Episode 107: RWS Live: New Years Q&A (Part 1)

Bob French 00:00
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.

Alex Murguia 00:41
Hey, everyone, welcome to Retire with Style, YouTube live edition first of the year. Alex and me here with my trusted companion. Wade Pfau. Wade, how are you man?

Wade Pfau 00:58
I'm doing great. How are you Alex?

Alex Murguia 01:00
Pretty good. Pretty good. We actually haven't recorded a podcast in a while. So it's, it's been a minute right way.

Wade Pfau 01:10
It has Yeah, we've been running a few repeat episodes to celebrate the end of the year as we've been off doing different things. Spending time with family, but we're we're ready for exciting and impactful 2024.

Alex Murguia 01:25
Awesome. Awesome. I loved your framing how it was we've been running a few repeat episodes. Good. It's best, though best common in the

Wade Pfau 01:37
past year

Alex Murguia 01:40
I hear you. And so yep, we're on it. Since we're doing YouTube. We're not looking at YouTube ourselves. We're not looking at that window. So bear with us. And Amber has given us the green light that we Wade you in particular look as handsome as ever on this thing. So we're, we're good to go. We're good to go. Interesting. We did send out questions ahead of time, truthfully, though, we're looking at them about an hour before the presentation. And I think we're going to have to break this up because we've got tons of great questions.

Wade Pfau 02:12
Yes. partners, we had more than 50 questions come in. So behind the scenes we've been planning to a long term care arc for a long time and I think that's going to get pushed back further because we're gonna do a few episodes now just trying to work through the questions so if we didn't get to your question today and some of these questions are paragraph essays they need to be parsed down a little bit not just read live on the air. But we'll we'll do a few episodes with with q&a but we'll get started with some of those questions today and also keep track of questions that come in through the the YouTube channel itself and

Alex Murguia 02:46
it's funny how you could tell that our listeners readers what have you are different breed. This is not. This is not your your mother's financial planning podcast, it seems it's you know, pretty in depth. So we'll get cracking there Will there really won't be time for small talk. Wait, what do you think about that?

Wade Pfau 03:08
See, enjoyed the small talk but not gonna get an expert day and what else Alex did during the New Years other than I hear a lot of push ups and a lot of pull ups. Well,

Alex Murguia 03:19
we're trying to we're trying man. Well, that to the kids to the kids actually. They did like, like 30 days in a row. So it was it was they did it even so that was good to see. But are that yeah, that the cold plunge? I just you know, we have like a horse drop. We just put it out in the back and we get in it every morning and it is what it is and never better. Never better. Wade. Yeah.

Wade Pfau 03:47
I don't even like getting into like a 80 degree water so cold plunges out of the question.

Alex Murguia 03:52
We'll see. We'll see for today. We don't we don't have limiting beliefs in this podcast. So why don't we kick it off? I will do my best to put the first question in the bank. No, we'll knock it out. So the first question. Here we go. Do you have advice on creating a detailed plan about how to build investments into your retirement income optimization map? That's the real map. I am trying to map future assets and liabilities in a realistic way. Income from my family's defined benefit retirement plan. Annuities and Social Security monthly projections are relatively straightforward, but I'm struggling with projecting investment assets into the real map. I am currently aiming for extremely low, safe withdrawal rate of 3.15%. Given my asset mix based on historical data, and because I want my projections to be conservative, how do you think about projecting the future income. That's the first part. Also, if possible, can you briefly touch on some strategies you would implement to reduce sequence of returns risk in a modeling using this framework in a model using this framework? Another question that specific actions are guardrails to implement in the real map in anticipation of the first 10 to 15 years of retirement would be appreciated. So that's to address the fragile decade. I'm familiar with some of your writing. So an end weeds level of detail would be great. Thank you for all that you do? All the best, especially to you, Alex and not wait, then

Wade Pfau 05:40
the question was addressed to you? Yeah, that's a good question. That's an example of one of the not the longest question we received. But it's the longest one we'll look at today. The others just for the sake of being able to read through them were a bit shorter. But yeah, there's a lot to unpack here. And maybe we should start with just reminding everyone what the reo map is, which it's just a visual presentation of how I like to think about retirement income, you've got the four I financial goals on the left that longevity, lifestyle, legacy and liquidity. You have the liabilities on the right, that are mapped to those goals, the essential spending, the discretionary spending legacy and contingencies are spending shots. And then you have three types of fine of assets for the planning process, you have the like, and what we call reliable income, of course, reliable income, the diversified portfolio, and liquidity for the unexpected spending shots. And it's a visual representation that we use to then move into the funded ratio. And I think a lot of what we can discuss with this question relates to how to think about this in the context of the funded ratio, at least the first part of the question. Absolutely. Okay. So in that regard, yeah, I mean, oh, do you want me to do it?

