Episode 103: Using RISA® Framework to find the right retirement plan strategy between spouses

00:00
Bob French
The purpose of Retire With Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to Risaprofile.com/Style and sign up to take the industry's first financial personality tool for retirement planning. Think of it as Eharmony for your retirement plan.

00:45
Alex Murguia
Hey, everyone. Welcome to retire with style. I'm here with my trusted companion, Wade Pfau. Just wanted to see if I could get one on you. How are you doing, man?

01:05
Wade Pfau
Doing good. Ready to rock and roll. Here with another episode of Retire with Style.

01:12
Alex Murguia
What are we talking about today, big guy?

01:15
Wade Pfau
Yeah, we are talking about with the retirement income style awareness. What happens when you have a situation where you have a couple who do not have the same retirement income style, which is something that you can expect? I always say, like, when people are deciding to spend their lives together, usually they're not checking to make sure they have the same retirement style in advance. So there's ultimately six combinations. And we just want to talk about thinking through some of the strategies and things that can be done with each of those cases to make sure that there's ultimately a compromise strategy that both people can be comfortable with.

01:52
Alex Murguia
Yeah, and at your house, just want to make it clear for everyone, the compromised strategy is your wife wins. Correct?

01:59
Wade Pfau
Well, that could be a big part of it, but we can get into that too, though, because sometimes one of the two styles might actually serve as more of the compromise. And we'll get into all that throughout the episode. But no, I get your point as well.

02:15
Alex Murguia
Again, the genesis is the Risa is making strong inroads not just with consumers, but within the advisor community. There are well over 500 firms using the Risa at this point in almost like a year. So it's really taken off. We're getting a lot of feedback with regards to interpretation because it's very easy. Okay, one person takes the Risa and the strategy is based on that one person. But as we know, that's not how the world works. There's two. So from that standpoint, as Wade likes to make the joke, when you're kind of dating your spouse, you don't ask them. That's one of the first questions. So what's your retirement income style to make sure we're a good fit? Although one day, Wade, one day we can dream.

03:01
Wade Pfau
We can dream on the dating sites.

03:06
Alex Murguia
Once we get that Eharmony integration, we'll be all set. But no, it's a great question. Like, what happens? Right? And so we have ideas around it, but we thought it'd be great to have a podcast just around that. How do you compromise with solutions? Because I think here in the greater scheme of things, folks are so used to giving somebody a risk tolerance questionnaire, and that always assumes a total return strategy. And we all know that not everyone's in that category. In fact, only about a third of the people are there. But it starts off with the basis of a total return strategy. Because the moment you do a risk questionnaire, that's kind of what you're implying, right? What's the portfolio that this goes into? And if spouses differ, usually you split the difference. And that's not really a compromise.

03:56
Alex Murguia
That's kind of a cop out, if you ask me. But we wanted to really talk about how different strategies can be

assessed and a middle ground can be reached. Now, the only thing we say too, when it comes to this is when we give folks the Risa and they're a couple, we want them to do it separately. It's very important they do it separately, not somebody overlooking somebody else along those lines, because you're just going to be influenced. Kind of like the Ash effect, if you will. You're just going to be influenced by other people or there's a lot of leading the witness and all of that stuff going on. That's how you can get a true sense of things, right?

04:34
Wade Pfau
You really want both people to be able to have their true voice heard so that after taking the assessment, that's when the conversation begins. If you work together one assessment from the starting point, already you kind of lose sight of somebody's going to dominate and their style is going to be the one reflected on the results. And what about the other person? They didn't really have the opportunity to get a fair chance to have their style reflected as well. So both individuals should separately take the Risa and that would be the starting point. And this is the Retire with Style podcast. If you're a new listener, welcome. There are a lot of past episodes where we talk in detail about the Risa for longtime listeners.

05:17
Wade Pfau
We don't want to bore everyone, but we should give a 32nd overview of what the Risa is because we're going to be talking about the different combinations of styles. And so you've got the two factors probability based, safety first and optionality commitment. Probability based, I'm comfortable relying on the market. Safety first. I want contractual protections. Optionality, I want as much flexibility as possible. Commitment, I'm comfortable committing to something that will solve for a lifetime need. And then you have the different combinations of those factors. That gives you four different boxes. If your total returns, your probability based and optionality oriented. That's more traditionally the investment approach. Build a diversified portfolio and take distributions. If you're safety first and commitment oriented, contractual protections. Commitment to a strategy, that's income protection. I want to have a floor of protected lifetime income from contractual sources.

06:12
Wade Pfau
And once that's in place, then I can feel comfortable investing on top of that. And then you've got the other two styles that are going to be less common in practice, they're more hybrids. You've got the time segmentation or bucketing, which is you want the safety first protections, but you also want a lot of optionality and flexibility. And in practical terms, that's let's bucket different assets based on when they'll be used over different time horizons. The simple idea of bonds for short term expenses, stocks for long term expenses. The last arc of episodes was about time segmentation specifically. And then finally, risk wrap is probability based. You're comfortable relying on the market, but you also are okay, committing to something. So I want this market exposure, but I also want guardrails around that and then that's risk wrap.

