Episode 108: RWS Live (not really) Answering your questions Part 2

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SPEAKERS
Wade Pfau, Bob French, Alex Murguia

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. Well, as we expected are curious bunch and had a lot of really great questions during the live way. Now Alex sat down with some that they didn't have time to talk about last week and dived in. They may not be clicking clack. But we're definitely playing stump the chump here.

Wade Pfau 00:58
Hey, everyone, welcome to retire with style. I'm way and I'm joined by my trusty sidekick and co host Alex, and we're happy to welcome you to a new episode of retirement style where we're going to continue with q&a. But before we get to that, I do understand that Alex has been serving as Mr. Mom in his household. Can you tell us a little bit about that, Alex?

Alex Murguia 01:21
Yes, yes, Mr. Mom? What was that was the sort of movie No, no, no, Mr. Mama, why am I blanking out? It was like, Batman the original. Yeah. Michael Keaton. There you go. In Detroit, I think something like that. Yeah. As you know, Wade, my wife, Christy and my mother in law, Marlene, went to Tanzania. They've they're sponsoring a school. And so they're helping out. They're actually my mother was spending three months there. And Chris will be there for food. I know. Right? For three weeks. Just getting a school off the ground for the school year. I think they started today, actually. So that's kind of interesting. And so yeah, it's left me alone with my 817 year old boys. The twins and 15 year old boy. So yeah, it's been a Mr. Mom and then some Brady

Wade Pfau 02:15
Bunch three boys and the Dan.

Alex Murguia 02:19

Yeah, right. There's a story but wasn't gonna say Yeah, yesterday I spent yesterday making it brought me back the my college days I memories of the college days were like on weekends, you'd cook for the week. You know, and so yeah, I made pork chops, steaks, chili, and rice and sausage for the whole week. So that should hold them down. Yeah, packaged it and everything's but the whole week again. So I mean, we can No, I don't know how it got me it was but it brought me back to that analysis brought me back to my days as a line cook at Chili's, where you will make like 100 pounds of mashed potatoes. Chilies actually and literate. Yeah, yeah. In the morning prep. You get it? I wouldn't get in like, oh, yeah, I would get in. No, no, that was like, I was a waiter. I was a waiter. But I was also a line cook because I want to learn how to cook. And this is like high school and liberal college. And I would get in at some in the weekends I'd get in if I didn't have a nightshift. I'd get in like at six in the morning. Six, seven in the morning. I don't remember exactly. And we start prepping. So by the time lunch is in, everything's already kind of done. And yeah, it was like 100 pounds of mashed potatoes. 10 gallons of ranch dressing. Like things like that. It was crazy. You'd smoke the ribs. you blanch the wings, you you know how to cook in bulk? Let me say it like that. So it was kind of like that sort of rehashing on a Sunday. So there it is, man. Amazing. The kids get this time. No, no blow up has has delivered down yet. So knock on wood. We'll see. But yeah, it's crazy. But I mean, Chris, he told me yesterday, she she made like 300 rolls of bread and about 500 loaves of bread as well for the kids. Yeah. She said that's going to last through Wednesday. And so Wednesday night, they have to go at it again. So it's amazing what teachers do. I mean, then they work. You know, almost like 12 hour shifts, if not more. So. Those It's pretty intense. That was kind of good. Yeah.

Wade Pfau 04:30
Yeah. Give me a chance. Yeah.

Alex Murguia 04:33
What did you do? What did you do on Sunday? Did you relax? Could you sit on your hammock and read revisions of your book?

Wade Pfau 04:40
For the latter? Trying to get that wrapped up? Gotcha. Moving along, though.

Alex Murguia 04:47
So what do we have today? Well, so we well, I know what we have so we

Wade Pfau 04:54
can procrastinate on the long term care arc because we got an overwhelming number of questions with Our call for questions for the the live session. I think we're I don't know how many episodes is going to be, but we're going to need a few episodes to work through the backlog of questions we received. And we want to make sure we address everything. So this session in particular, even on the live that our last episode YouTube Live, there were more questions asked in a live session than we were able to get to. So we want to work our way through the rest of those. And then we'll we'll proceed in further episodes to get through the questions that came in before that session as well.

Alex Murguia 05:33
No, I think it's awesome. Then we're going to turn this into a talk show.

Wade Pfau 05:39
First time caller long call.

