Episode 50: Navigating the Retirement Income Dashboard

Bob French 00:00
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Alex Murguia 00:51
Hello, everyone, welcome to Retire with Style. I'm Alex and I'm here with my trusted companion Wade.

Wade Pfau 01:00
Hi, everyone.

Alex Murguia 01:03
And last episode, we spoke, we sort of did an investment, heavy market review year end market review. And while we made a point to talk about that luck within the context, it's really not a big deal. What happens in the last 12 months based on the the earth revolution around the sun? Or is it the sun's revolution around the world? Earth? Right, Copernicus. Yeah. But we, what we try to do is what's the context and then how to really interpret it, and what Wade, Wade has created a for a few years now he has this these running indices so that I think, really provide excellent context of how you can take what's been happening and introduce it within a retirement income lens if you are viewed within a retirement income lens. So today, we'll take the market returns last year and take it view it through a glass darkly. No I'm kidding, and just reviewed within the context of these retirement distribution rules, and Wade do you want to take some time and and just start laying the groundwork for this?

Wade Pfau 02:16
Sure, sure. And so right, this retirement income dashboard, I believe we started in 2015. It's been quite a while it's, it's been available. It's not something that I used to update it quarterly that I think before January 2023. When I updated it, I had last been updated in April 2021. So it has been a little

Alex Murguia 02:37
Wade that I think there's an inverse, in terms of the number of emails you get relative to him. The amount of times this has been updated. You know, is it since 2015. And now I mean, you you've kind of blown up in a good way. Oh, yeah, that could be Yeah. And because of that, I must say, Wade. I'm noticing we now are putting these podcasts on on YouTube. And we got a great review. But they did say hey, we're talking too long. So this is an exhibit of that. But another one YouTube. Wade, did you cut your hair recently? I think you're due for a haircut. I've never seen you with this long.

Wade Pfau 03:11
No, no, I got a haircut. Actually, last week, I really had much longer hair. This is the first haircut I've gotten. I was noting in almost 20 years. It wasn't just a simple buzz cut.

Alex Murguia 03:22
Oh, really? Did you drive with the windows down this morning? That or something?

Wade Pfau 03:26
Yeah, I did wear a hat when I took my kids to school this morning. And I may not have Yeah. It's kind of the judge,

Alex Murguia 03:38
It makes itlook hipper. Sorry, I digress. Wade. So I've been updated to 2015. You were updating them quarterly. Take it away.

Wade Pfau 03:54
Right. So it's really there's two different aspects of the retirement income dashboard. And the top part we'll talk about first. And that's I thought a really cool concept it it didn't take off necessarily. And the way that I thought, wow, this is revolutionary back seven years ago. Maybe it still has some potential. But I think it's a really interesting idea. We'll talk about that first. And then the second part of the dashboard is getting into all the numbers that if you were looking to build a retirement income strategy today, how much could you get through a bond ladder through an annuity through a distribution strategy from an investment portfolio? And that's what the dashboard is all about. It relies on the idea that as interest rates fluctuate, in particular, and probably most importantly, that impacts sustainable spending from bonds from annuities from an investment portfolio. And so tries to put some context around that idea. And that sort of discussion gets in the news a lot with Morningstar. I was part of the original Morningstar, study back. Again, this was maybe 2013 2014 that's since been taken over after David Blanchett left Morningstar by some of the other folks there. But they provide updated numbers on safe withdrawal rates. And they talked a while back about a 3.3% withdrawal rate, most recently a 3.8% withdrawal rate. And it's the same sort of context or concept of what the retirement dash income dashboard is doing, which is just providing that sort of update on sustainable spending strategies. It's based on the market environment that changes over time,