Alex Murguia 07:06
No, you're on a roll. You're on a roll? No, it sure. I mean, to bring it into a funded ratio, what we said is, effectively, he's looking at an ass, he's looking at assets and liabilities and liabilities being future spending, right. And from that standpoint, what the funded ratio does is it's a big division, it's assets divided by liabilities, which is how pensions and companies like and that's how they decide how they're going to, if they're funded or not, relative to their future liabilities. So we feel the funded ratio is a perfect first step towards really getting a sense of how you want to strategically allocate your balance sheet in preparation for doing what this person wanted to do with regards to their, their plan. Now, here, we're going

Wade Pfau 07:59
to get into that. So we do the with retirement research, or the periodic retirement income challenges. We'll have the next one, I think, in the last week of February, and that'll give you the first is first of March. It'll be coming. We haven't announced it publicly. It's coming soon. And you do get access, we have a tool to do the funded ratio. So as we're describing this process right now, just keep in mind that you, you can have the opportunity to take a look at this. But it's it's an effort to quantify the the real map the retirement income optimization map and Ben's thinking about this right in terms of looking at reliable income, Social Security, pensions, annuities on ladders, that sort of thing. And with the funding ratio tool, we show you do you have enough reliable income to meet your essential expenses? And then we look at diversified portfolio matched up against the discretionary goals and legacy. And it's all based on getting into I mean, this question is getting into the idea of investment risk and so forth. The funding ratio is based on Do you have enough assets without taking market risk? If you just earn bond like returns? Do you have sufficient assets to meet your goals? And if you have a large enough diversified portfolio, which with interest rates, where they are, if you're looking at a 3.15% withdrawal rate that is below the you can safely support that with bonds and the current kind of interest rate environment that we face, you'll find yourself over funded. And so then you can think about how much of that portfolio will you allocate to the lifestyle goals to the legacy goals. And then you may also be able to reposition some of that portfolio into reserve assets to deal with spending shocks as well. And that's really the first step and understanding like what sort of risk you want to face. I mean, when you think about what's my

asset allocation going to be my my ratio of stocks to bonds. Part of that is based on your risk tolerance is how comfortable Am I Am, Am I with market volatility, but part of that is based Stan, your risk capacity? How much risk? Do I even need to take? If I if I can safely meet my goals? Because I'm over funded by primarily using bond investments? Then I can think about well, do I want to take market risk? Or how much market risk do I want to take? Or do I want a lot part of that into make sure I've got those spending needs covered, and then invest the remainder more with more a more aggressive approach. But that's really how to start thinking about the first step of asset allocation is just understanding is market risk even needed. And that's what the funded ratio tool is designed to do.

Alex Murguia 10:34
What what I would add in terms of that first partner, and this is the framing in which he was asking, and we get this as well, this phrase, I am currently aiming for extremely for an extremely low safe withdrawal rate of 3.15, given my asset mix based on historic data, and because I want my projections to be conservative, a couple of couple questions that that statement arises for me. The first is, if you're a if you have previously, you stated you have pensions, and annuities, and Social Security. And so, um, I had asked myself, how much of those income sources are funding your essential expenses? If it's if it's a significant amount, then are you doubling up, quote, unquote, on the conservative ism, on the your portfolio, right, because at the end of the day, you can't take this with you. And, and you don't want to spend a, you know, let's say you retire at 65, and you got until 95, you don't want to spend a good 20 to 30 years, just sacrificing for not when you have essential expenses covered. And so I would kind of rethink that a little bit. The other piece is based on historic data and stuff like that. I, you know, historical data is fine, but I think you got to look at what the current environment is signaling going forward, rather than just being overly reliant on historical data, because that's just what happened back then. I mean, you get measures of central tendency, and things along those lines from the historical data, but I think you can project without like trying to time the market, and be more realistic about things. That's from the first part. Do you agree with my interpretation of the first kind of statement that the person

Wade Pfau 12:17
may? Yeah, yeah, absolutely. In terms of with a defined benefit pension, annuities and Social Security, I don't know what the spending goal is, but it's quite possible, you have enough reliable income to meet your essential spending, which gives you a risk tolerance, your lifestyle is not as vulnerable to a market downturn, because you have all this reliable income. And in that regard, there's two ways to be more aggressive in face of this capacity, you can spend more aggressively or you can invest more aggressively. And I think that's the point you're getting that with, you don't necessarily need to use a low withdrawal rate from the investments if you already have all this reliable income, because you have the capacity to potentially spend down your portfolio and in the face of sequence of returns risk and so forth, but not have it disrupt your retirement in a truly disastrous type of way. So