Alex Murguia 05:42
Yeah. All right, let's let's go with the first one and start knocking it out. But yeah, wait, I'm extremely excited. Number one. It relieves us from always having to think of okay, what are we going to do next? Which we still have plenty to go through. But at least it's less work. And questions are more, more poignant, they're, they're more, the valence is high. Because you know, these are questions you folks want to answer

Wade Pfau 06:07
in your mind, and also it shows like, where we might not be fully explaining something or there may be some confusion or it's helpful to know what you're thinking.

Alex Murguia 06:18
Okay. And so, here you go. Number one, can you discuss the pros cons of purchasing a deferred annuity in the pre retirement planning phase prevents five years or so, particularly for those who are interested in guaranteed income for essential expenses? Wait, you're taken away? So

Wade Pfau 06:41
use that and there are a lot of questions about annuities mixed throughout the broader sets of questions. This one just uses the term deferred annuity rather than specifically a deferred income annuity. So deferred annuities can provide lifetime income with living benefits. That'd be like the variable annuity or the fixed indexed annuity with a lifetime income benefit, where you don't annuitize the contract, or it could simply be a deferred income annuity, where you do annuitize and lock in the income so that you know in advance what that protected lifetime income amounts going to be. And so there's pros and cons from doing that. And I guess, really, we need to try to list what those are to provide an effective answer to the question here. Now, this was in particular for those interested in guaranteed income for essential expenses. And that is a trait of being income protection. So if your retirement income style is more income protection, or potentially risk graph with the broader collection of deferred annuities, you may look at this if your total returns or time segmentation. The con is that you're probably not really interested in this in the first place. But then more specifically, pros and cons. Pros, you get risk pooling. risk pooling is a powerful source of spending that an investment portfolio can't provide. It's only available through actuarial science. It's through the annuitization. With the deferred income annuity or the living benefit on a deferred annuity that can support a higher level of income that can you be can work as a bond replacement in the portfolio to support over the long term, higher level of spending and support. And that would be the main Pro. I mean, that's why you're thinking about doing this. Maybe cons and there was another question on the list from the live session as well. Asking about cons of speeches and single premium immediate annuities, which they then list them. So for cons, we can just work through which of these are actually cons and so forth. But potential cons credit risk, or private equity industry involvement. This is just the issue of if you're relying on the insurance company to provide you a protected lifetime income stream that could potentially extend over 30 or 40 years, you kind of want to make sure that that company is going to be around for the duration of the contract to to be able to actually support those payments. So a potential drawback Wait,

Alex Murguia 09:13
when he wouldn't you want to fully make sure just kind of Yeah, fully makes sure. Well, you

Wade Pfau 09:24
know, it'd be nice to know what the company will be around. Of course, there's no guarantees that that would be the case. So this is a potential con. And now many of the large mutual insurance companies that have been around since the 1800s have survived a number of different environments and have there's a lot of regulations built into the what the general account of these insurance companies can invest in and so forth. So it's not necessarily a high risk, but it is nonetheless nothing's 100% safe. And that would be one potential drawback of using an annuity and the private equity industry involvement. There are some other questions that came up about this with the Bermuda Triangle. And we had Carrie Pachter on the show, one of our past episodes where he talked about that as well. That's the

Alex Murguia 10:10
potential. Now, that Bermuda Triangle doesn't mean that you choose to get on a plane. And because you have an annuity while you go over there, and the Bermuda Triangle, the magnetic force gets lost than you think it's more has to do with some loopholes that private equity companies are doing with regards to investing the proceeds from annuities, etc, etc. But that's for another time. But, you know, I mean, on a relative basis, relative to the risk of the stock market, it's it's apples and oranges. Now, that being the case, I have a question that the spurred for me Wade, because look, I'm, I'm 51 just turned 51. Wade, December 26. So whoever wants to send us Thank you, buddy. Thank you. I think I think you did it on teams. There you go. Thank you. Thank you for that special touch. You know, me people don't know this about you. But Wade is such a great guy. I mean, he gave me a thumbs up on teams made my day. But what's that? What are your thoughts on this? Because I'm going through this and I, you know, deferred annuity kind of sings to me, but so does a que lac. If somebody's thinking about a deferred annuity, and also kulak, do you think that one cancels out the other? And so just get one? Or could they get both? And then another follow up question I have for you from this would be I know the answer. But I like it. When you go through the ins and outs of it. What happens if I die before the income starts coming in? At my law? Am I at a loss from that money that I that I used to purchase the annuity? Or take

