

Inflation can 'kill an income stream'

The longer you live, the longer your retirement fund has to last. Your biggest worry about that: inflation.

Even mild inflation hurts over time, because inflation's ravages are cumulative.

"Inflation can really kill an income stream after 20 years," says Clare Hushbeck, economist for AARP.

For retirees, inflation means that they must withdraw a bit more from their retirement savings each year to keep up with rising prices, or make do with a bit less. So if you base your retirement calculations on a flat withdrawal each year, sooner or later you'll come up short.

Another problem: Managing an account when you're taking money out is a whole different proposition than managing one when you're putting money in. Taking withdrawals reduces your gains and aggravates your losses. In a bear market, that can be devastating.

Suppose you had \$100,000 in your account when you retired in September 2000, and you were invested in the Vanguard 500 Index fund, the nation's largest stock mutual fund. You took out \$500.00 a month to supplement your retirement income. That's a 6% withdrawal rate.

By September 2005, you would have dwindled to \$57,416, Lipper says. That's a 43% decline, even though the fund's share price has fallen just 8% during the same period. Your withdrawals aggravated the fund's losses in the 2000-02 bear market and reduced its gains when the stock market rebounded in 2003.

Unfortunately, you can't stay out of the stock market entirely. "If you get to less than 50% in stocks, you can't generate enough income to overcome the inflation rate," says John Markese, president of the American Association of Individual Investors.

Even then, most studies have shown that you should take no more than 4% out of your retirement fund a year, at least in the first years, if you want your retirement account to last longer than you do. That's not much. You may be able to take out more, if the market is kind and inflation is low. But for at least the first few years, start slowly.

By John Waggoner, USA TODAY