Alex Murguia 13:08
and that gets to the second and third part of the question, which is, I think there's similar statements, which is, you know, how would you go about reducing sequence of return risk using this framework? And then, what are what are guardrails to implement, you know, in within the real map within the first five to 10 years of retirement? So effectively, I'm entering the fragile decade, how do I, you know, ease into this, and that mess myself up? I'll start it off. And you can finish it off here. If you look at the real

map, this goes, this is kind of a little bit of an extension to then our previous statement, which is, if you're funding to the degree possible, essential expenses with reliable income and reliable income is not a sustainable withdrawal rate. There is no safe withdrawal rate from volatile portfolio that just isn't, you know, the marketing won that game by calling it safe withdrawal rate, but it is what it is. The reality is you want to see what you have, you know, how much of it is matched, you know, within that, and then from there, you can do certain things to kind of ease into it, you know, Wade spoke, spoke about a gliding, a glide path portfolio, which has an effect, it's almost like a, like a undercover bond ladder strategy, you know, and that should give you some sort of, I don't know, buffer and buffer is the wrong word and the way we use it, but that should give you some sort of comfort and knowing that if, you know, when you start your retirement and things go sideways, well, you have a higher than expected bond allocation that should dampen the volatility. Now there's because you already have though, again, the pension and the annuities, maybe there's no need for it. There could be a little bit of an overkill here. But Wade,

Wade Pfau 14:56
yeah, that's so like, how do you manage sequence over returns risk. At the end of the day. Talk about there's four basic strategies which have a lot of subcategories. The one is just using a lower withdrawal rate, which I think is where this question is starting from. But you do have other options too, you can have variable spending. So if if you just build in this idea that I'd be comfortable cutting back on spending a little bit, if I do get a negative sequence of market returns, that kind of support a higher initial withdrawal rate. And that helps reduce some of the sequence risks because it doesn't force you to sell the, to fund the same level of spending in a declining market environment. You can do that sort of bond laddered approach or a time segment and approach where you have assets that are not exposed to market volatility match to the short term expenses, you have individual bonds maturing to cover the short term expenses, which can give your portfolio an opportunity to recover in the face of a market downturn, you can look at different types of annuity strategies. But I think that's already pretty much covered for this individual with all that reliable income. And then there's the buffer asset idea. And I think there were other we've had other questions that we'll get into, in subsequent episodes with the series on on the rising equity glide path, but also on buffer assets. And buffer assets is something outside the portfolio, not correlated with the portfolio that you really think of as a buffer that if if you get a negative sequence of market returns, you can temporarily tap into the buffer asset to cover spending without having to sell from your portfolio and that will hopefully give your portfolio a chance to recover could be a pile of cash. It could be the growing line of credit on a reverse mortgage, Home Equity Conversion Mortgage and variable rate heckum. It could also be if you've set this up in advance the cash value of a whole life insurance policy as well. Those are examples of buffer assets that could provide again, temporary spending resources to help manage that sequence risk in the early retirement years.

Alex Murguia 16:56
Yeah, and just to state the we don't consider like, Oh, my bond allocation as a buffer acid. Just one of those things.

Bob French 17:04

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Alex Murguia 17:30
Okay, I think we can move on. That was a great question to get us started. Yeah.

Wade Pfau 17:34
Yeah. There's a lot of questions coming in on the YouTube Live.

Alex Murguia 17:39
Want to give some of those since they're live? Sure.

Wade Pfau 17:42
Yeah. Can you talk about the first one? So we'll just kind of look at this. Can you talk about a stock annuity portfolio being more efficient than a stock bond portfolio for supporting spending in retirement? Sure, yeah. And that actually touches on themes related to some of these other questions that we'll be looking at. But for me go with research that I did. Now, about 12 years ago, this idea of the efficient frontier for retirement income being more of a stock annuity portfolio instead of a stock bond portfolio that protected lifetime income. Replaces bonds, when you don't know how long you're going to live to, to have protected income that matches the length of what you need to make your retirement work. So Well, that's the basic idea that the efficient frontier for retirement income, to the extent possible, we're not thinking about annuities as stock replacements. And one of the other questions we'll talk about later today gets into that point in more detail. You think of annuities more as Bond replacements that they manage the spending, you need, if you live a long time, they give you more income, if you don't live very long, you don't get as much from the annuity, but you didn't need as much in that scenario anyway.

Alex Murguia 18:59
And I would say high level why? Why is this research turning out like this? It's simply if you think about it, the expected returns from bonds are the bond yields, right, whatever that bond yield is relative to the maturity. With annuities, insurance companies effectively take your money and reinvest it in bonds, right, they can do it on an institutional level. So there's some benefits, and maybe they can squeak out an extra basis point here and there. But because they're able to pull your mortality, and base their liabilities on average lifespan, there is a little bit of a bump, there's a mortality premium that they can present so they can provide higher returns, you know, through pooling everyone's mortality. And so that is where, in essence, the extra bump comes from. And so if you have similar investment characteristics as bonds, plus a mortality premium, then it's very hard to On a numbers basis show how, you know, a basic plain vanilla annuity isn't as much if not better from an income standpoint than bonds from an you know, from an income and efficiency standpoint, that's really high level where it's coming from. Did I miss anything on that one? Well, it

Wade Pfau 20:17
also ties into the previous question to that, when you have that reliable income, I really like to think about that as part of the bond portfolio. Because if you look at the present value of these income streams, they are very bond like in nature. And that just then means with your remaining investment portfolio, it could be invested more aggressively, because you'll have all these bonds on the site as well, in addition to the portfolio.