Wade Pfau 11:50
it from there? Yeah. So with the qualified longevity annuity contract, that's you can purchase it inside of an IRA, and then extend payments past the date that required minimum distributions begin and get a little extra tax deferral for that reason. But whether like, Well, how do you manage the credit risk of the contracts, one way would be to diversify between different companies. And so in that regard, you can purchase a kulak with one company and there's a limit for Culex of $200,000, this year is a premium to go into those contracts, you can then also use annuities with other companies as well. And then you're at least not fully exposed to, if one company goes under, you lose everything you would may just be at risk with relation to what you put into that particular company. Now, there are state credit guarantees that for annuitize contracts, that can provide some protections up to certain limits of premium levels within each state. But yeah, that would be a way to just diversify between different companies to help offset the potential risk of of credit risk. You did mention the risk of early passing, and that was also on the list of potential drawbacks from annuities. Now, that that's the whole concept, it's risk

pooling, those who don't live as long will not get as much out of the annuity, those who live longer will get more out of the annuity, because they receive more payments from it. And so you are accepting that sort of risk by entering into the contract. But in doing so, you can support a higher level of spending throughout your retirement because you're going to be paid closer to as though you live to your life expectancy, which could be in your early to mid to late 80s. Rather than if you're worried what if I live my money and I have to behave as though I might lift into my 90s or even 100, that would mean spending much less. And so though you accept the risk that you will not get as much out of the contract, if you do not live very long. Those years that you were alive, you get to spend at a potentially higher level, because you know that money is going to be there for you if you do live longer than average. And so I don't I mean, it's a risk that but it's offset by the benefit. And when you think about the liability, you're trying to fund it for retirement, I need to fund my expenses over and unknown time horizon. Well, if I don't live very long, it's not going to take as much assets to fund that expense. And so use of an annuity in that context, in the short run could reduce legacy value for assets. But once you start getting past life expectancies, as more and more that spending is covered through the risk pooling of reinsurance, it might actually increase the legacy. And so it's more flattening the legacy over time, and that that's how you might assist that particular aspect of it. Okay. You could also add a cash refund provision as well so that if you do not live long, any premium that you did not receive as benefits you could, could go to your beneficiaries. Now if you do that it's going to have a lower payout rate which just you did not offer as much risk pooling to the risk pool. So you do not get as much out either. But that could be a way to offset that risk of early passing for those who are worried about that. And in reality, there are very few life only annuities that are sold most have some sort of refund provision of some sort included in the contracts, because people are worried about not living very long after paying a big premium for an annuity.

Alex Murguia 15:21
Okay. And on that just because I had a buddy of mine, I, you know, when we did the LinkedIn live, I sent out a link to a bunch of friends who are always asking questions, I said, now's your chance, and one of them couldn't get in. But since we were talking about this annuity, just to get this one out of the way, his his question was, effectively, are there you know, are there any hitting fees or anything like that, not just with a deferred annuity, but just with a standard annuity. And I think this goes back to a little bit of the marketing. Influence, if you will, that effectively equates annuities are bad investments or good. I personally think when you view annuities not as invent annuities can't be viewed as investments, they're effectively an insurance product. They're just the reverse of a life insurance policy, if you will, you know, things like that. But it's an insurance product. And so it's price as an insurance product. When you compare it to like the expense ratio of a mutual fund. It looks egregious, but it's a different thing. You're paying for something different, now handed off to wait to take that home.

Wade Pfau 16:30
So yeah, the potential downside or came out here is annuities may have high fees. And that yeah, like hidden fees, or gotchas that requires a little bit of unpacking, because a lot of times when critics of annuities start talking, they are creating hybrid annuities that don't exist. So for time out, a simple income annuity. Now a drawback of a simple income annuity is it can be that irreversible decision, you annuitize a contract, you don't have access to the funds anymore. But those do tend to be pretty low fee. And it's not, there's not an external fee. It's a spread product in which, just like if I put money into a checking account, the idea that the bank can loan that money out at a higher rate of interest than they're paying me for depositing my funds at the