Alex Murguia 05:29
To your point where there's there's kind of these two start of the year reports that come out that kind of get headlines for the week and then die off where there's three things. The first one is always people have fun, always pointing out how wrong people were the previous years, in terms of their forecasts, you know, there's always said that you can always look forward to every year right. The best headline I saw was profits and losses, but profits spelled as in like, a biblical prophet, if you will. The second sort of article that you see pretty consistently at the start of every year is what's the expected return of the stock market going forward? Because New dividends, P E ratios, etc. And then the third one, that's a new comer that I'm seeing now, more and more is, is this is what's the safe withdrawal rate right now? Yeah. And so I think you were ahead of the curve, you know, with regards to that, you know, I think this, this, this is, this is an important part. The other thing is, we're talking about a dashboard, just so you

know, it, this is on retirementresearcher.com, forward slash dashboard, retirementresearcher.com, forward slash dashboard, we'll put it in the show notes. But this is actually a great resource. If you're an advisor, it's a great resource, to get to start getting like quick and dirty numbers in to get an assessment of things. And if you're a consumer, it's a good, it's a good reality check. You know, you know, from a savings standpoint, and from a distribution standpoint.

Wade Pfau 06:56
Yeah, and if it that slash dashboard is too much to remember, if you just go to retirementresearcher.com. There's a tab along the top of the webpage, it's home about articles, resources, if you hover over resources, the dashboard is on the bottom of the list there. So it's pretty easy to get to it is freely accessible. It's not behind any sort of paywall or anything. And it's updated somewhat infrequently, but it gives you that look at where we are in terms of sustainable spending in retirements over time, and provide some historical context around that. And that being said shall we begin? let's go down the list. The first one is called the retirement wealth index, I think to keep it consistent, maybe a description of what that is, what are some assumptions? And what did the numbers say? What do you think Wade? Yeah, and this, I thought was a pretty neat idea back again, going back seven years,

Alex Murguia 07:52
it still is Wade, it's still, it's still is. You're doing God's work.

Wade Pfau 07:56
like having these. It didn't, it didn't catch like wildfire or anything, but it's there. And it's, the idea is to just provide some sort of benchmark around if you've been saving consistently for your retirement, how much should you have saved up? And how would that compare on a historical basis to people who are following the same sort of investment strategy as you but just had different market returns, because they were saving at different periods in history. So it's a pretty simple ideas you'd have it doesn't translate directly in any real world situation, but it's an index, it's, for the last 30 years, I've been saving for retirement, my salary has grown with inflation over the last 30 years. And I save 15% of my salary each year. I invest it save and invest over that 30 year period. And I invest in a target date fund and the target date fund strategy is reflective of kind of the average target date funds that you'll find out there with and it's the idea you invest more aggressively when you're 30 years away from retirement, and you work your way into a less aggressive stock allocation, as you get closer to retirement. And then it's just reflecting.

Alex Murguia 09:11
No, no, go on, go on.

Wade Pfau 09:12
Yeah, how much wealth do you have at your retirement date. And in January 2023, you would have had about 9.8 times your final salary. Again, with these simplified assumptions, you've been investing for the last 30 years, saving 15% of your salary a year, investing in a target date fund. Doing that would have allowed you to accumulate 9.8 times your final salary. And that is on the low side.

Alex Murguia 09:39
So let's put this in one more perspective. So I'm a 35 year old person and I'm gonna save for the next 30 years until I'm 65 When I retire, I'm gonna you have to start a number so you pick some sort of basic number let's say 100, grand or whatever. And you start saving right from 35 to 65. Consistently saving for 15% of your salary and your salary is affected by inflation. Correct? Okay, so then it changes, right. So at the end, I'm 65 years old, and that, that that that $100,000 salary is now whatever. But more importantly, let's say the 100,000 salary is Inflation Material. Right. And so you still are making $100,000 35 years later. That what that saying is your wealth would then be nine point 9.8 times that $980,000? Way, correct? Yeah, whatever the final sale, or whatever the final salary is times that's how much it would have been 980 980,000. Sorry, no, no, that's fine. That is at the 17 percentile. That means that that number is lower than 83%. of any other 30 year periods since 1950. So Correct.

Wade Pfau 10:58
Yeah, those 30 year periods are calculated since 1950. So using data going back to around 19.

Alex Murguia 11:03
Okay, so interestingly, imperfect, no, no, no God.