07:00
Wade Pfau
So we've got total returns, income protection, time segmentation, and risk wrap. Now, two different individuals take the Risa. They will each be identified as a retirement style. And it's possible just by the flip of the coin, sometimes they'll both have the same style, but more often than not, they will not have the same style. And that's where we want to get into. There's six different possible combinations of styles. And with today's episode, we want to make reference to each of those six combinations and then talk about some of the strategies that might be a way to compromise between the.

07:40
Alex Murguia
It has. Remember, the underlying assumption here is that there's many ways to get retirement income, right? I mean, Wade and myself are different. I'm income protection. Wade is risk wrap. And so how do you find that compromise? It's weight. It's like you and your wife, right? You want to see bridgerton, she wants to see piggy blinders. And you settle on the great. Something like that.

08:03
Wade Pfau
Something like that.

08:04
Alex Murguia
All right, so what's the first combination that we can start talking about?

08:11
Wade Pfau
Yeah. Well, so this is somewhat random in terms of the order, but we thought we'd first talk about how total returns links to each of the styles and then work from there to get the other combinations. So the first one is one individual in the couple, spouse or partner is total returns. The other is time segmentation. So you've got the upper right and upper left quadrants of the Risa matrix. Both people have that optionality orientation, but time segmentation is more safety first, probability based. I'm sorry. Total returns is more probability based.

08:47
Alex Murguia
Okay, what are the first things that come to mind to try to begin to find a middle ground here?

08:56

Wade Pfau
Well, the first thing that comes to mind for me is really going back to harold Avinsky in the 1980s wrote about something that he doesn't call. He specifically says it's not time segmentation, but it might serve as a compromise here. He talked about this idea of a five year mantra that if you had five years of spending in cash and it doesn't necessarily have to be five years, but the idea is, if you have this pile of cash sitting on the sidelines, you could use that to help build a bridge to cover spending if markets aren't cooperating. So it does kind of sound like a bucket of money to cover upcoming expenses. But he didn't view that as time segmentation.

09:40
Wade Pfau
He called it a risk management strategy for well, maybe I'm changing the wording a little bit, but it's like risk management for total returns, you've got your total returns approach, but as part of risk management, you have a bucket of cash available as reserves to help bridge any sort of market downturns and so forth. So to me that sounds like a compromise between time segmentation and total returns.

10:04
Alex Murguia
I think so. And it's more palatable right now simply because of where rates are you're not looking previously. Maybe somebody's saying, well, that's dead money. But even right now I think it's something that maybe because we're anchoring where rates were, I don't know, three years ago. But the reality is, again, I think it's a more palatable thing. I agree, that comes to mind, keeping cash on the side. And I'd venture to say a lot of clients kind of, at least in McLean, they kind of do this in the sense of, obviously the money that we have it to manage in the markets. We don't necessarily keep money in cash by ourselves because it's like you don't need to pay us a fee to keep money in cash, right.

10:45
Alex Murguia
And so you always get the sense that they have cash on the side for a few years just in case from that standpoint. So I think it's one of those that practically it's used quite a bit now from a strategic allocation standpoint other than cash reserves, because cash is still an allocation, but let's pretend it's not. I think this fits very well into some of the work you've previously done with regards to a rising equity glide path, because I think that can begin to serve two masters here. The rising equity glide path really makes sure that you have that probability based exposure. And at least for the short term, you're taking more of a significantly more prudent view of your finances by having a lower equity allocation, being in bonds and then letting those mature.

11:33
Alex Murguia
And just by default, you increase your equity allocation to the like. So you're giving yourself that initial, at least bucket of safety. You want to expand upon that.

11:44

Wade Pfau

Wait, right. And I think in this context it's more you have a bucket, a fixed income bucket to cover upcoming expenses, but you don't have any plan to replenish that. And so as you spend that down, you're shifting over to it's kind of initially your time segmentation. But since you're not going to replenish that bucket you created, you're going to transition into total returns. And once that's spent down, you now have a total return strategy. And having that initial bucket in place can help you manage that sequence of returns risk in the early retirement years, which is what really is driving that time segment and desire with the concerns, the safety first concerns, they want to have protections against sequence risk and that bucket can provide that sort of protection.

12:30

Alex Murguia

And the only other thing I would add, and we just did a whole arc on time segmentation bucketing. So you can check out the previous articles. But we did mention here, and I think it bears mentioning whenever we talk about it is when we're saying higher exposure to bonds specifically for this piece of it, we're talking about individual bonds. So you can actually take the yield but also let them mature, not necessarily bond funds simply because as you saw a few years ago.

12:58

Wade Pfau

Even this year.

13:00

Alex Murguia

Yeah, well, I don't even want to.

13:01

Wade Pfau

Look.

13:04

Alex Murguia

But they're subject you were talking 20% drop a few years back and so that doesn't do you any good either. So you're looking at having things to maturity when it comes to specifically to an income strategy. Bond funds are fine within the context of an overall investment portfolio to reduce deviation and the like. But here is specific to income piece. Now Wade, if somebody reads up on the stuff and sees, hey, but I read something on a bond tent, how is that different from rising equity glide path? Because I think that serves as that sort of middle ground as well.