bank. And that spread is how the bank can make money. And they may have various fees for different things, but you could have a no fee bank, that still makes money just to this spread. And that's also how income annuities or fixed annuities work, which is you pay that premium, the insurance company will be paying interest as part of its payout to you. But technically speaking, they're earning more than they're paying to you, they're keeping some of that spread for themselves. And so it there's an internal fee in that regard, but there's not an external fee. Now, variable annuities do tend to have fees. And you have to just look at what those fees are covering. Part of it is for insurance protections, if you're have a lifetime income, that's a valuable attribute that you need to pay for. Now, there are currently fee only annuities that don't, they're going to have lower fees because they don't have to bake in a commission to be paid to the advisor. But a traditional commission based annuity may have a higher fee drag on it because insurance company has to pay the advisor. Now a financial advisor who charges a percentage of assets under management has to they kind of it gets a little squiggly for them in terms of saying you should never look at a annuity because it has high fees when the reality is those fees are just in large part to pay an advisor which the advisor is probably also charging fees as well. So it's not necessarily a critique of annuities specifically, but it's the variable annuities that do tend to have the higher fees.

Alex Murguia 18:46
Okay, but again, they're for things that you're paying for, they're not like, Okay, this annuity all in the fees, or I'm gonna get up 3%, whereas the mutual fund is at a bips. Point 8%. What gives? What gives is that you're you're paying for the protection, such as the living benefits, the annuitization option, etc, etc. There it is. Next question. Have you thought through the various issues and risks when one partner retires much earlier says eight to 10 years than the other? Especially if it is a primary earner who retires early? Sounds like someone wants their spouse back to back at work?

Wade Pfau 19:27
Yeah. This question is to clarify if the reason for this is because that primary earner is older, is this person eight years older and retiring eight years earlier? Are they the same age and one person's retiring eight years earlier? But I think the risks here aren't necessarily as much on the financial side is just on the potential for relationship dynamics. And I think you're hinting at that a little bit like if the primary earner has retired and the secondary earners still working in that primary earners at home while they They may have certain expectations that are not being fulfilled, or whatever the case may be that I just I would be thinking more about potential dynamics in that relationship. For that reason.

Alex Murguia 20:14
I was I was thinking of it. I mean, I was just joking about that. But

Wade Pfau 20:18
a real issue, though, I think, yeah, like,

Alex Murguia 20:21
I don't want this person around for eight hours a day, well, you know, etc, I was thinking a bit more like, okay, they're going, they've effectively extended their retirement, if they retired 10 years earlier than expected, they've extended their retirement by 10 years. And so there are extra risk. I was just viewing that, as you know, to the degree that you're relying less on human

capital and more on your investment capital to draw retirement paycheck, that obviously increases the risk that you have in retirement, specifically longevity, liquidity issues for like spending shocks, and, and potentially, you know, longevity, health care issues that you could have that you may not be able to draw on from a work standpoint. So yeah, there are increased risk, but I'm assuming their retirement wasn't involuntary. It was voluntary. And

Wade Pfau 21:17
that's if, if this person is an early retiree, they have then design or financial considerations. If they're retiring at a traditional age, but they're just older than the other spouse, then they still have the same sort of planned time horizon ahead of them. Now, just one point, the primary earner if the primary earner is significantly older, that creates a much stronger case for delaying Social Security to 70. Because the survivor benefit in that record could potentially it lasts until that younger spouse passes away, which the older spouse may have been long deceased by that point, but if that person was going to be 110 years old, when the younger spouse passed away, that benefit is around for a very long time and would support delay of Social Security quite strongly.

Alex Murguia 22:06
Okay. Excellent. Well said, good man.

Bob French 22:11
If you're looking for more personal advice, please know that our show is sponsored by McLean Asset Management. Learn more at McLean am.com. That's mcleanam.com. But clean Asset Management is a wealth management firm where we help you design and implement the right retirement plan for you.

Alex Murguia 22:32
Roth conversions are effective only if one can predict accurately, the marginal tax rates are going to be higher in the future. Why is this disclaimer never mentioned during discussions about Roth conversions? There's there's two things for me to say wait, it's not just that tax rates are going to go higher, it could be that your own tax rate, it just happens to be in a higher bracket than what you are now in the future, etc, etc. To me, I don't why is this disclaimer never mentioned during discussions about Roth conversions? To me, it's the linchpin of Roth conversions. But