Wade Pfau 11:08
Well, that the highest that ever was, was just slightly past January of 2000, when you would have had more than 19 times your final salary. The lowest that ever was, was back in 1982, when you would have only had about seven times your final salary. And really, the only times that you would have had less wealth than at the present was that gap from the late 1970s. Through the mid 1980s. During that period, you would have accumulated less, and also slightly in the early 1950s,

Alex Murguia 11:41
When he means less than what you would end up with right now. Remember, this is

Wade Pfau 11:46
less than now.

Alex Murguia 11:47
Yeah, 9.8 is a low number, historically speaking, okay.

Wade Pfau 11:53
And any other point, you would have had more and even a year ago, so in early 2022, that number was about 11 and a half times the final salary.

Alex Murguia 12:02
You know, it gets me upon looking at this chart, because there's a lot of variability here, right? We You're right. I mean, in the like, right before the.com crash, if you would have followed the same discipline strategy of saving, you would have had roughly 19 times your salary, whereas now you do the same discipline, save, and you only have 9.8 to 10 times your salary, same consistent discipline strategy, it doesn't mean that the one that the person that did it now is wrong. It's just how much fortune

plays into, you know, your retirement account. It's interesting, it's still, you know, it's not for the long term, yes. And it's still better than just doing nothing with it, not saving, etc. But it's funny how Wade, how it's funny, not in a comical sense. But just interesting.

Wade Pfau 12:47
It illustrates the the lifetime sequence of returns risk, because these are people who are behaving in an identical manner. They're theirs, they're great savers, saving 15%, a year for 30 years. And it's just what was the sequence of returns they got if if they retired in 2000, they've got almost 19 times their salary saved up if doing the same strategy. If they retired in 1982, they've got about seven times their salary saved up. It's a big difference. And it's, we talk about sequence of returns post retirement, but it applies pre retirement as well. It's kind of what were you in a lucky scenario when you're doing your savings? Or were you in the unlucky type market scenario. And it's, the market returns close to the end of that 30 year period, matter a lot more, because that's when you have all your savings accumulated and you've put money into the account and all your savings are being hit by those returns, compared to early in your career when you haven't put much into the account yet.

Alex Murguia 13:42
Yeah, you're right. I mean, this is the worst time, then the 70s through the early 80s. And the the start of the 1950s. Really, this is comparable to those times. Yeah, sorry, everyone, no, one of those things. And why does this dovetail into what you called, in the next graph, the retirement affordability index?

Wade Pfau 14:08
Right, so the retirement affordability index, and actually there's some good news, kind of not great news necessarily.

Alex Murguia 14:16
Want to keep it consistent, no no I'm kidding.

Wade Pfau 14:21
Now, but that's taking your wealth number, and kind of just doing a simple calculation on what sort of like annuity income stream could you generate with your savings? Not that you're necessarily it's not the recommendation to buy the annuity from that, but just where where interest rates are, and how that impacts what sort of sustainable spending strategy you'd be able to do. And with the retirement affordability index, the fact that interest rates did come up quite a bit in 2022. Kinda leads to an interesting scenario. So the replacement rate, and this is still not a great number, it's 38.7%. And what that means is based on the fact that you had in January 2023 9.8 times your salary saved up, when you turn that into an income stream based on where interest rates are, you could expect to replace 38.7% of your salary or to put numbers on that if your salary is $100,000. At retirement, you'd saved up $980,000. And you could expect to have an income stream generated from that $38,700.

Alex Murguia 15:30
So if you wanted to buy a personal pension, hey, I don't work for the school, I don't work for whatever some government agency, I don't have a pension, I want to buy a pension. This is the going rate of what you could get your 980,000 right now will buy you roughly 38.7 $38,700 worth of income a year.

Wade Pfau 15:51
Yeah, and that's inflation adjusted. I didn't mention that which today will in this will come up again later. You can't purchase a CPI adjusted annuity right now. So you couldn't actually purchase the financial product that would give you this income stream, but if you could it would offer about that particular.

Alex Murguia 16:10
So if someone's asking, What about a non inflation adjusted annuity, just directionally what what do you you had to like guesstimate what do you think?