13:41
Wade Pfau
Yeah, it's really the same thing. The bond tent idea is when you look at your asset allocation, if you build like a front end bond ladder that you're going to spend down and not replenish, it's kind of this tent that you're creating, it would be an upside down tent. Or I guess if you're defining your bond allocation, it would be a normal looking tent. Your bond allocation starts at the highest level, but then as you spend down that bucket, it comes down and then it flattens out on the ground of where your bond allocation is going to then become fixed as part of the total return strategy. Okay, so you get something that looks like a tent when you're plotting your bond allocation instead of your stock allocation.

14:21
Alex Murguia
So then if someone is thinking this and they take the Risa, and by the way, we'll have a link below to take the Risa as well. So if you have someone's in time segmentation, someone's in total return approach the middle ground, just a kind of level set here. The middle ground is effectively a rising equity guide path, having a cash buffer and the like. And you put those two together and you're effectively creating a nice compromise on that end and then four years pass, you can decide to revisit that. Or maybe the person that was in time segmentation feels comfortable enough that they're like, okay, the market was in our favor the first few years. We've gotten past that critical period. I'm fine now with regards to being more total return centric.

15:09
Alex Murguia
Or it could be the other way that the person who was total return just appreciated having that cash on hand.

15:19
Wade Pfau
Through the fragile decade when you're most vulnerable to that sequence risk.

15:23
Alex Murguia
So it's not so much kicking the can, but it gives you that optionality, which is, remember that's what they both have in common, where they differ is probably safety first, but they're both sort of really clinging to that optionality piece of the equation here. Anything else to add on that compromise, Wade?

15:47
Wade Pfau
No, I think that covers it.

15:50
Alex Murguia
You're like King Solomon here.

15:52
Wade Pfau
We got one down, five to go.

15:54
Alex Murguia
All right, next up. Batter up. What do we got in the next one?

15:59
Wade Pfau
Yeah, the next one is actually probably of these six that we're talking about going to be the most common one that you'll see. It's total returns and income protection. And these are the two most common styles that we observe in practice. And also one of the few demographic differences we see is by gender. Men do tend to tilt more in the direction of total returns. Women do tend to tilt more in the direction of income protection. So if you have that combination in a couple, the ODS are of any of these combinations that you'd see. It's one's total returns. The other is income protection.

16:37
Alex Murguia
Now, sometimes what you did for a living and the government has kind of set you up already for this compromise.

16:47
Wade Pfau
Right? Because with income protection, you don't have to do anything if there's no income gap.

16:52
Alex Murguia
The idea is you want just to be specific.

16:57
Wade Pfau
Yeah. So you want protected income to cover your basic expenses. You already have some protected income. Probably you have Social Security. Or if you're in a government position that's not part of Social

Security, that's what I think. What you're alluding to is you may have chosen this job because you'll have a large pension at the end of it. So between Social Security and a traditional lifetime pension, you may have sufficient protected income in place that there's no need to enter into the commercial annuity markets. The income gap is once you account for your protected income that you already have in place, is that enough to cover the spending that you want to have protected?

17:35

Wade Pfau

If not, you look to fill that gap with generally, like a commercial annuity product that provides a protected lifetime income more in the fixed annuity world, where the payout rates could be higher than in the variable annuity world. So income protection is about filling any gaps with protected lifetime income through annuity total returns, though, they're not worried about filling that gap because they don't even really emphasize that gap. They look at what's my overall spending goal? I'll just take distributions from my investment portfolio. I'm not really distinguishing between my essential spending and my discretionary spending. I'm just looking to meet my overall spending. If I have Social Security or pension. Great. But beyond that, I'm comfortable and happy just spending from my investments to cover the rest.

18:27

Bob French

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18:52

Alex Murguia

Now, you've done some work on this, which I think Bears mentioned, because I think at least once people hear the word protected income, they think they're sacrificing upside here. How does that work? If you come to a good compromise between these two strategies, where there's a portion let's assume there's de minimis Social Security and there is no pension, right? But somebody is in the income protected income, and the other one is total return, how can a compromise be adhered to that actually sets them up for potentially a more optimized retirement income experience?

19:34

Wade Pfau

Yeah. So as much as possible, thinking about any sort of protected lifetime income as part of the bond allocation becomes important because especially with, like, a simple income annuity, it really is a bond. The insurance company is taking your premium and putting it in their general account, which is generally a bond portfolio. There may be a little bit of allocation to other things, but it's primarily a bond portfolio. And your payout rate reflects the general level of interest rates at the time of the purchase that's going to become part of that payout. So if I'm a total return individual, I don't think I need annuity. I'm fine with my stock bond mix.