Alex Murguia 20:45
Okay, and then, and incidentally, as we're getting right into it, please don't write like a lot of texts, simply because we can't spend 30 seconds reading it and digesting it and trying to think of a quick answer. Yeah. YouTube Live cliffnotes, as much as possible, just Dragnet, just the basic stuff. So here's the perfect, like, you know, type of question, what are the thoughts about buffered ETFs as an investment? You want to go first way? Yeah,

Wade Pfau 21:15
yeah, that actually ties into one of the questions we had planned that came in beforehand to that was, so buffered ETFs are the cousins of fixed index annuities, or registered index linked annuities. And so we got a question on the annuity side of that, but this would just be the investment side, I think there's potential there to provide an interesting play on the risk return trade offs for a retirement portfolio, like a buffer DPF to just explain real quickly, if the buffer is zero, it's going to act more like a fixed index annuity where you wouldn't be able to have a negative return. And then you get some portion of upside, but not the full market upside potential. If you have a, say, a 10% buffer, then if it's linked to some external index, say the s&p 500, and it's linked to the price returns, not the total returns. But if the price returns on the index that that would be excluding dividends. If the price returns are negative, the buffered ETF with a 10% buffer would eat the first 10% losses. So let's say the s&p 500 ended down 5% for the year, you'd be credited with zero, if it was down 15%. And you'd have a 5% loss. So it does take away some of the downside risk. But in exchange, it may have a cap, where if the cap say 20%, if the price returns were 30%, you would be capped at 20% as a game for the year. If the price return was 10%, you get the full 10% of the return. So it's compressing, it's changing the dynamics of upside and downside. Pulling that in closer, David Blanchett did publish an article where he said a 10% buffered type product approximates a 6040 portfolio. So instead of it's kind of like a 60% stock allocation, instead of being fully invested in the underlying stock index, and I've been able to develop similar results to that. And so I do think it's an interesting tool that it fits more in the risk grab quadrant, and then potentially thinking about the role, especially with like a 0% buffer as a bond alternative in other quadrants as well.

Alex Murguia 23:30
Wait, what did you made send it to the beginning? What makes it a cousin of those structure products that insurance companies have, as opposed to you know, a closer like a sibling?

Wade Pfau 23:41
Well, maybe sibling is a better term, it's just the underlying return structure is quite similar, but one is an insurance product, and the other is a investment like mutual fund or ETF. So

Alex Murguia 23:55
what benefit or non benefit does an insurance product have versus just buying it off the ETF? While

Wade Pfau 24:01
the insurance version of it can always be annuitized? They rarely do that. But it could have a lifetime income benefit. And that's where looking at a fixed indexed annuity or registered index linked annuity with a lifetime income benefit, gives you the risk pooling and mortality credits as well. And then in the insurance framework, you do get tax deferral, but you don't get the long term capital gains treatment. So there's some tax differences as well.

Alex Murguia 24:28
Okay, perfect. We got a question about long term care insurance, but I don't you know, I appreciate the question. I just it's timing in life is everything right?

Wade Pfau 24:39
I get through these Q and A's we are planning an arc on long term care. So we'll we'll address that question in depth in coming episodes. Okay,

Alex Murguia 24:49
then let's come back to the questions from that we gave out to the our readers this weekend, just to you know, do a little dance here. 80% of essential The living expenses will be covered by pension and Social Security. That's great. How should having those guaranteed annuities impact the way I look at allocating investments to fund the remaining 20 plus percent? I'm reading Wade's book, and it is very helpful. Thank you. Thank you. That was Mary Beth file.

Wade Pfau 25:24
Mother? Yeah, I mean, great question. And I addressed it a little bit, there's two opinions about this. And I addressed the opinion i i Take, which is, you can treat that as part of the bond allocation, which allows you to invest more aggressively with the remainder. The other opinion about this is you don't you just kind of ignore the reliable income sources, whatever. You look at the investment portfolio in isolation, and whatever your risk tolerance tells you as a suitable asset allocation based on your ability to stomach short term volatility. That's what you'd go with your regarded. So it wouldn't matter if you had no social security, no pensions, or if you had all your expenses covered by Social Security and pensions, that wouldn't impact your asset allocation. Again, I'm saying that that's not my preferred approach, my preferred approach is, if you've got your expenses covered, for the most part with reliable income sources, if you want, I mean, it's not needed. It's not essential. But if you want, you can invest more aggressively with the remaining investment assets for that reason.