Wade Pfau 16:18
Well, it'd be the same idea that interest rates have been coming up, and that would support more.

Alex Murguia 16:20
More income,

Wade Pfau 16:20
it's just that would not adjust for inflation after that point.

Alex Murguia 16:29
38,000 would stay steady is what you're saying on this one? Gotcha.

Wade Pfau 16:34
Yep. Yes, steady with inflation growth, just like how the 4% rule designed. And this number is actually not that far away from 4%. Given that we're talking about almost 10 times the salary saved, and then almost a 40% replacement rate. But this number would have been the highest again, around the year 2000, where you could have had more than 100% replacement rate, you could have more than replaced your pre retirement salary, with the savings you accumulated based on interest rates at that time. Yeah, and then the rate arrays? Yeah, we've got an array is actually closer to 110%. And it's been higher, like in the early 2000s. After the early the downturn, like after 2002. When markets started recovering again, that number was hovering between 70 and 80%. As the replacement rate, the financial crisis brought it down to around 50%. And then as interest rates continued to decline afterwards, the magic number since the financial crisis has just been somewhere between 40 and 50%. And then just over the last couple of years, when interest rates got to such extreme lows dipping below 40%

Alex Murguia 17:50
W-Wade, why are you saying and I wanted to make sure everyone catches a copy of could you said it but I want to make sure it it sort of digest that even though the markets have gone down because interest rates have gone up the external retirement affordability index hasn't been hit as hard as you would think.

Bob French 18:10

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Wade Pfau 18:35
Right, right. And that's the silver lining. And I think this applies a lot to just the broader issue of a lot of people listening may have less financial assets today than they did at the start of 2022. Because 2022 is a really rough year for stocks and bonds, as we reviewed with Bob last week's episode. But at the same time, you have those losses your portfolio smaller. But now looking forward from today, interest rates are also a lot higher. Part of the reason your bond portfolio last is because interest rates have been rising. And that increase in interest rates is offsetting the loss of financial assets. So that the replacement rate available today did not drop it stayed steady, even though the retirement wealth index did drop noticeably over the last year.

Alex Murguia 19:30
Okay, so, so far, what we've come just to begin to because we're speaking numbers and in episodes where we're talking a lot about this, it's good to just level set so far, where you are right now, if you would if you would have been a diligent saver and if you retired January the first you'd be walking out with your save. If you look at your statements, it should be roughly 9.8 times your current salary boom that's historically at the 17 percentile. So there have been 83 82% of the time, it's been better. That being the case, if we were to turn around and take that 9.8 salary, which out of let's say, you start with $100,000, when you began this experiment, and there's been no inflation and your salary is still $100,000, on the day you retire, you walk out with you have, you should have roughly $980,000 In your nest egg from from this, that could support buying an annuity that will pay out 38,000 or $38,700 a year 38% 38.7% replacement rate. We've been kind of buffered, a little bit buffered, but we've we've been cushioned a little bit the past few years, because rates have been going up so that that's helped out on the payout amount, but it's still on a relative basis. Since 1980. Since 1984, or 82, is pretty low. It's the replacement rate was over 100% in the year 2000s. But it's been gotten steadily after the financial crash, it really sunk and we're hovering around 40% The last few years. So far, so good, right, Wade?

Wade Pfau 21:18
Yeah, you got it right. And also, because this is based on a real inflation adjusted income, we haven't had pips for the whole history, and the Cleveland Federal Reserve Bank does estimate real interest rates going back to 1982. So that was the constraint on this chart that these numbers go back to 1982. And the replacement rate was higher in 1982, even though the real or the retirement wealth index had a lower number, interest rates were quite a bit higher in 1982. And still still the replacement rate then was around 60%. And even though the wealth accumulation index, it's less today,

Alex Murguia 21:55
But you've answered right, you've answered for this person, the hypothetical person reading this, okay, I should have this amount of money. You know, check this amount of money, if I want it to be protected income, at its most extreme case, and buy a pension on the open market, I would be getting a

distribution of 38k, you know, maybe exactly 38.7k. Now, if I don't want to buy a open annuity, and I'm let's say I'm typing segmentation, in its most extreme case, where I'm just buying a dedicated portfolio, I don't even know that's time segmentation, right. But if I'm just getting a dedicated portfolio, what I mean is you're getting bonds, you want to set it up. So we've checked off the annuity sort of income only piece, you want to talk about the next one, which is sustainable spending from just dedicated income sources.