20:14
Wade Pfau
But to help protect that other individual in the couple, all right, let's reposition some of the bonds into the annuity, and then that person can feel more comfortable and you have more risk capacity. Your lifestyle is no longer as vulnerable to a market downturn. And so once you've met the needs of the income protection individual, you can now invest the rest more aggressively, and you're not necessarily even changing the amount of stocks that you own. It was you were allocating from bonds into the annuity. And then if that total return person can set that aside, that, okay, we did put something into annuity. Now that we've done that, now I can truly have my total return strategy with the rest. I think that's a pretty reasonable way to think about a compromise there.

21:02
Alex Murguia
I think that's an excellent way. While you were saying that, two thoughts came to my head. Wow, Wade, I forgot to mention that you shaved. Yeah, exactly. I was like, wait, something's different. The other one goes back to the work with Blanchett and Finke, which is, once you have this sort of protected income paycheck coming in, you kind of give yourself this license to spend. Because if you're just doing total return, yes, you could be confident. But I think you have in the back of your head this little voice that says well, let me just hold some back just in case.

21:41
Wade Pfau
Right, right. And especially if you're doing total returns but it's not your true style. I think that would be a bigger issue. You're somehow worried about you're not allowed to spend that money 100%.

21:52
Alex Murguia
And so not only do you take more conservative allocation, you actually don't even enjoy the money that you could spend. And so this both what's right word on an accounting level and on an existential level, I think is a great compromise because it wins on all fronts. I like it a lot when it comes to that. What's another thing that can be done? And it begins with a Q. Yeah.

22:20
Wade Pfau
So another way to just treat the income protection with less assets is some sort of deeply deferred income annuity. And the QLAC, the qualified longevity annuity contract, which is the IRA equivalent of a deferred income annuity that gives you the extra deferral on required minimum distributions as well that can

provide that tail of longevity protection. So that if I have a QLAC that's going to kick in at age 85, I don't have to worry about what if I live to 105 and I run out of money. I can now tailor things more towards I got to make sure my money lasts age 85. Then if the assuming the QLAC income is big enough, I can kind of coast after that point with the QLAC.

23:04

Wade Pfau

And because it skips all these payments, if it only begins making payments at age 85, it's going to be much less expensive than purchasing an income annuity that would begin payments immediately for the rest of your life.

23:17

Alex Murguia

The other thing I would say here's where it's an interesting point where we talked about the first one where total return and time segmentation, they're dissimilarities in safety first probability base, but they're similarities in optionality. Here they're diametrically opposed in the sense of one is probability based and one is optionality and one is safety first and the income mimic orientation. So there's no kind of similar anchor that they can use. And something to think about here when I'm looking at this is the folks in the protected income, they're on the lower side of the matrix and you tend to have more of this longevity aversion, running out of money fear. Right. Whereas on the total return approach, it's not that they're not worried about running, they're not worried about essential expenses. It's just they're not concerned about the example of breathing air.

24:17

Alex Murguia

I'm not worried about I know oxygen is important, but I'm not worried about running out of breath in this podcast. Right. And so those folks that are in the total return are more concerned about discretionary stuff, these sort of higher level goals, and that's where they need that exposure to the market. So coming to some sort of middle ground around those two competing forces. If you're an advisor, I would try to get at the root of it. If you're talking to your spouse, I would try to get at the root of it, I think will go a long way towards QLAC, how much of the bond replacement do I want to do, et cetera.

24:56

Wade Pfau

And back to the point you were making, too, at the beginning about just mathematically, a lot can be said for income protection. You're not necessarily giving up the upside potential if you're not selling stocks to purchase annuities, if you're selling bonds to purchase annuities. For individuals who face longevity risk where they don't know how long the money needs to last, annuities can work much more effectively than bonds to meet that particular goal in the face of longevity risk. And so I tend to argue that mathematically income protection is a stronger strategy. Now with respect to the retirement styles, if somebody's total returns, fine. Do your total returns approach. At the end of the day, it's up to you, and that's a viable strategy as well.

25:37
Wade Pfau
But when you have people who are both income protection and total returns, then I have to get back to the point of, well, truly speaking about this, income protection is a better way to do things. So go ahead and meet the needs of that individual, and then you can go hog wild with the rest for your total returns approach.

25:54
Alex Murguia
Hog wild? Wade HOGWILD.

25:56
Wade Pfau
Yeah, you can. So I will avoid talking all kinds of dramatic asset allocation strategies.

26:04
Alex Murguia
Nice. No, I think that makes a lot of sense. There's a beauty in the simplicity of just look, take a little bit from here, take a little bit from there. Now, we said annuities just for the uninitiated. What specific annuities on protected income are you kind of referring to as bond replacements?

26:23
Wade Pfau
Well, the natural one. These are the simple income annuities, single premium, immediate annuities, deferred income annuities, and QLAC qualified longevity annuity contract is a type of deferred income annuity. You exchange a lump sum premium for a guaranteed income for life. It's the simplest kind of annuity. There's no quoted fees on them, but if you reverse engineer, it's usually a relatively cheap way to provide lifetime income protections. That's generally what I'm talking about here. Also, it's worth looking at fixed index annuities with lifetime income protections because their payout rates, though in theory should not be competitive with income annuities. In practice, they sometimes are.