Alex Murguia 26:31
Yeah, what you find here is, ultimately, you're doing great. I think anything over 70% is like amazing, you know, and 70% is great. So you're, you're beyond that. So congratulations. I think it's the phrase risk is a preference, you know, at that level of weights getting at how do you frame your allocation? Do you look at the household allocation? Or do you look at it in individual slices, and this goes back to even the research, really, if you're a time segmentation person, or something along those lines, you'd

probably tend to bucket these kinds of views of the allocations. And that's where Wade was getting at, like, look, I want to make sure every single bucket is doing well independently, right? I think a more efficient way, if you can stomach it, or if if you have the sort of the framework in place, and the right, right temperament is to look at it as a household. And you kind of have a license here, because of how your income is set up. To really do what you want. You have a lot of preference here. So I don't I don't I, I think you're good either way, but our own proclivities are, you know, you have room to run on the investment side? All right. There

Wade Pfau 27:48
are a couple more live questions coming in to filter them and one of them is can you discuss how far in advance of retirement should you do annuity planning, such as for IQ, lack, or speed to be set up? And we've had a few questions about Culex. So we will talk more about what that is in general. But specifically for this question How far in advance, I generally say like as a rule of thumb about you, you don't you can wait until retirement before you start thinking about it. But if you're planning in advance about five or 10 years before retirement, if you're much further than that, you may not really know when you're going to retire in large part. And it's not necessarily going to be tax efficient to have an annuity start paying you while you're still working. So like in my case, I am interested in acute lack in a single QX all different but a single premium immediate annuity deferred income annuity. But to the extent that I don't really know when I'm not going to have sufficient labor related income coming in, I don't know when I should have those payments start. And so in that regard, it's really too early to plan for that. But once you start getting within five or 10 years before retirement, and you're becoming fairly sure about when you plan to retire, that could be a good time to start thinking about it.

Alex Murguia 29:08
Okay, another question here, but you're your your tutorial tutorial, Preferences here. Yeah. He's representing McLean Asset Management. I was telling my kids as I got as I as I set them up to school, I've had this sweater since I think my freshman year in college. It must stretch because I've definitely gained weight. Yeah, right. But 40 question, Alan. I know 30 But Alan, yeah, man, we got tons of tons of swag, tons of swag, etc. The caps. So here we go from Mike and wait, I don't know what you would about what you're thinking is we have questions on that came in but you know the live one ones can take us through through this session, and then we will just knock these out. Yeah, sure, you know, on a, you know, okay, so since these are live kind of I don't know, there's a little more energy when they're live. So have you seen Professor Stott? Already when they begin like that? No, I've never seen any. Have you seen professors Scott? Akin? It's a little too small. My screen XYZ Scott something he research demonstrating, see to her recent research demonstrating that a 5050 us ex us all equity portfolio, beats a stock bond or target date fun in both accumulation and retirement very interesting. Well,

Wade Pfau 30:42
yeah, and we had questions about that same article come in to as part of this backlog of questions we're working through, I've not read the article. And so I don't know if it really has anything truly interesting or new in it. But this general idea that all stock portfolios be more diversified portfolios, is not necessarily a new concept. It's something that you see over and over. And I certainly have observed it in my own research as well with different countries data and so forth, that there sequence risks with

stocks. But generally, when you look at historical data, whenever the stock market has gone down, it recovers quick enough, so that an all stock portfolio might still meet the spending goal and support a higher legacy than a diversified portfolio. That sometimes leads people to the conclusion that retirees should hold 100% stocks. If you're very probability based, you might ultimately go that route, not everyone's going to be comfortable with that sort of approach. But certainly, it's not really a surprise are a new thing that high stock allocations outperform other equity allocations. But in terms of what else that article has, I did, it's a very long article. So I did not actually read it yet. But I have seen, I mean, I just don't know if it has something new or if it's just really rehashing past results.

Alex Murguia 32:09
Yeah, what you see is these kinds of things that kind of go in cycles, right? Like, okay, this guy may get his 15 minutes of fame, and then, you know, disappears. And then seven years later, someone writes something very similar. And, you know, that kind of thing. Look, the way I would look at this is, is really just take it with a grain of salt the way Wade said, at the end of the day, there's there's a very famous article written a while back by I forgot who very, very famous guy, but you know, falls on deaf ears for me, why not 100% equity, right, in terms of a portfolio and the joke was because over the long term stocks go up. So why not just go all in? I think it's a preference on an accumulation standpoint, I can be a little more sanguine, about about that kind of option. Because I'm working, I have human capital, I can work, I don't need the income. You know, I can just always accumulate accumulate, you know, put it in, but my deferrals and when the stocks go down, it's actually a good thing from $1 dollar cost averaging perspective. But as you retire, you have no more human capital, you have no more fall back up is anything to fall back on. And so this is becoming a retirement paycheck for you. And the reality is, it's just not a safe thing to do. It's not necessarily prudent, I mean, yes, over, over the long term, stocks go up, everyone gets the math, but the path that it takes to get there is a bit circuitous. And it's not necessarily aligned with your yearly liabilities. And then that's when you run into problems,

