How Much Money You Really Need To Retire

Rida Morwa Jul. 29, 2019 9:35 AM ET

Retiring early, on time or late can have life altering outcomes.

Many people save too little and start too late on catching up.

How much you need to live on can drastically change outcomes.

We examine how much you need depending on various factors highlighted below.

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Retiring is an end-game goal for most investors. We get it. No one wants to end up broke in their retirement, and very few want to live on a pittance while struggling through what should be their golden years. We also acknowledge that saving for retirement is often a lifelong journey that many start too late and are forced to catch up.

We previously examined how many investors are too conservative with their retirement investing - making an already hard goal to achieve nearly impossible!

Today let's get our hands into the dirty facts of reality and ask how much you need to have saved to live at different annual income points.

The Goal Moves Based on Two Factors

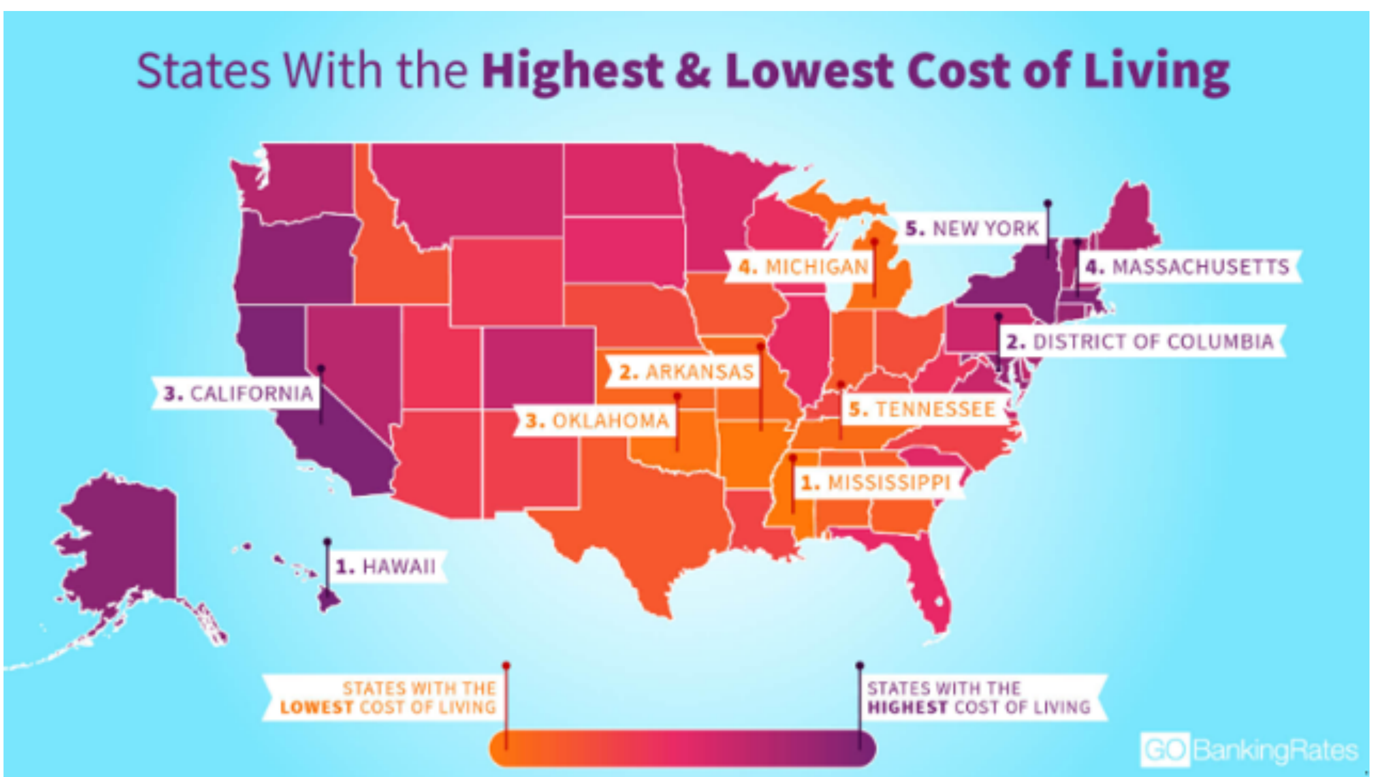
The outcome remains the same - you want an annual income from your investing of a certain dollar amount - or X. To get there you need to save a certain amount - or Y. The total dollar amount of Y changes based on X and how much of a yield - or Z, you achieve on Y. So Y*Z=X