27:03
Alex Murguia
Okay, again, I wanted to bring that out simply because we're going to be talking about now different types of annuities when we get to different types of potential middle ground compromises. Numero quatro.

27:21
Wade Pfau
I know my Spanish.

27:26
Alex Murguia
No, I messed up. Numero trace numero trays.

27:31
Wade Pfau
Yes. This is going to be total returns and risk wrap. So this is we're on the right hand side of the matrix. Both total returns and risk wrap are probability based. So comfortable relying on the market, but total returns is more optionality oriented. Risk wrap is more commitment oriented, comfortable committing to a lifetime strategy. Yeah.

27:55
Alex Murguia
So here you have that common ground now, some sort of market exposure, if you will. What do you think here? What could be some nice compromises here? I would imagine it would have to do with guardrails.

28:09
Wade Pfau
Yeah, both of these are comfortable with relying on the markets, but the risk rep just somehow doesn't want to be fully dependent on relying on the market. So having some sort of guardrail, a couple options there. We're seeing more and more developments in the area of, well, in the true investment world, like a buffered ETF, but in the annuity world, the RYLA, the registered index linked annuity, normally investment returns have a bell curve distribution. A long tail to the left, negative returns, a long tail to the right, positive returns, most of the returns centered around the average. That sort of looks like a bell. These structured annuities or structured ETFs just change that. They cut away some of the downside risk in exchange for having less downside risk, they take away some of the upside growth potential.

29:05
Wade Pfau
But still, for someone who wants a guardrail, it can be worthwhile to accept less upside potential in favor of having more protections on the downside as well, less of a downside risk exposure. So that's a practical way to get a guardrail. The other would be just in the world of traditional deferred variable annuities with living benefits, looking for something that has more investment freedom so that you can invest more aggressively. But with the lifetime income protections, if markets do well, you get step up opportunities for

higher income. If markets don't do so well, you have a floor on how low your spending can go. And that floor is often lower than with the other kinds of fixed annuities were talking about previously.

29:49
Wade Pfau
But the trade off again is you have this guardrail to then give you more upside potential, a lower downside floor, but more upside potential, growth potential that can appeal more to the risk wrap style.

30:01
Alex Murguia
I think it's spot on. What would you say to somebody listening in and their response to you is, but markets aren't the returns aren't distributed like a Nobel curve. They're leptocurdic, they're fat tails that still.

30:15
Wade Pfau
Looks like a bell.

30:16
Alex Murguia
Yeah, I would say shut up. No, you always get those right. There's always somebody that has to say, oh, but it's not normally distributed. Blah, blah.

30:28
Wade Pfau
Yeah, not normally distributed. It could have a fat tail, but it still looks like a bell.

30:33
Alex Murguia
No, I get it. It's good enough for what we're talking about. No, I get it.

30:39
Wade Pfau
Yeah.

30:39
Alex Murguia
And so here where you have flexibility is the guardrails at the end of the day, you're getting exposure. So how big of a safety net do you want around that? And the more the bigger the safety net. The less market

exposure. Right. And so it's that kind of give and take care. And as you said, Rylas, but also variable annuities with living benefits, you would.

31:01
Wade Pfau
Have the ones that emphasize more investment freedom, because every insurance company will have a different marketing angle on their living benefits. Some of them put more emphasis on having investment freedom, while others, you may be very limited in how aggressively you can invest. When you own that protection, you're motivated to invest more aggressively because you have something that if markets do well, you benefit. If markets do poorly, you have that protection in place so that you're not exposed to the full downside risk, but the insurance company will be on the hook to pay you a protected lifetime income. So you take advantage of that by investing as aggressively as you can. And then some variable annuities allow you to invest more aggressively than others. So it's more the ones that allow you to invest more aggressively. Potentially.

31:49
Alex Murguia
No, 100%. I think that's spot on. Now, we talked about here when we talked about total return and risk rep, they're all to the right, they all have that common denominator of probability based. Now, what happens if they all have the common denominator of safety first, but they differ on optionality and commitment? That would be time Segmentation and protected income, otherwise known as numero quadro.

32:14
Wade Pfau
Numero quadro. No more total returns. We're now right. It's time segmentation and that's right.

32:20
Alex Murguia
Let's move away from total return. Let's move away from the Ken Fishers of the world.

32:25
Wade Pfau
That's right.

32:28
Alex Murguia
Oh, by the way, I don't know if you heard the day of our.

32:30

Wade Pfau
Recording, the Dave Ramsey's of the world, too.

32:32
Alex Murguia
Yeah, I was going to mention that to you. Oh, my goodness. On social media. But it's almost like FYI, Dave Ramsay had a little rant it's on Twitter about, oh, just take 8% a year and you're fine. Because the markets return 12%, inflation is 4%. So twelve minus four is eight, and off you go. Right. Obviously, that's stupid. And it doesn't even merit no, it is what it is. I'm not going to pussyfoot around here, but it doesn't even merit a response. But the FinTwit world is going up in arms saying, oh, look at this guy, and they're using it as a punching bag. But to me, the guy's irrelevant. So it's just who cares, right, when it comes to that? But you're right.

