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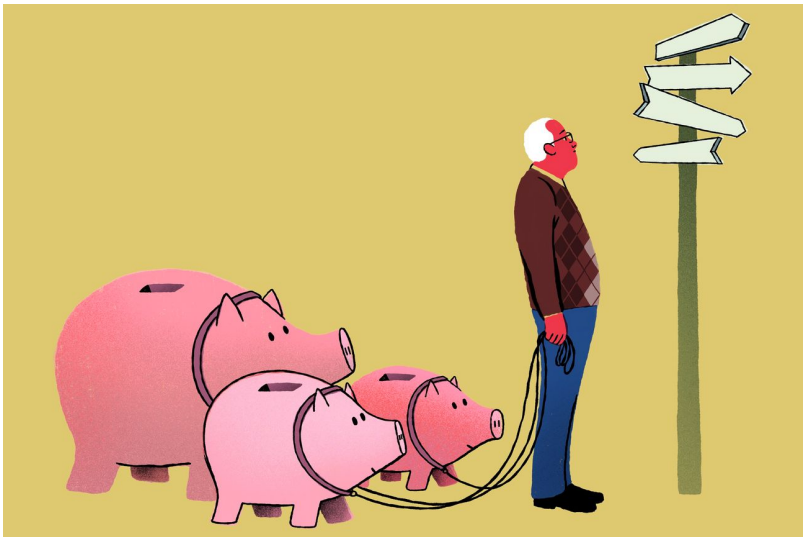
How to Estimate a Future Rate of Return on Your Retirement Savings

Retirement calculators ask for that crucial number. Here's how to come up with one.



There is more than one way to estimate a future rate of return for your retirement investments—some simple, some not.

ILLUSTRATION: MARTIN TOGNOLA

By Glenn Ruffenach

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I'm approaching retirement, and I'm using several online calculators to see how my nest egg might hold up. Each tool asks me to enter a "rate of return" on my investments. What's a reasonable number? How do you figure out what your savings might earn in the future?

A critically important question. Many preretirees can do an adequate job of estimating what their expenses will look like after they leave the office. But predictions about our income largely depend on how our investments will perform. And here, most of us draw a blank. After all, it's difficult enough to forecast what markets will do in the short term, never mind over the course of a 30-year retirement.

So, let me suggest three ways to estimate a future rate of return: two simple ways—and a better way.

One simple way is to use historical returns. The good news: We have almost 100 years of data to work with. And these figures tell us that stocks, on average, return about 10% annually and that intermediate-term bonds return about 5%.

Even better, we can, and should, adjust these figures for inflation and calculate a "real" rate of return, a more accurate measure of how the value of an investment is rising or falling. Given that inflation has averaged about 3% annually since the early 1900s, the real rate of return on stocks and bonds, respectively, is closer to 7% and 2%.

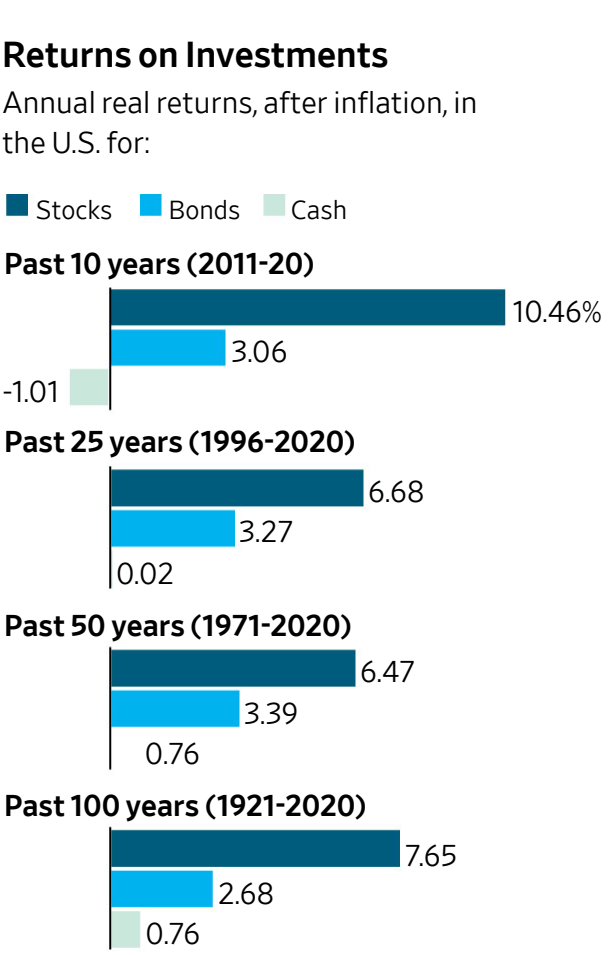
The bad news: This approach is a bit too simple. It doesn't account, for instance, for the above-average returns that stocks have given us during the past dozen years; as such, many economists anticipate lower returns from stocks in the years ahead.