Wade Pfau 22:47
Yeah, and so as you scroll down the dashboard, you get into that sustainable spending from dedicated income sources. And it shows spending numbers spending rates for 30 year bond ladders, as well as for single premium immediate annuities for a in the these examples are for a 65 year old couple, joint and 100% survivor benefits of the same income for the lifetime of both individuals. And it is a life only annuity. It's the the bond ladder numbers are based on the long term rate well, real and nominal long term interest rates on January 1 2023. And the 30. Year Treasury was at 4.11%, then this, it's declined since then, actually. Interest rates are so volatile these days, that 30 year tips yield that treasury inflation protected security is at 1.78%.

Alex Murguia 23:41
Wade that's okay. Because this this will we'll publish this next week, and maybe the rates are back on that'd be back at work. This was

Wade Pfau 23:49
Yeah, keep your fingers crossed for that. But But yeah, that's then okay. If I could get an average yield out of my 30 year bond letter based on that average long term real interest rate, which is a times I was saying 30 years, but these are I meant to say these are the long term average interest rates as reported by the Treasury Department. So the average long term rate was 4.11, the average real long term rate was 1.78. And that does correspond to if I actually went through the mechanics of building a bond ladder with the entire yield curve available. If you build a 30 year bond ladder, what you're looking at is for spending with no inflation adjustments, such as fixed spending, the spending rate would be 5.62%. And that would give you with bonds, 30 years of spending, no increases for inflation. If you had a million dollars saved $56,200 a year, not inflation adjusted and you spend your portfolio down to zero at the end of the fifth

Alex Murguia 24:53
So you're 65 years old. You're putting your life expectancy is 95 mm You know, because you're gonna have zero money after because you're using 100% bond portfolio, but you're, you're taking the yield and when they mature, they mature and then you're going to use those maturities as well, etc, etc. So you're saying you could take out from that 5.62? Okay. So that 4% rule, right?

Wade Pfau 25:23
Well, yeah, although this one wouldn't be that there's a later number coming. Depends on the spending strategy, the 4% rule equivalents coming up soon.

Alex Murguia 25:32

Preview, but Okay, you're right, you're right.

Wade Pfau 25:36
Why I've been making that point for years. And actually, David Blanchett, I think just released an article on thinkadvisor encouraging people not to confuse fixed spending for inflation adjusted spending. So the the next number is, I want my spending to grow annually at 2% as a fixed number, so not pure inflation adjustments yet, but just a fixed 2% growth rate on my spending. With the built in ability to grow spending at 2%, here, the initial spending rate I could use with a bond ladder would be 4.41%. So 5.6, drops down to 4.4. To allow, it's an initial lower initial starting point, but then spending will grow at 2% a year for the 30 years. And then the CPI adjusted number. So this is the one that's more equivalent of the 4% rule logic where you have constant inflation concentrations, a more substantial CPI. And you get that by investing this 30 year ladder would be built with tips, treasury inflation protected securities. And to make the 4% rule work, you need about a 1.3% real rate, while the real rate was 1.78%. And that translates into a 4.25%. Sustainable spending rate for that 30 year period, with inflation adjustment more than 4%, which, for long time it was going to be less because interest rates were the entire tipps yield curve was negative at some points. And that supports a much lower spending number than at the present. We're now getting 4.25%.

Alex Murguia 27:15
So if you lock in now, on 100% bonds, taking making it a dedicated portfolio, assuring you both don't live to 90 past 95. It's this is what you would get right. It's kind of it's not the end of the world really. Right?

Wade Pfau 27:32
It was much more attractive than past. Yeah, exactly. It's with lower interest rates.

Alex Murguia 27:37
This is one of these a little bit go on....