33:14
Wade Pfau
It's an example of an extremist total returns position.

33:18
Alex Murguia
Yeah, exactly.

33:19
Wade Pfau
You're really comfortable relying on the market.

33:21
Alex Murguia
Yeah, exactly. You're married to it no matter what. Okay, so time segmentation and protected income on the left hand side. What do you got for me, man?

33:31
Wade Pfau
Yeah, so with time segmentation, it's more about front end protections. With protected income, it's more about lifetime protections. And so how do you develop a compromise between the two? There's a few things we can look at. There one, if we're leaning more in the time segmentation direction. It could just be having a bigger front end ladder or front end, like a bigger short term bucket. Your front end ladder, instead of being three years, is going to be eight years.

34:02

Alex Murguia
Let me set that up actually a little bit more because I started thinking. So just to think conceptually. So time segmentation, that person is thinking of having protected income, like contractual income in windows of time. Right. If you go to protected income sorry, contractual income. If you go to the protected income piece, that person wants a complete floor in perpetuity. So how do you balance somebody that wants contractual income in windows of time versus someone that wants contractual income over perpetual floor? And so you can't have both. So what do you do here?

34:35
Wade Pfau
Right. There's a few different approaches, but the first one is this just well, whatever the length of ladder that time segmentation person would have picked, extend it some to create more comfort for the income protection. It's still not a lifetime protection, but you've got a bigger front end ladder. Yes.

34:55
Alex Murguia
So if somebody initially their own proclivity is, look, I want two, three years, I want three years of protected income. That's what I want my ladder to be. But the other spouse is, I want like, a pension, I want an income floor. I don't want to mess around every three years. Then the answer is maybe get a seven year ladder or something like that. That's one way of doing, extending that. That way you give yourself more time. And hopefully both of them kind of are good with that middle ground piece there. And you do that you can do that with a bond ladder. And again, by bond ladders, we're specifically, I always say this, but we mean like safe securities, like government securities. Or you can do that with a MYGA, which is effectively the insurance version of a CD ladder, if you will.

35:44
Wade Pfau
That's a multi year guaranteed annuity.

35:46
Alex Murguia
Yeah, multi year guaranteed annuity, sorry for the acronym. Okay. Does QLAC also work there?

35:55
Wade Pfau
Yeah, back to the QLAC again. So another option is the other way. Yeah. Yes. Coming in right from the other direction. Income protection wants that protected lifetime income. Looks like were saying earlier, you get the protected lifetime income, but by starting that income at a later date, it lowers the costs of the protected income, and it still provides you that tail of if I start. This income at 85. It may not cost me a whole lot, but now I know I've got a protected lifetime income starting at age 85. And that could satisfy the income

protection desires, while at the same time, because it takes less money to do that, it still leaves plenty to build that front end time segmented ladder as well and have growth portfolios as well. It could be another angle at getting at a compromise. There.

36:45
Bob French
Are you getting close to, or are you in retirement? Well, investing during retirement is a little bit different than during your working years. Your investments are there to help you pay for retirement. And now is when they need to earn their keep. To make sure you're on the right track, download retirement researchers eight tips to becoming a retirement income investor by heading over to retirementresearcher.com eighttips Again get retirement researchers eight tips to becoming a retirement income investor by going to retirementresearcher.com eighttips that's the number eight tips.

37:25
Wade Pfau
And then the final approach here would be a fixed index annuity, potentially, where you don't necessarily use the living benefit, but you're thinking of it more part of that front end bucket. But every annuity does have annuitization option included. And so it's kind of like you have the option to turn on a lifetime income that you may or may not ever take advantage of, but it's there. And the fact that it's there is maybe going to help the income protection person feel more comfortable because you have the principal protection with a fixed index annuity, a big market downturn isn't going to suddenly deplete that asset. You know what its worst case scenario will be if you never get any step ups.

38:07
Wade Pfau
And so you can always kind of keep track of, well, if I were to annuitize this contract, here's the protected income that I would get. And so you're not buying the lifetime annuity, but you're holding in the back of your mind that you have this option to buy the lifetime income protection. And that could potentially be another way to compromise by having this sort of deferred fixed annuity or a MYGA can get you the same sort of thing. Your front end buckets could be converted into lifetime income floors if you I think personally, that's where I would go.

38:43
Alex Murguia
For whatever reason, that sings to me the most of these options in this type of compromise. But again, to each his own, right? I'd stick to the 8% distribution. I don't know.

39:00
Wade Pfau

Yeah. In that most recent clip, it was advice for somebody around age 30 who was ready to retire and was wondering if they can use an 8% withdrawal rate.

39:10
Alex Murguia
Really?

39:13
Wade Pfau
See how that plays out.

39:15
Alex Murguia
Yes.

39:19
Wade Pfau
All right.