Wade Pfau 33:42
when that's actually that's it does align with my answers to some of the earlier questions too, about, if you have plenty of reliable income, you can be 100% stocks at the rest. And the reason to say that is this point that 100% stocks tends to outperform lower stock allocations. But if you don't have that reliable income, and you're dependent on that portfolio, even though on average, and even most of the time, the 100%, stock allocation would do better, it does create more shortfall risk more downside risk, and you just have to assess whether you're comfortable with that. And just behaviorally, it can be hard for individuals as they age to maintain 100% stock allocation. So if even if this is the truly rational answer, about asset allocation, you do have to consider whether you can stomach the volatility that might generate as well

Alex Murguia 34:35
while you're taking income it's not just because the stomach in volatility and the accumulation is different than stomach and volatility during the accumulation when you're dependent on the on the paycheck but again, based on your risk profile, maybe you have essential expenses covered maybe your income protection and you're just looking at this you know as a surplus, but if your total return and your only total return as your strategy. I would caveat those studies because you don't have human capital anymore. And that's the difference. And you're

Wade Pfau 35:05
right about today's recycling. I remember even maybe it was, yeah, years ago, there was one about how you should actually leverage, like, be 200 or 300% stock allocations. And, and it's the same concept is because on average, you you do better that way. But again, it's, it's a risky strategy. Yeah,

Alex Murguia 35:25
you see it all the time. I mean, you know, the recent outperformance of US versus International is you're gonna see studies on is international stocks even needed, you know, our international stocks even needed it, etc, etc. It is what it is. So, let's see here. What else do we have?

Wade Pfau 35:41
Yeah, we're getting lots of these live questions, we might even the pre planned questions, we may just save for the next episode. We'll

Alex Murguia 35:48
just save them for the next episode. Because if people are live, I'd rather try to kind of like,

Wade Pfau 35:52
yeah, so then the next one on the list is we want to defer Social Security until one of us is 70. The cost to do so will be about 20% of our savings, is that a reasonable expense to maximize Social Security? Based on research I've done yeah, I certainly, that's the idea in the short term, until you get to 70, you're gonna be spending down your other assets more quickly. But then after age 70, your Social Security benefit is so much higher, that reduces the distribution pressure on your other investments. And so if you live to, at some point in your 80s, probably, you're gonna start to be better off with your remaining investments, even though you spent them down more quickly. After age 70, the less pressure there is on those investments, they're going to have more opportunity to recover or at least not decline as quickly. And in the long term, you're going to be able to leave a larger legacy with the Social Security delay. So Social Security delay doesn't work if you don't have the resources to fund the delay. But I do think that just 20% of the savings is within a reasonable range of yes, that can be okay. If you're someone who is planning for the possibility of living into your 90s you're likely to still benefit from a much larger legacy or more assets remaining at the end of that retirement by having delayed Social Security. Even though in the short run you were accelerating the spin down of those assets for a while.

Bob French 37:23
There you have it. 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 retirement researcher.com/eight tips again, get retirement researchers eight tips becoming a retirement income investor by going to retirement researcher.com/eight tips. That's the number eight tips.

Alex Murguia 38:05
Here's another one here. Critics of factor investing. And then in Perez, for example, okay, you know, value stocks, small value, etc. Critics of factor investing recommend holding international for diversification, but rarely in proportion to world cap weightings. Seems hypocritical thoughts? Okay, I'll start I'll start this one off. I don't know if it be critical is the right word. But I know what you mean, hear effectively. Listen, if you're into passive investing, and you know, the markets, you know, the markets and aggregate, have all the information and it's reflected in prices, then you can make the case a strong case that in that line of thinking, you should have your portfolio, your equity portfolio should just reflect the world equity portfolio, because that's how the world chooses to allocate their assets in aggregate. Any deviation from that is quote unquote, a bet. Right? That kind of thinking. Where I would say is, you should hold that global representation of stocks to the degree that you consider yourself the aggregate average investor. And so once you put that up against that assumption, it kind of falls apart, you know, quickly in terms of why don't you hold what the world represents, right? The first one being that we're in the US. And so you spend money in the US. And so it's much more valuable to overweight that accordingly, you know, and simply put, there's a lot of moving around as well. You know, and so, where I would say a few years ago, the world represented like it was split world us like 5050, roughly speaking right in the low 50s with a tip tip of the hat towards us were in the 80s a lot more us than, you know, recent than it was like 5050 ish. Now it's well over 60%, US versus International, and you're not going to be moving around bumping around just because of that arbitrary sort of composition. So just because, Oh, I gotta hold the world assets, you're not you're not the average investor, you know that that's a good enough reason to deviate relative to you're not making market bets, right? Now, you can make the same case what about with bonds and things along those lines? That gets a little trickier, you know, and even backtrack with equity a little bit. The reason to diversify to me with international stocks is you have a greater sample, a greater representation of which you can capture market return, so why not? Why not capture? Right? When I do that, you know, and I don't think you need to have point blank, look at global and domestic and be like, Okay, I'm gonna 60% So I gotta match 60%, or the world is at 55, and then go down to 50. But I think really, you get a healthy slug of it, and you're in good shape. For us McLean, where we bought, it has that beautiful jacket, effectively, we're two thirds, you know, us to international, why two thirds? It's a good round number, frankly, it gives us a healthy dose of it, and it gives us good representation of potential market returns across the globe. Why are we whatever the exact number, because it doesn't matter, you know, and I don't think we're necessarily, you know, we're passive investors, we're not necessarily being hypocritical or not. But I think it has to do with how representative they are. Now, when it comes to fixed income. That's a little bit of a different ball of wax, there's less randomness there. And so you don't need to diversify. And by randomness, I mean, like, you know, the stocks or bonds are kind of known, you know, the expected return of the bond is what the yield is, and you just do the math on that, and you can figure it out. So there's less randomness to be had, there are extra returns to capture from a diversification standpoint, it's a little more muted from that perspective. So you have that, as you don't need to sort of do as much. The other piece is the currency risk. If you introduce currency risk, within your bonds, those things can go all over the place, which then defeats the purpose of being in fixed income anyways, but there is something to be said for having, you know, if you go international, and if you can sort of hedge for currency, then you know, dip your toes in a little bit, you know, assuming it's high credit, etc, etc. You can do that. But I don't think there's any need to be robotic about following the global representation of that for the reasons I previously mentioned, to equities, and even less so in fixed income, handed off the way. But