"Safe" yielding stocks like the ProShares S&P 500 Dividend Aristocrats ETF (NOBL) only yield 1.99%. This ETF will provide a stand-in for a myriad of other ETFs that retirees may decide to invest in and live off of the dividends from.

We aim for our portfolio to yield 9-10% and focus on recession resilient and strongly covered dividends. For the sake of calculations, we'll assume our portfolio yields 9.5%.

We will also include if your portfolio yields 4% - the maximum most retirees want to withdraw from savings annually.

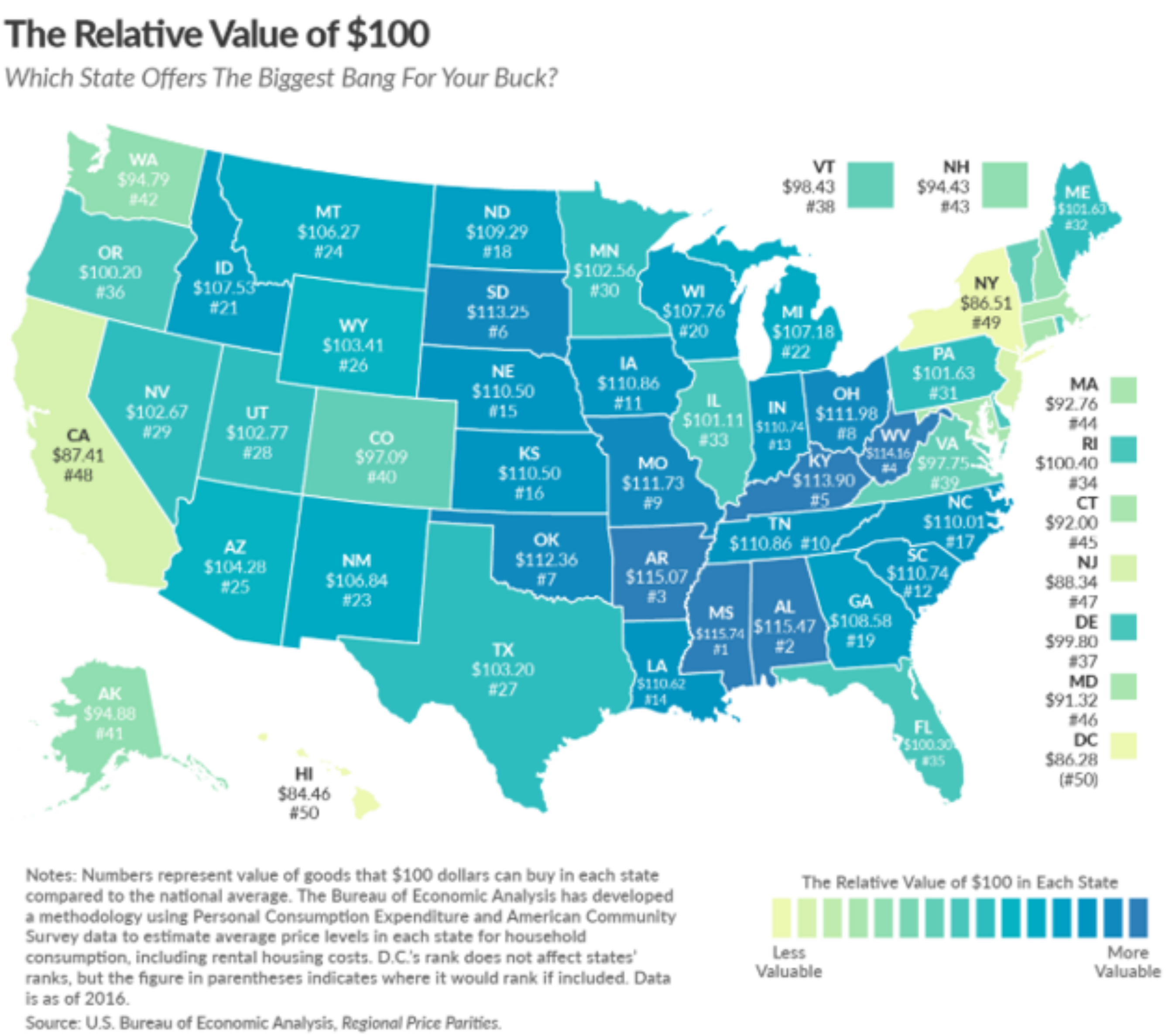
So we have our variable yield options determined. How much do you want to live off of to retire?