39:22
Alex Murguia
Number five. So now let's go diametrically opposed the other way, time segmentation and risk wrap. So you have here to me, this is interesting because these are both behavior strategies. They're not necessarily they're kind of a blend of total return and protected income. It's just how you want to do this. And again, to me it's quite interesting. But with time segmentation and risk wrap far away, what are some thoughts that come to your mind? That come to mind?

39:57
Wade Pfau
Well, and first, noting this is going to be the least likely combination of the six we're talking about today because.

40:04
Alex Murguia
Thank God, because this is the toughest to compromise on.

40:07
Wade Pfau

Well, yeah, they are really diametrically opposed, and they're also less common. And so to get a couple where their time segmentation risk wrap, it won't happen too often.

40:20
Alex Murguia
Start with a marriage counselor.

40:25
Wade Pfau
Yeah, but there's a few possible ideas here. Sometimes when people talk about a variable annuity with a living benefit or some of its cousins, it's called a contingent deferred annuity. It's like a living benefit you put on an investment portfolio. There's this idea of pay for this protection during that fragile decade. And then if markets do fine, you can drop it. Once you get past any sort of surrender charge period, you could just decide to no longer own that annuity, not have to pay for that lifetime income protections for the rest of your life. And so that could be a way to think about, we're going to have this variable annuity with a living benefit, which is the risk wrap solution.

41:13
Wade Pfau
But if we're just thinking, let's just look at how things go over the next five or ten years, and if markets do okay, and we're not getting hit by a bad sequence of returns risk, we'll drop that protection. You could kind of frame that as a bucket, a short term bucket to provide that safety first sort of protection for those early retirement years. And then if markets do poorly, then at that point, the variable annuity would be in the money, the living benefit. You're likely to then be able to have that lifetime income protection from it. But I think the time segmentation person could sort of frame a potentially short term use of a living benefit as a way to build a short term bucket.

41:55
Alex Murguia
It's interesting, as we're saying these two, you start thinking about, okay, how can I bring something to light here and there's blending strategies, which is kind of we've been discussing, but we've also discussed an order of strategies. Try this one first to sort of accommodate that thing, to accommodate that preference and play it by ear. And if it works out, great. If it doesn't work out, then execute the second strategy. You follow what I'm getting at. Like, there's this ordinal piece to it. You're not kind of like blending where you're doing total return income protection. That's a true blend because you're saying, okay, that's going to be part of your bond allocation and the overall piece, the annuity is part of your bond replacement strategy, et cetera. Right here, it's almost like try this as a starting point, see how it goes.

42:48
Alex Murguia

And then if it goes accordingly, if it goes stupendously, great. If it doesn't go stupendously, then execute this strategy. Right. I kind of get that vibe listening to you speak. Am I off on that?

43:04
Wade Pfau
No, that's a fair assessment of and it's that and it's just having different options and thinking about, well, which one do we feel is a better compromise in our personal case? But yeah, if that's not really going to work for you, or if that's not on the table we talked earlier about the idea of cash reserves, and this might be another area where you can emphasize that is the more broader the buffer asset idea, which could be cash. It could be the growing line of credit on a home equity conversion mortgage, aka reverse mortgage. Or it could be, if you had life insurance in place, the cash value of life insurance, which is you could frame that. It's not a short term bucket.

43:50
Wade Pfau
But if markets aren't cooperating and it is a contractually protected type income source that you could pull from during a market downturn to satisfy the time segmentation concerns, while at the same time it's a guardrail, you're taking the investment based approach with risk wrap. But if there's a market downturn, rather than selling from a declining portfolio, you're going to tap into this alternative resource held outside the investment portfolio that's not correlated with the markets so that it's not losing value when the market's going down and it can provide a bridge to cover spending during that sort of market downturn. And that's how you could frame it as a guardrail on the risk wrap side framing.

44:37
Alex Murguia
Yeah, but I like what you're bringing in. You've introduced a couple of concepts here that I think are worth mentioning. I think sometimes we're anchored in retirement income and it has to have some sort of investment portfolio piece to it all has to be driven by the investments. And so you start thinking, how can I come up with solutions that have to do with something with a ticker symbol that has participation in the market? Right. We've expanded that to include the annuities, which are contractual insurance products. But you brought two things to light the Hecam, the equity line of credit on a reverse mortgage and a straight up life insurance piece to it, building up the cash reserves. And so I think it's important when you're thinking of compromises to amplify your solution set beyond just a traditional investment portfolio.

45:31
Alex Murguia
And as much as you can profile individuals with a reset, you can profile solutions. And so what Wade just did here is you brought two non investment centric solutions such as the insurance policy and the HECA, and shown how that could be know to come to this middle ground if you wait. I mean, I think.

45:58
Wade Pfau
There'S four different ways to manage sequence risk. And this is the buffer asset approach. It's the asset outside the portfolio that can be a temporary resource that provides a guardrail and it also provides characteristics of a short term bucket. It's just you're not automatically tapping into it.

46:16
Alex Murguia
So the guardrail satisfies the risk wrap and the short term window satisfies the well, I mean, the window component, whether short or medium, I don't know. But the window component satisfies the buffer, the time segmentation piece.

