society of Actuaries. Figures assume a person is in good health.

Methodology and information for charts:
Charts 1 and 2 are not intended to project or predict the present or future value of the actual holdings in a participant's portfolio or the performance of a given model portfolio of securities. For both charts, which highlight varying levels of stocks, bonds, and short-term investments, the purpose is to show how portfolios may be created with different risk and return characteristics to help meet a participant's goals. You should choose your own investments based on your particular objectives and situation. Be sure to review your decisions periodically to make sure they are still consistent with your goals. You should also consider all of your investments when making your investment choices.

Chart 1 was produced using Fidelity's Retirement Income Planner tool. The tool's illustrations result from running a minimum of 250 hypothetical market simulations. The market return data used to generate the illustration is intended to provide you with a general idea of how asset mixes have performed historically. Our analysis assumes a level of diversity within each asset class consistent with a market index benchmark that may differ from the diversity of your own portfolio. Please note that the projections do not reflect the impact of any transaction costs or management and servicing fees (except variable annuities); if these had been included, the projected account balances would have been lower.

For Chart 1 several hundred financial market return scenarios were run to determine how the asset mixes may have performed. For the Extended Down Market chart, a 90% confidence level was utilized. This means that in 90% of the historical market scenario run, a balanced asset allocation performed at least as well as the results shown. Conversely, in only 10% of the historical market scenarios run, a balanced asset allocation failed to reach the results shown. The estimated returns for the stock and bond asset classes are based on a risk premium approach. The risk premium for these asset classes is defined as their historical returns relative to a 10-year Treasury bond. Risk premium estimates for stocks and bonds are each added to the 10-year Treasury yield. Short-term investment asset class returns are based on a historical risk premium added to an inflation rate, which is calculated by subtracting the TIPS (Treasury Inflation-Protected Securities) yield from the 10-year Treasury yield. This method results in what we believe to be an appropriate estimate of the market inflation rate for the next 10 years. Each year (or as necessary), these assumptions are updated, to reflect any movement in the actual inflation rate. Volatility of the stocks (domestic and foreign), bonds, and short-term asset classes is based on the historical annual data from 1926 through the most recent year-end data available from Ibbotson Associates, Inc. Stocks, bonds, and short-term are represented by S&P 500, U.S. Intermediate Term Government Bonds, and 30-day U.S. Treasury bill, respectively. Annual returns assume the reinvestment of interest income and dividends, no transaction costs, no management or servicing fees, and the rebalancing of the portfolio every year.

The calculations and results generated for chart 2 are based on historical monthly performance from January 1972 through December 2008 from Ibbotson Associates: stocks, bonds, and short-term investments are represented by S&P 500, U.S. Intermediate- Term Government Bonds, and U.S. 30-day T-Bills, respectively.

The Ibbotson U.S. 30-Day T-bill data series is a total return series that is calculated using data from the Wall Street Journal from 1977 to present and the CRSP U.S. Government Bond File from 1926 to 1976.The Ibbotson Intermediate-term Government Bond Index data series is a total return series that is calculated using data from The Wall Street Journal from 1987 to present and from the CRSP Government Bond file from 1934 to 1986. From 1926 to 1933, data was obtained from Thomas S. Coleman, Lawrence Fisher and Roger G. Ibbotson's Historical

U.S. Treasury Yield Curves: 1926- 1992 with 1994 update (Ibbotson Associates, Chicago, 1994).The S&P 500® Index is a registered service mark of The McGraw-Hill Companies, Inc. and has been licensed for use by Fidelity Distributors Corporation and its affiliates. It is an unmanaged index of the common stock prices of 500 widely held U.S. stocks and includes reinvestment of dividends. It is not possible to invest directly in the index. All index returns include reinvestment of dividends and interest income. Investors may be charged fees when investing in an actual portfolio of securities, which are not reflected in illustrations utilizing returns of market indexes.

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