Wade Pfau 23:14
where do you want to? Yeah, that's where it's good to get these questions to make sure everyone's on the same wavelength. Because this is part and parcel of the whole, the underlying assumption of why we're even looking at Roth conversions is to try to find opportunities to pay taxes at lower rates, which by definition, then means you're only doing it if the rate today is lower than it would be at a future point. So it's like, this is the entire reason. It's I when I don't know how you lose this disclaimers, it's not that people are just talking about Roth conversions for the fun of it. It's they're doing it to pay lower taxes. And so that's I don't know how to like, why do we need that disclaimer. I mean, that's what we're trying to do in the first place. And it is important, what came out effective marginal tax rates. So that's where the Social Security tax torpedo. The surcharge is on Medicare, the loss of subsidies for the Affordable Care Act, if you're getting health insurance, that way, the stacking of preferential income on ordinary income can all lead people to face higher tax rates than the federal income tax

brackets would imply. And that's what we're trying we're looking for opportunities to pay taxes at lower effective marginal tax rates.

Alex Murguia 24:26
Yeah, the whole reason this whole reason for the Roth conversion to me, I'm gonna exaggerate to make the point here. But that's like saying to live you need to breathe air to

Wade Pfau 24:37
why don't we tell you that every day what this question but by asking you don't just do Roth conversions because it's an exciting thing to do. You're doing it? I think the opportunities to pay lower

Alex Murguia 24:55
taxes. I would think the person got you know, you got to Also think about where we're coming from it, we live and breathe this stuff to take the air example, right? And maybe, you know, we're too in it. And we need to take a step back and just the basic underlying assumptions. And I think perhaps maybe this person got some bad advice. And they just said, Hey, transfer, you know, do a Roth conversion, because you can now have a tax free forever and ever, but they didn't realize that there's taxes to be paid that, and it doesn't make sense to pay them now versus later at XYZ tax rates, it could have been lazy thinking, you know, behind an Advisors decision to do that. And that person is now once bitten, twice shy about this kind of stuff. And

Wade Pfau 25:36
it's the same argument, even prior to Roth conversions is should I contribute to a traditional IRA or traditional 401 k or a Roth IRA or 401k? Well, that decision also depends on when can I pay taxes at a lower rate today versus the future? In which case I should contribute to the Roth today? Where am I paying taxes at a higher rate to a higher rate today than I will be in the future? In that case, get the tax deduction today by contributing to a traditional account?

Alex Murguia 26:04
There you have it. Okay, so I'm going to read this one, because you're gonna have to digest it while I'm reading it, because it's, it's a, it's a paragraph here. Again, only retirement researchers do this. Hello, I am a 65. I have a 65. I gotta get in character, I gotta get in character again. Hello, I am a 65 year old recently retired physician. My wife is a 61 year old physician who is still working. You know, at the end of this, I want to see if saying that you're a physician is relevant to the story, but that's fine. My wife is a 61 year old decision who is still working likely for one or more years, her and my estimated monthly Social Security payments taken at full retirement age will be approximately equal. Both of us are in good health. We are financially set and do not need to take Social Security early to support retirement, we were thinking that both of us should begin Social Security payments at age 70. However, when I tried the online open social security tool, it recommended that I begin Social Security at age 70. But that my wife begins Social Security at age 62. I am trying to understand whether this whether there is an actuarial reason, or otherwise, she should do this. In particular, given that her Social Security payments would be similar to mine and not less. Thank you.

Wade Pfau 27:39
Okay. And yeah, so probably the reason I've seen the wife to be, are there is the age difference, too. Yeah. Okay. So sometimes when you get to good strategies, there's not a whole lot of

difference in the ultimate lifetime results versus when you're comparing a good strategy to a bad strategy. The bad strategy here would be to both claim and 62. If you both live long enough, the best strategy would be to both claim at 70. But I think the reason the open social security tools suggesting one claim at 70. The other 62 is the survivor benefit is still relevant. Now they both have about equal benefits. So there's no spousal benefit at play here. But there's still a survivor benefit, that when the first of them passes away, the the higher benefit becomes the survivor benefit. So by having the younger spouse claim at 62, they're going to have that lower benefit at that point for as long as both of them are alive. But as soon as the first in the couple passes away, the individual who's delayed till 70, the older spouse, that becomes a survivor benefit. And so then the breakeven age on on this particular having the low earner or not, it's not a low earner in this case, but about equal earner claiming earlier, it doesn't make that much difference. Now, I do think the Open Social Security tool uses longevity estimates that are more in line, if I remember correctly, they use like the Social Security life tables for the average American, which doesn't have as long of longevity, and therefore it might just come out slightly ahead to have in this case, the wife claim is 62 instead of 70. Whereas if you change the longevity assumption, and you put that you both live to 90 or something like that, that might be enough to switch it over to both claiming 70. But but that's basically the issue.