46:29
Wade Pfau
Better said. Yeah, I think it's good.

46:33
Alex Murguia
Wade, I think this is the first time. We've called the time correctly in terms of, oh, this should take one episode. We didn't know how many episodes this would be, but we're rolling nicely. What do you think?

46:42
Wade Pfau
Continue. We just got one more to go.

46:46
Alex Murguia
Yeah. The final combination, the final countdown. All right, number six. We have now the common theme here that we started with the common theme being optionality. The common theme here is commitment orientation, right? They differ on safety first and probability, but commitment orientation is the same. And this is protected income and risk wrap.

47:11
Wade Pfau
Take it away. And if you liked Alex's singing there, please let us know in the podcast reviews if you want more Alex singing.

47:21

Alex Murguia
Who doesn't like Europe? Who doesn't like Europe? I think that's who does that, right. That's a resident development reference as well.

47:29
Wade Pfau
Yeah, right.

47:29
Alex Murguia
Look at that.

47:30
Wade Pfau
When Job comes out to do his illusions. All right. But, yeah, we've got income protection and risk wrap. So these are both more in the commitment orientation. So if there is an income gap, looking to fill that gap with a protected lifetime income source, income protection is more what can give me the highest possible payout rate in the worst case market scenarios. And then I don't worry as much about growth potential. Risk graph is more I'll accept a lower payout rate in the worst case scenarios because I believe there's going to be potential for growth and step ups and increased income over time. Well, where do you find a compromise between the two? It can be just looking at the different annuity options, probably more in the space of either the fixed indexed annuity or the registered index linked annuity world with living benefits.

48:22
Wade Pfau
And if it's a fixed indexed annuity, there's different ways interest is credited. Sometimes you have a participation rate which could be, say, just, I'm making up numbers, but you get 70% of the price returns, positive price returns for the underlying market index, no matter it's unlimited, it's uncapped. Or if you put in a cap, you could say instead of getting 70% of the price returns, I'll get 100% of the price returns up to a cap of 10%, and I don't get anything beyond 10%. So if markets do better, if there's a big market return, the participation rate credits more interest. If you get a small positive market return, the cap approach gives you a higher credited interest. Yeah, go ahead.

49:08
Alex Murguia
But based on your sort of set up here, I would imagine then the participation rate is what you would want to lean towards as opposed to the cap rate.

49:19

Wade Pfau
If you risk rappy, it's more risk rappy, it's kind of a more risk graph orientation to go with the participation rate over the cap. So that's the sort of thing, looking at compromises, that are giving you an adequate amount of downside protections, but also giving you more upside growth potential as well. So somewhere in that sort of middle ground between fixed index annuities and registered index linked annuities yeah. With living benefits.

49:51
Alex Murguia
I think that's good. I think this is a good overview. You could always get more nuanced and the like, but because it's a podcast and there are no slides to see, the limits of what someone can visualize will decay the impact of what we say. So I think this is good. But to me, at a general level, what we've done here, if you think of these quadrants as colors, basic colors, we have those as our primary colors, and so we're able to create other colors. So as opposed to again, I can't stress this enough in practice, somebody does a risk questionnaire, which, again, just assumes total return, and that's just one third of the population. Don't forget, another 33% of the people will identify as protected income, and 15% will be time segmentation and 15% will be risk graphs.

50:44
Alex Murguia
You got two thirds of the population that are not resonating with total return. Right. Especially when it comes to retirement income. A risk questionnaire is useless when it comes to that because it doesn't pull for the sensitivities around retirement income that you would want for. So if you're kind of splitting the difference on some sort of allocation from a risk questionnaire, you're using the wrong tool for the job. And so I think a much better way to go about doing it is something like this, where think about total return being yellow and think about protected income being the color blue. And so now it's a matter of not splitting the difference between yellow or splitting the difference between blue, but trying to find the right shade of green, yellow and blue.

51:35
Wade Pfau
Now I understand that slide you made that has those circles, those colors. I had no idea why you were really now I understand the slide. Like you added a slide where there were these circles.

51:53
Alex Murguia
I was worried, am I going to get the phase right when I say this? No, that's what you're doing. What you're doing is you're trying to get the right shade of green and the right shade of green when you're playing with yellow and blue is okay. What we just discussed on this podcast, this is how you want to be thinking about this. Again, I can't stress enough there's no right or wrong answer, but this is the type of mindset that you need to give it to, and this is the type of thinking everyone will have. We could do this podcast again, and we

will probably come up with slightly different answers, to be completely honest here, but we'd have different ways of explaining it. The point being now what's important is not that.

52:32
Alex Murguia
What's important is the decision making that we took to come up with the solutions. And that's kind of what this framework helps us do to a large extent. Wade, do you want to take us?

52:44
Wade Pfau
Absolutely. Yeah. So thanks everyone for listening, and hopefully this was helpful. I learned something about the different shades of colors and hope you did too. And we'll catch you next time on Retire with Style. So have a good week, everyone.

52:57
Alex Murguia
All right, everyone, take care.

53:02
Bob French
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