Wade Pfau 42:50
yeah, I do see the point of the question about this seems hypocritical to not want to overweight towards particular factors, but at the same time not taking the market portfolio with international I do like the whole dat world portfolio myself with the Internet. So that that international application, a little bit under 40%. But close. Yeah, you got some flexibility. And I guess the argument in favor of not holding that world portfolio is kind of if your liability is in US dollars, you're trying to fund expenses linked to US inflation, it could make sense to overweight to the US market. But yeah, beyond that i is subject to some interpretation, or flexibility for what individuals feel most comfortable with.

Alex Murguia 43:41
Okay, and then we'll just do these. We got three more, and then we'll call it on on the Live episode here. Wade.

Wade Pfau 43:49
So we've got that, where do we where can one explanation regarding the Social Security tax torpedo in the best methods to avoid it outside of listening to Episode 105, of retire with style, which is that the article where I talk about the effective marginal tax rate? Let me I actually have our podcasts open here. And let me kind of in real time, check what episode 105 was, yeah, managing taxes and retirement using the effective marginal tax rate. So that's brand new content, this idea of using tax maps, I think it really helps to understand the tax torpedo. What I've been doing this past week is updating the the retirement planning guide book will by the end of the month, we'll have a 2024 edition. And I'm completely redoing the whole explanation of tax efficient retirement distributions. So I think there's going to be much better explanations of the Social Security tax torpedo in the context of these tax maps. So I would say look for the 2024 edition of the retirement planning guide book. And then as well with the retirement researcher, we do have workshops that NASA much on Social Security for this topic, but on the tax planning for tax efficient retirement distributions, I do talk about this in the retirement planning guide book in chapter 10 on tax planning, and I will be significantly revising the discussion around that for the 2024 edition.

Alex Murguia 45:18
Yeah, again, that pitch retirement researcher but pitching retirement researcher, that's a huge education site that Wade and myself but really, like Bob French, curates it, and manages it. So I definitely if you want more info, just check that out. Retirement researcher.com. But also on that episode 2105, we have in the show notes, I believe we have a link to the article. Wait, if you have it up, can you just double check that the link is up there? Because we'd wrote an article on it with I'm gonna mispronounce that gentleman's last name. Well, Sasser two L's acid, you know, that reminds me of that reminds me of who said attorney in Arrested Development. That

Wade Pfau 46:04
character or the or the mob, bla bla,

Alex Murguia 46:07
bla, bla, bla, bla

Wade Pfau 46:08
bla.

Alex Murguia 46:10
It's a little bit like the age a little bit like blah, blah, blah, blah, blah.

Wade Pfau 46:18
All right, we didn't see what the tax torpedo was. But just as a reminder, as you start to generate income, and you have a social security benefit, $1 of ordinary income can also trigger tax on a portion of your Social Security benefit. And so it compounds the tax impact, where you may think you're in the 10% Federal income bracket, and you're paying 18 and a half percent, or you may think you're in the 12%, bracket and payment 22.2%. Or if you're a single person, the tax torpedo can hit you when you're in the 22% bracket, where you're now paying at a 40.7% rate. So that's where people can be surprised at just how high the effective marginal tax rate is on their income and retirement.

Alex Murguia 47:05
Okay, and does that tie in to the last question? Wait, I was reading the other question. So I didn't hear your full answer.