Source: [GoBankingRates]

GoBankingRates compiled data from the Missouri Economic Research and Information Center to develop a map of the most expensive and least expensive states to live in within the United States. This map is based off of 2017 data.

Another way to evaluate the amount needed to live is consider the value of $100 in each state:



Source: [Taxfoundation.org]

The Tax Foundation used data from 2016 gathered from the U.S. Bureau of

Economic Analysis to generate this map.

Both maps outlay a major trend - it can be extremely costly to retire in some states more so than others. *$100,000 in annual income is worth 3% more in Texas and almost 14% less in New York!* If we pile this on top of the extremely low yields of the "safest" investments - bank CDs or saving accounts - or the "safer" investment of NOBL, investors have a real uphill climb.

Okay, let’s do some math! I'm sure this was everyone's favorite subject in school.

How Much Annually Vs. Needed Savings

Assuming a desired annual income of $40,000, $60,000 and $80,000 we can calculate the total savings required to achieve this annual payout. This assumes your portfolio is earning a steady yield and that you are not deducting anything from your portfolio's principle.

Source: Author's Calculations

An individual wanting to live off of these annual incomes would be required to save large sums of money prior to retiring - regardless of their age.

Consider this, *an investor wanting to have an annual income of $80,000 would need $4.2 million to survive off of a portfolio yielding 1.9% but only $842,105.30 from a portfolio yielding 9.5%.*

This of course assuming they have no other sources of income - like social security or pensions - playing a role in achieving their desired annual income. Even the smallest amounts of annual income have significant differences in establishing retirement amounts required. For example, someone working part time for $10,000 a year in their retirement would need to save $250,000 less based on the 4% yielding portfolio.

What about dividend cuts and the possibility of a recession?

High yield stocks do pay out a higher percentage of their cash flow and often have less of a buffer than lower yielding ones to maintain payouts. It is therefore essential to constantly evaluate each investment to make sure it meets the cut (no pun intended). Or authors have identified several potential dividend cuts before they actually happened. We even identify investments that are likely to do better during bad times and those that yield slightly less but have huge buffer to maintain payouts.

For example, we recently added a quality baby bond yielding 9%. **NuStar Logistics 7.625% Fix to Float Sub Notes** (NSS) yield 9% and more importantly have their interest payments covered over 3.5X. Unlike the distributions on the common shares (NS), which have coverage of 1.4X, the interest coverage (which applies for bonds), is significantly better and provides much better recession resilience.

Another example of a recession resistant yield is one you get from **RLJ Lodging Trust CUM CONV PFD A** (RLJ.PA). It yields just 7.3%, which would be on the lower side for sure, but that dividend is covered more than 15 fold when you see the relationship between preferred dividends and adjusted funds from operations (AFFO). We believe that blending a good mix of these investments significantly improves the odds of making it through the next recession without income cuts.

Further, even if we assume that because of the slightly higher risk of unforeseen cuts, you would need a higher buffer, you would still need a lower starting nest egg. With an even 50% buffer, a yield oriented portfolio would need to be $631,579, versus $1 million. Such a portfolio would provide adequate safety and room for growth as well while requiring 37% up front capital.