So, speaking of economists...a second way to estimate returns is to look at what the experts are projecting. Each year, several major financial firms—BlackRock, JPMorgan and Vanguard, among others—forecast long-term returns for various asset classes. You simply can use their numbers in your retirement calculators.

(Note: Christine Benz, director of personal finance at researcher Morningstar Inc., and one of our favorite writers about retirement planning, thoughtfully compiles several of these forecasts in a single article each year. Her most recent survey was published in January. Registration may be required.)

Vanguard currently estimates that annual returns for U.S. equities in the next decade will average between 2.4% and 4.4%, and that returns for bonds will average 1.4% to 2.4%.

Be careful here: Some firms project returns for the next decade; others will look 20 or 30 years into the future. BlackRock, for example, in its latest projections, expects large-cap stocks to return about 7% annually over the next 20 years and bonds to return about 2.4%.



Source: Deutsche Bank, 'Long-Term Asset Return Study'

Finally, a better way to forecast returns is to sit down with a financial adviser who, ideally, can dig into this topic and into your particular nest egg. Among the issues you and your adviser should tackle:

What are the possible returns for the various asset classes in your portfolio (say, for small-cap stocks or international bonds)? Are returns calculated with dividends, or without? Will your adviser's calculations be based on average annual returns in the future, or on compound returns?

And what do best-case and worst-case scenarios look like? For instance, from 2000 through 2010, the S&P 500 returned, on average, less than 1% a year. Yes, that's a relatively short time period. But who's to say that we won't see multiple decades of low returns.

I realize that you're looking simply for a number to plug into a calculator. And that's fine. But please recognize that the forecasting business, even as practiced by the experts, is inexact, at best. Not to mention exceedingly complicated. (If you wish, you can explore concepts like the Gordon Equation or CAPE, economist Robert Shiller's cyclically adjusted price-to-earnings ratio.)

The point: I hope, at some point, that you, and a capable adviser, are able to give your particular question the attention it deserves.

How long do I have to work to get the maximum benefit from Social Security when I retire?

As is often the case with Social Security, there's more than one way to look at this

issue.

ASK A QUESTION

Have a question about planning for and living in retirement? Email askencore@wsj.com.

Your benefit will be based on your highest 35 years of earnings that are covered by the Social Security program. (And, if you're interested, each year's pay is indexed for inflation.) So if you work for at least 35 years—and if, in each of those years, you earn or exceed the maximum amount of pay subject to Social Security taxation—you will get the top benefit.

To be specific: A person retiring this year at the full-retirement age of 66 and two months—and meeting the requirements outlined above—would receive an initial monthly benefit of $3,148. And, in 2021, the maximum taxable income is $142,800.

That's the first answer to this question. There's a second answer, as well.

If you delay claiming Social Security until age 70, you earn "delayed retirement credits," which pump up the benefit you eventually receive by 8% a year. In 2021, a person who first claims Social Security at age 70—and, again, who met the requirements discussed above—would receive $3,895 a month, the maximum benefit.

Mr. Ruffenach is a former reporter and editor for The Wall Street Journal. Ask Encore looks at financial issues for those thinking about, planning and living their retirement. Send questions and comments to askencore@wsj.com.

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