Wade Pfau 27:40
I just I mean, today, interest rates have come down, they're still above the number needed to have 4% work. So it's still about 4%. But it wouldn't be quite,

Alex Murguia 27:48
I know what you would be getting that without any market volatility. It's a delicate bond portfolio. So there's no volatility. It's a huge kind of thing. How does this compare? You have it on the other call? Obviously, I'm looking at it, but I just want to verbalize it. How does this compare to the speed of the single premium, immediate, immediate annuity life only if you were to buy an open market pension, from a distribution standpoint, apples to apples,

Wade Pfau 28:14
You've got a couple, they're both 65, they're buying life on the joint SPEEA to provide an income for the rest of both of their lives. So it's not fixed at 30 years, if they don't live very long, they're not getting this much. If they live a long time. They they know they're gonna get the spending, they need to match their

lifetime, their joint lifetime. And for the fixed spending, it's 6.4 6.42%. And this is the the average of the top three quotes available at immediate annuities.com. That's where these numbers are coming from. But the bond ladder was 5.6. The annuity providing the equivalent fixed spending is 6.4%.

Alex Murguia 28:53
With the caveat that it's not adjusted for inflation, it's just straight up flat number.

Wade Pfau 28:57
Well, neither these numbers are adjusted for inflation. Yeah, that's right. And it's, it's higher, because the joint life expectancy of the couple is less than 30 years. Then you've got the 2% cost of living adjustment spending goal. The annuity with a 2% Cola has a 5.1% payout, compared to 4.4% for the equivalent 30 year bond letter. So again, higher spending power, longevity protected, but then your beneficiaries don't get anything in this scenario if you live less than 30 years, but you know, you're covered. If you live more than 30 years, that's the trade off. until higher income you

Alex Murguia 29:41
And then Wade, said it with the life expectancy comment, but why would why would we expect to see a number in which the annuities are actually on a distribution basis, paying out a little higher. So folks can kind of understand

Wade Pfau 29:55
What the annuity it offers the risk pooling so it's calibrated more or to the life expectancy. And so if 50% of the couples don't have somebody making it to 95, the insurance company doesn't have to plan the spending to last 95. And the way that the plan that the bond ladder does, and that's why you're getting the situation that the annuities offering a higher payout rate, the longer the bond ladder is meant to last, the lower the spending rate it could provide. If I only wanted a 20 year bond letter, that would give me a higher payout rate than the annuity because the annuities projected life expectancy would be more than 20 years. But in this scenario where I want the money that lasts for 30 years, the bond ladders going to give me less spending than the annuity.

Alex Murguia 30:45
Okay, so you've taken just in the process of this, we've looked at what would happen from replacement base rate buying an open market, pension, if you will, a private pension Sansome annuity, what would happen if you instead of doing that, by a complete, dedicated portfolio and dedicated portfolio is you're buying individual bonds that are providing a yearly yield, and they're maturing, and you're just taking all of those assets and using it for the district for your distribution? And then you compare that fixed 2% Cola CPI adjusted to an equivalent annuity to assess just the percent distributions. We're not doing that with the individual annuities simply because for CPI adjusted because there is no annuity that sells for those, you know, per that characteristic?

Wade Pfau 31:36
Yeah, since January 2020, no commercial annuity provider offers a CPI adjusted annuity, Social Security as a CPI

Alex Murguia 31:44
Yeah exactly. Now you can say, Why doesn't anyone Oh, we get this question like, Why doesn't anyone else? Why doesn't anyone offer that? That's one of the first things that comes up. I mean, you kind of have to make do with a COLA that you feel comfortable with? Because I would say, and please correct me here way. Insurance companies, it's very hard for them to price it. And so because inflation is so volatile, you know, and it's hard to price it that they would have to charge you so much for that that it wouldn't make that much sense, ultimately,

Wade Pfau 32:12
yeah, they they can't hedge the inflation risk beyond 30 years, they can up to 30 years. But for those payments that go beyond 30 years, they don't have any mechanism to hedge that risk. And so that makes it harder. I think there's it's partly a supply and demand type problem as well, where the when they offer those, the consumer interest is minimal. And kind of the running joke is when they did have CPI adjusted income annuities, hardly anyone purchased them. Hardly anyone searched out for them. There was one relatively recent New York Times article where the author actually sought out the one person that bought a CPI adjusted SPIA through one of the major online annuity sellers.