Wade Pfau 47:11
Oh, yeah. I didn't see that. But right. There's so what's the effective rate tax rate on Social Security's tax torpedo? The marginal is 40.7% for a single filer. Yeah, it can? Well, it depends on how big your Social Security benefit is. And this is where there's not just one tax torpedo. But for single filers. They can be running into the tax torpedo when they're in their 22% bracket. And so that's what we create the 40.7% effective marginal rate. That's why a couple married filing jointly, because they're gonna get through the full tax torpedo while they're still in the 12% bracket. So it'd be a 22.2% effective marginal rate.

Alex Murguia 47:51
Okay, questions, keep them coming in? Well, I didn't see that. Okay. Do you do recommend buying tip bonds or tip on ladders in a taxable account for those people in retirement that don't have a lot of money in IRAs? What about the phantom income tax? Is it ever okay? That's almost like a planning question. But we have to look at that person's particular situation, right? And then it's like that one I bonds and how much planning to put in,

Wade Pfau 48:19
but you definitely need to look at the individual circumstances. But if the question is just more, basically, should you never buy tips in a taxable account? I would say no, there may be situations where it's fine to buy tips in a taxable account, especially if you don't have other options, and you do have a time segmentation strategy, or you do want that inflation protection, you shouldn't be scared away from owning tips in a taxable account. Just because this will the phantom income problem, which is where you have to pay taxes on the inflation adjusted principle, even though you don't receive that back until it matures. So you're paying taxes on the income you haven't received yet. They're not tax efficient. It's better when you can to have tips held in a tax advantaged account. But if that's simply not an option, it

doesn't necessarily lead you to conclude you should not own tips. Also, don't forget about AI bonds. If you have a long runway, you do have that allocation I bonds, which provides the inflation protection though at a lower level than tips generally. But at least you do get the tax deferral with with high bonds.

Alex Murguia 49:31
Okay, and wait, since we're 45 minutes in, and these are great questions, Brian, Paul, Jeff, etc. I think we can address this but I don't know what do you feel? Do you want to push through or we were trying to do 45 minute limit or podcast this season? See, we can keep to that but I'll leave it. I'll let Wade be the bad guy. Yeah,

Wade Pfau 49:56
it would be nice. There are getting to be more and more Are the live questions, so we probably aren't going to get through them all. Now we can we'll do them in the next episodes. But maybe at least one more question.

Alex Murguia 50:09
Okay, why don't you dealer's choice?

Wade Pfau 50:16
Okay, how about this Medicare related one, although I haven't fully internalized it, but okay, I'm age 63, retired not collecting Social Security and covered under my spouse's employer health care. I always make the maximum HSA contribution every year, should I sign up for Medicare Part A at 65 or defer? So that the issue here is I guess we're still assuming you're going to be covered under the spouse's employment, health care after age 65. So you have the option not to sign up for Medicare. If you qualify for Social Security, you should qualify for premium free Medicare Part A. So a lot of times the recommendation is you may not want to sign up for Part B, since you're covered through this spouse's plan. But there's no harm in signing up for Part A since there's no premium and it would be secondary insurance, if there's a hospital stay. The only downside of that is you can no longer contribute to an HSA account after your you've signed up for Medicare Part A. And so if you really value probably why they put Yeah, so that would be why this question. So if you value the ability to contribute to the HSA account, and you don't think you'd get that much advantage over having Medicare Part A as a secondary coverage, then and you are you have to do you have to ensure your spouse's health care planning, she, she or he or she is at a company with at least 20 employees and does qualify as primary coverage for individuals that are eligible for Medicare. As long as that's the case, you may defer signing up for party as well, so that you can continue making HSA contributions. So

Alex Murguia 51:55
I think the the question here is that the breakeven, not the breakeven, but the trade off better said is, okay, do I sign up for it now, and in case things go sideways? Yeah, sorry, six in case things go sideways, and I need that secondary coverage, is that worth not contributing over the next few years to HSA, whereas HSA will come into play in a more significant level later, and they could rule the roost. It's kinda like, that's what they're asked which which side to

Wade Pfau 52:27

enact. But that could also depend in part on how good the that employer health plan is, like, if it has really good coverage so that you're not really worried about a hospital stay leading to big bills, then you may not need the Medicare party at that point, as a secondary coverage.

Alex Murguia 52:43
Yeah, I think that's what I would ask internally in terms of looking looking inward. But all right way. That concludes episode one for this year, YouTube Live.

Wade Pfau 52:56
All right, yeah. And your questions, including the other live questions, we're gonna record a few more episodes, where we're going through all the questions that have been asked both today in the live session as well. And when we had that email, call out for your questions, where we've got an overwhelming response to that, so we're gonna continue to answer your questions in the upcoming episodes. Most

Alex Murguia 53:18
definitely. I think we're onto something here with just you know, getting getting more interactions with our audience members that I'm actually quite enthused, so thank you very much and long

Wade Pfau 53:27
term care as well. So that's another

Alex Murguia 53:33
alrighty, everyone, thank you so much.

Wade Pfau 53:35
Thank you like I'm far too great. 2024.

Alex Murguia 53:39
By now

Bob French 53:40
Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with the risk including risk of loss. Past performance does not guarantee future results.