Alex Murguia 29:39
I think that's what's happening Wait 100% Because, let's say I'm gonna assume that my sort of simplifying assumption is is that the younger one is female, the older one is a male. And so let's say there's a seven year spread between their life expectancy. And, you know, but she's collecting at 62 as opposed to 70 in May limit, it just makes that breakeven calculation harder to hit. And so yeah, if they're both dying in the same time, I can see that, yeah,

Wade Pfau 30:07
eventually, with the fact that he's older and male, his, she will probably outlive him. So his benefit will become her survivor benefit. And I'm guessing probably has benefited me even though they're approximately equal, his might be slightly higher. So she's just going to have that lower age 62 benefit until she gets the survivor benefit. And at the end of the day, it's not going to make that much difference whether she cleans at 62 or 70. But he should definitely clean it

Alex Murguia 30:35
was what was one, a pediatrician and the other one? All right. What's the next one here,

Wade Pfau 30:45
just if you go back to the tool and use flip off the Social Security life tables to enter your own longevity data, I'm guessing that if you just put in your book lift a nine B, or if that doesn't do it yet, soon, 9192, somewhere right around there, it will make that flip to tell you to both claim at 70. But at the end of the day, it's not going to be that much difference between these two strategies, whether the husband claims a 70, whether the wife claims at 62, or 70, is not going to make that much difference to the lifetime benefits they receive.

Alex Murguia 31:22
And that goes back to your first point as long as you don't make the quote unquote bad decision. Don't Don't worry too much about the least good decision. Right? Something like that. I can you dress spear annuity trap bow

Wade Pfau 31:38
and we kind of pack that's the universe. Yeah, maybe we did.

Alex Murguia 31:43
Insurance credit. Yeah. You when you talked about the triangle and all that. Okay. Next one. What do you think about investing in small cap value index funds, and large cap value index funds as a portion of your stock investments related to the farmer French three factor model? A kick this one off weight? And you can go about doing this? It depends on we kind of answered not answered this. But we gained momentum in the previous q&a. When we were asked about US International, right. I personally, am fine with factor investing. I do think there's a story there that's systematic and not necessarily one of these things that disappears. Once it's seen, you know, whether you buy it as a risk premium, or whether you think it's a behavioral sort of gap within there, it's it's persistent, and identifying it doesn't disappear now, over the last 10 years, you know, you've had egg on your face, if this is something that that you promoted. Right. But you want to look at a couple things, whether it should be inclusion, whether there is whether you should include this within your portfolio. I mean, I don't think something fundamentally has changed with regards to economics and the risk reward concept. I think there's something to be said for that. And I do believe value stocks have that sort of risky component. Now, risk is not necessarily, but when I when I define risk, you know, it's cost a capital argument, right? value stocks are fundamentally cheaper, and they're cheaper for reason, because there's some inherent risk involved, right? And so should you be compensated for that relative to other stocks that are deemed as more safer investments? I personally think that's a good bet, to take over the long term. That being the case is now the right time to get into value or not, and things like that. I'm gonna sidestep that because I can say yes, and five years go by doesn't show itself and doesn't mean that I was wrong, or I was wrong, I still think it's going to be there. What I would say is, you want to ask, Has the fundamentals change in the terms of has value gotten cheaper relative to growth? And if it's gotten cheaper, is it because of some fundamental issue that has going on from an accounting standpoint with the stocks? And what I mean by that is the spread between value stocks and growth stocks continues to widen. From an accounting standpoint, that means value stocks are more value than growth stocks than they've ever been before that that spread is there. And why is that? You could ask because the earnings just aren't there. And the price goes down to such an extent that it makes a more valuate. Or the other way is the earnings get better. But to some extent, it's not reflected in the price. Hence, they're there. They're more value driven. And that's what you see a lot. That's what you're seeing a lot. You know, the spread is high, but you see it because of that, that value stocks are still fundamentally sound sounder if you will, than they were in the previous years. They're not like hitting rock bottom, that's why they're there. You know, they're excellent buys, it's just their price hasn't hasn't yet been reflected in their earnings capacity, and relative to growth. So they seem, you know that there's a higher dispersion between them on the, on the performance side of things. And so that being the case, I, you know, I'm more sanguine about, about value stocks and before but, again, this is a restore, you need an investment lifetime to be able to accomplish this. So I personally, am personally, so you have to, you know, assess your own situation, I see nothing wrong with exposing your portfolio to these factors. You know, I think more so than before, frankly. But that being the case, there's nothing wrong with the market portfolio, because the biggest investment decision you will make will not be, you know, what's my value to market split? Or what's my size split between large and small, the biggest decision you will make for an investment portfolio will be stock, the bonds, that's going to really be the main sort of thing that the variable that will guide your investment returns after that, you know, you're looking at more,