Immediate Income Investing Is Key

The common theme regardless of when you wish to retire that I've seen throughout my life is the cost of retiring. You can be 30 and have enough to retire tomorrow or 90 and still struggling to get enough funds together. Investing in high yielding immediate income stocks provide a footing in which having a reliable income stream and comfortable retirement possible.

Looking over the chart above again, you can see that even a portfolio yielding 4% requires significant savings for an individual to retire - regardless of age.

By focusing on immediate income we previously saw how 20 years of reinvesting dividends turned $100,000 into $755,515.40. This also assumed no additional capital deposits and only reinvested dividends. The key to how much money you need to retire varies heavily on the yield you seek from your portfolio and the amount you want to live on.

Which is better? I know many investors who would kill for the safety of a saving account and $4.2 million to live off of, but reality is that investing in high yield, recession resilient dividend paying stocks can make retirement much more comfortable, or early retirement much more achievable.

If you want to live off of $40,000 annually in investment income. The Income Method way it only takes $421,052.60 compared to $1 million at a 4% yield. I ask you which is more achievable, rational or beneficial. With the income method, retirement saving becomes one more goal post and no longer a doomsday march.

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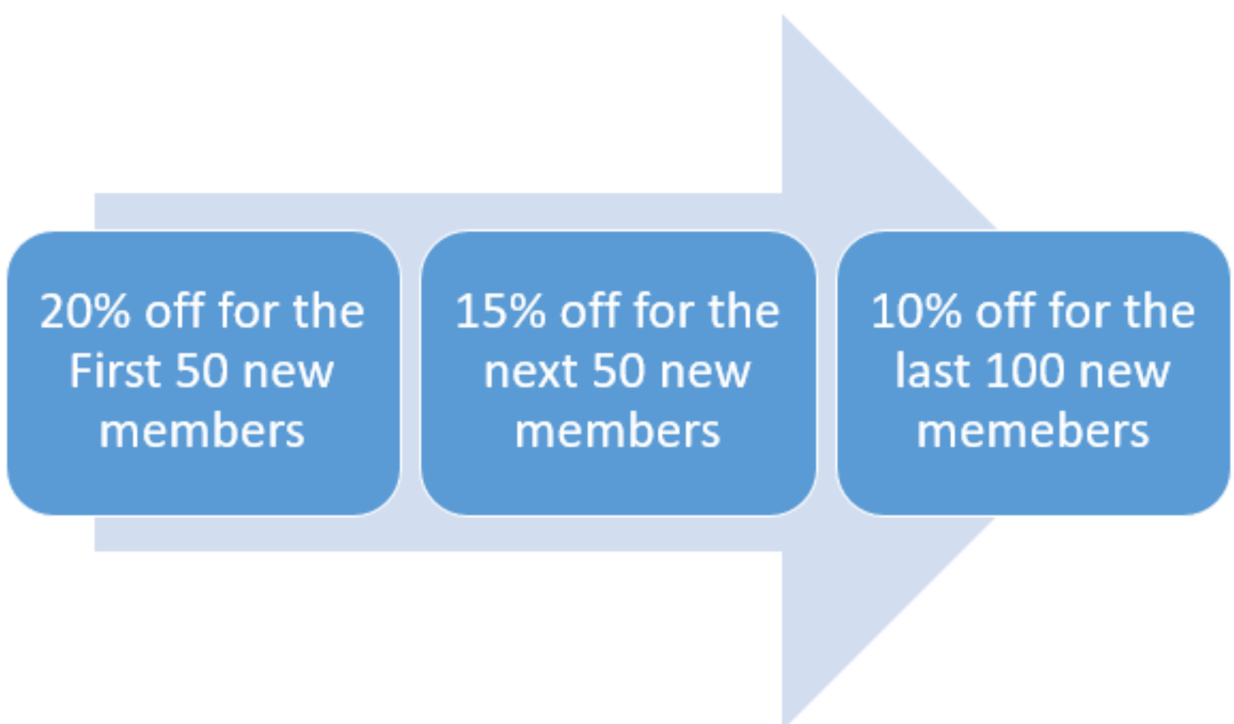

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