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BRETT ARENDS'S ROI

Opinion: Retiring with \$1.3 million? Here's what that really means.

What you need to know now about your 'retirement number'

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How much will you have to live on when you're no longer earning a paycheck?

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The average working person thinks they'll need about \$1.3 million to retire, according to [a new survey](#) based on conversations with 1,500 people conducted by investment company Schroders.

Yet most in the survey also think this number is beyond them. Nearly half, 48%, told Schroders pollsters they expect they will have to retire with less than \$500,000. Just 30% think they will make it to \$1 million.

It's not clear how people arrive at these figures, other than randomly guessing. Yet the \$1.3 million number gels with estimates emerging from similar surveys. And it's quite common to hear people express similar ideas. When people talk about the economics of retirement, they often have some magical "target figure" or "retirement number" in mind. Usually without further explanation.

But are they right?

Retirement planning is a "process [that] must be worked out backward," [writes professor Javier Estrada at IESE business school in Barcelona, Spain](#), "from the lifestyle desired in retirement, to the withdrawals needed to sustain that lifestyle, to the portfolio needed to support those withdrawals, to the contributions needed to build that portfolio."

Or, to put it simply: Ask not how much money you need to have on the day you retire. Ask how much income you think you'll need every year in retirement, to support the lifestyle you want.

After all, we live on income.

How much income would that \$1.3 million provide you?

Per the so-called 4% rule: \$52,000 a year. The 4% rule, coined by financial planner Bill Bengen in the 1990s, has been a widely cited rule of thumb for these calculations. Bengen's math, based on history, was that if you had invested in a balanced index of U.S. stocks and bonds you could have confidently started your retirement by withdrawing 4% of your portfolio during the first year, and then raised the amount each year by just enough to account for inflation. Do that, he calculated, and you had an excellent chance of making your portfolio last for at least 30 years.

The good news is that [Bengen has recently upgraded his math](#). Now it's the 4.7% rule. On this basis, a \$1.3 million retirement account on the day you retire should allow you to withdraw \$61,000 in your first year, and then higher sums in line with inflation in the years that follow.

We can probably do even better. Invest that \$1.3 million in lifetime income annuities, life-insurance contracts that turn a pile of cash into a guaranteed income stream for life, and a 65-year-old man would secure an annual income of just over \$100,000. (A woman would get slightly less, \$99,000, for a simple actuarial reason: Women live longer.) That's a payout ratio of 7.9%.

The biggest worry with annuities is inflation. But if you buy instead an annuity with payouts that will go up 3% every year — covering the Federal Reserve's 2% target inflation rate plus a small annual margin — your first-year payout would be \$76,000 for a man, \$72,000 for a woman. (This is assuming retirement at age 65.)

Most working people can expect to receive Social Security, as well. Although some sort of cut to Social Security is now all but inevitable, there are a couple of cushions for future retirees. The first is that cuts are likely to be at the expense of future rises in Social Security payments. You may get less than you were expecting, but you probably won't get less than people are getting today. Second, those cuts are probably going to fall most heavily on the highest earners.

The current [average Social Security payment](#) for retired workers is about \$24,000 a year.

So a \$1.3 million retirement account, coupled with average Social Security benefits, would guarantee a 65-year-old retiree an annual income of between \$95,000 and \$124,000 (depending on whether you bought the annuity with the 3% annual increase).

Note that this is for an individual. For a married couple the numbers would be different. They may have two incomes. At minimum they may also get Social Security spousal benefits. They will have shared costs.

Is this income enough? Well, that's up to you. I have no idea what your financial needs are — let alone your wants. But when someone says they need \$1.3 million to retire, this is what they are effectively saying.

Meanwhile, here's what we do know.

The median retired household is living on [around \\$50,000 a year](#), according to the Pension Rights Center, and that includes individuals and couples. The figure for singletons is around \$30,000. For married couples it's around \$76,000.

Meanwhile, most retirees tell pollsters [they are happier with their retirement income than they expected to be while they were working](#).

"Hedonic adaptation," meaning the human ability to adapt to circumstances, works both ways. Or, to put it another way: We may need less than most of us think.



About the Author



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Brett Arends is an award-winning financial writer with many years experience writing about markets, economics and personal finance. He has received an individual award from the Society of American Business Editors and Writers for his financial writing, and was part of the Boston Herald team that won two others. He has worked as an analyst at McKinsey Co., and is a Chartered Financial Consultant. His latest book, "Storm Proof Your Money", was published by John Wiley Co.