not icing on the cake. I think that's a little too cute. But you're looking at more secondary things that could help juice those returns. And yeah, I think value makes a lot of sense. I think size makes a lot of sense. And especially after the last 10 years of underperformance relative to growth, because they haven't, their fundamentals haven't been degradative More, they're not like now they're almost bankrupt. It's more that, you know, their earnings have continued to, to maintain it's just, it makes it look poor relative to the growth stocks out performance right now.

Wade Pfau 36:50
Wade, you're in that's more of a bob or Alice question. But just in my own case, I do tend to be more of just hold the total market portfolio. But I also bought into the idea that with the Roth account, that's where you think more about the higher potential returns, but less tax efficient asset classes and money in the Roth, I may not be touching for 40 or more years. So I did buy into the idea that having an allocation to the small cap value and emerging markets, which have been underperforming in recent years. But since I'm kind of in for the long haul, not planning to touch that money for a very long time. So I do have that weight over waiting in that regard by having those funds in my Roth account. But I don't think it's necessary, and it's just more what you're comfortable with. And and otherwise, for the most part, I just use total market funds.

Alex Murguia 37:41
Yeah. Again, there's, like I said at the beginning, you know, there's no reason, you know, any deviation from if you're talking about now, us total stock market global could be different, because you know, you spend in the US, but if you're looking at a total US stock market fund, there's nothing wrong with that. You can't you can't say that's bad on merits. You know, any deviation from that is a bet. And so here, this is a bet that value will perform, because they're inherently riskier than more stable companies. And there should be an expected premium for that. You know, but that's an investment horizon and investment horizon is, unfortunately, a 30 year plus horizon. It's not something that he didn't work out for 10 years. So this premium is BS, but it doesn't work like that. Yeah, there it is. Next question. In what situation could a l i r p, life insurance retirement plan, be a good investment for retirement can

Wade Pfau 38:42
that's yeah, ulurp is preferred pronunciation of that.

Alex Murguia 38:47
So there you go. lurpak, Irma, are getting together and are getting married.

Wade Pfau 38:53
If you start raising them at these alert plans, they usually spend a lot of the setup talking about the national debt and how tax rates need to be much higher in the future to pay for that debt. And that's a big part of the story. You have to be facing high tax rates before using life insurance just to create the tax free income sources becomes a truly just worthwhile in and of itself. And that's that's kind of the story. The belief that taxes will be much higher in the future. So you're better off paying for insurance fees and things because none of that the fact that you can develop a life insurance policy that will support tax free distributions. Will Will the tax benefits outweigh the costs. Now if you're not in a very high tax bracket, or whatever the case may be later in life, or if you do good tax planning so that you don't have that big IRA to generate those big RMDs for you later in retirement and so forth. And it may not be necessary, and certainly wouldn't advocate for the use of these alert policies. specifically, but I also can't

entirely dismiss them that life insurance provides tax benefits. And if that's something that can be advantageous to you, which to be an, you'd have to be somewhat wealthy for this to be an issue in the first place. But to the extent that this could be a benefit to you, then it's something definitely people can look at.

Alex Murguia 40:21
And on orders of magnitude, what do you mean by wealthy? Because the person who's listening in who has $2 million, that doesn't think he's wealthy, the person who has $5 million, doesn't think he's well, the person who has $10 million? doesn't think he's, but what levels are you talking about?

Wade Pfau 40:35
Yes. So what would be the wealth levels, it's really you've got to be in the higher tax brackets in retirement, when you no longer have work income. And that requires having a lot of taxable income, whether 400 500 $600,000 of taxable income in retirement. So we're talking about, and I didn't really do background research to say what is wealthy in this context, but I'm a lot, it's an approximate guess, I'd probably say somewhere around $10 million, would be where we're maybe a little less than that eight to $10 million, where you might start looking at the potential for benefits from LARPing. There's some sort of expression use look like, Look, before you leap or leap before you learn or before you start learning your retirement. You probably want wealth levels in that range.

Alex Murguia 41:27
It sounds so much like I can't I can take it seriously. And then can finish it off with this one. I can get 6.3% on a seven year Maiga or 6%. On a 10 year Maiga. Should I replace half of my bond portfolio with his guaranteed asset? Well, before I answer that

Wade Pfau 41:57
question, I thought that another direction that came up recently with our retirement Research Academy, someone was angry about this point that why can I get a higher interest rate on a shorter investment than on a longer term investment? In the answer, one, that usually the longer the maturity, the higher the interest rate, but we do have a bit of an inverted yield curve right now, which is suggest that the markets expect short term interest rates to decline in the future. So that if you bought that 7%, or seven, year Maiga, at 6.3%, when it came to renew in year seven for the next three years, you'd be getting much less than than 6% at that rate so that you're somehow not better off just going the seven year route. Getting that out of the way. This question is getting into we have to be careful about we can't recommend specific strategies to listeners, you have to go through a financial plan. So should I replace half of my bond portfolio with this guaranteed asset? We really can't say it's a consideration you have to think about what are the drawbacks of the mic? I mean, the benefit here, I guess, the suggestion is this is yielding higher than they could get with other bond alternatives. It's yielding higher, there will be surrender charges, if you need to get your money back out of the contract sooner. There is that whole Bermuda Triangle issue that's impacting my goals, where now this is a shorter term horizon. But you may have some concerns about the viability of the insurance company offering if especially if they're offering yields, notably higher than what other bonds are providing. And another benefit of the MAGAZI get the tax deferral compared to bonds in a taxable account. But that would be how you'd really want to be thinking about this, is it worth locking up that money for this time horizon facing potential surrender charges and credit risk to get that higher yield

compared to what I could get with other bond assets? And we're not able to answer that question for you. But But those would be the issues to think about.

Alex Murguia 43:58
I would I would add to this here, and I say one of these things, depending on your research style, right? I I'm always promoting, hey, look at the household, look at the household portfolio, don't worry about buckling your portfolio, because at the end of the day, it's all one asset on your balance sheet. It's not like, you know, broken up. But I do feel strongly that if you're in a total return strategy, then I kind of get away from looking at individual bonds are, you know, remember the same token individual like my guys or something like that. And you're taking a distribution from the entirety of the portfolio, and then bonds, I wouldn't look at them from the standpoint of how can I eke out greater yields? Hey, this one has a 5% yield and this one has a 5.5% yield. So let's target that one. Even though you're you're doing a total return approach. You know, I think that leads to ultimately bad behaviors because you start getting falling into this yield creep. and you start losing focus on the overall portfolio and bonds are the ballasts to keep the equity, volatility in check. And that's my number one sort of priority. So to the degree that you can do that, then fine, but I wouldn't do it because oh, it has a half, half percent greater yield and so forth. Because ultimately, look, yields come from somewhere, someone's taking the risk. And so you have to respect that. And within a total return portfolio, bonds are just, you know, they're supposed to deflect the volatility, you know, if you want returns, do it from the equity side, you know, that kind of thing. And I don't, I don't mess around like that, not to the degree that you're asking this from a time segmentation perspective, and the like, and this is for income, direct income purposes, then I think Wade, Wade answers is as good as any way. The I make sense.

Wade Pfau 45:55
Nailed it. All right.

Alex Murguia 45:56
Thank you. Thank you. That was the end of the veto song, and get back. I hope you enjoyed the audition or something like that. When they did Abbey Road at the end of Get Back, John Lennon does you know he you know, he's a bit of a smart, smart aleck. And he was like, I hope you appreciate the audition, you know, after after their song. Yes, thank you. Alright, I think that's good for these next sets of questions. We're in our newly established 45 minute mark. Anything to add with? No,

Wade Pfau 46:37
I'm just we're going to have more of these episodes. And actually in our next episode, we'll get to what we were planning for the original Live episode last week. And we we still have a lot of questions to work through. So it's fun to go through everyone's questions and we'll we'll continue to do so with the next few episodes. Thanks, everyone, for listening. All

Alex Murguia 46:55
right. All right, everyone, have a good day. Enjoy your time. Bye now.

Bob French 47:01
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