Alex Murguia 32:56
And how did you respond when they contacted you?

Wade Pfau 33:00
me? It was, but it was a retired actuary living in Arizona. And actuaries may understand the value of inflation adjusted income,

Alex Murguia 33:11
but he saw an arbitrage he saw, he saw a he saw an opportunity.

Wade Pfau 33:15
And he was probably pretty happy when inflation started picking up these last couple of years, too.

Alex Murguia 33:19
All right. And so then, as we go down that this dashboard, what's the where do we take this now? Now? Okay, we did all those kind of you know, it's not too dissimilar from going through the return strategies and all of that. Now, from a total return standpoint, what do you got?

Wade Pfau 33:39
Yep. And so that's where, okay, what's the safe withdrawal rate? Like, there's the 4% rule work? Or what's the equivalent of a 4% rule? And that's what the next table that's sustainable spending from volatile investment, portfolios, addresses. And so it looks at different spending strategies. And then an offers the spending projections for conservative, moderate and aggressive. And those just relate to what kind of asset allocation will you use? How long do you want the money to last? What probability of success are you seeking and so forth. And so when we talk about something like the 4% rule, the assumptions for that would be the closest to the moderate scenario, where the 4% rule, strictly speaking, was based on historical data with 100% success rate. But if you start to translate that same

data into a Monte Carlo simulation, you're looking at around a 90 to 95% success rate for the 4% rule with a 50 to 75% stock allocation. And so that's the closest to the moderate scenario, which is you're going to use 50% stocks in retirement, and you want a 90% chance that you don't deplete the portfolio my 30 years into retirement. The conservative scenario As you use 25% stocks, and you want a 95% chance that you have at least 10% of your wealth remaining by the 35th year of retirement. And then the aggressive scenario is, you're going to use a 75% stock allocation, and you seek an 80% chance that you will not deplete your investments by year 30 of retirement.

Alex Murguia 35:25
You got all of that?

Wade Pfau 35:25
We've got, we've got numbers here. There's the nine numbers, because there's three different spending strategies for these three different sets of assumptions. And then it also gets into what if he had a buffer asset, and also what if he is a variable spending strategy,

Alex Murguia 35:41
What I would recommend is we did a whole series on sustainable withdrawal rates. And so if you're in this dashboard, and you're looking at it, and you're seeing, like the Guyton Klinger decision rules and things along those lines, just just have a listen to the those episodes where we discuss them, just to help you along the way we, you know, with regards to these items here.

Wade Pfau 36:05
And when we did discuss the guiding and cleaner decision rules, part of that conversation was I was explaining how for the analysis we were talking about that day, I simplify the rules, because I think they're just way too complicated to use in real life. This table going back to when I created this all seven years ago, or so, this is using the more pure version of guy can including your decision rules. And the the notes do explain the particular decision rules use for that.

Alex Murguia 36:33
Okay, and so what's what's the number everyone's waiting?

Wade Pfau 36:37
Well, so if you're just talking about fixed spending, and we'll just mention that briefly first, because it's not what you people are usually thinking about when they talk about safe withdrawal rates, but from conservative to moderate to aggressive, you're 3.7% 4.88% 5.38%.

Alex Murguia 36:58
And by fixed spending, you mean you have $100,000? And I'm going to take out $4,880 a year. For the rest of my life. Yeah, that's the model for the rest of my life. That's the exact number that I'm taking. I'm not adjusting it for inflation or anything like that. It's fixed.

Wade Pfau 37:18

Yeah, and then right, no inflation adjustment. And since that's the moderate number, it means you're using a 50% stock allocation. And then you have a 90% chance that by doing that, you're still going to have money left after 30 years. And the range on that. You're sorry, with a 10% chance that it's empty. You've run out before 30 years, and that's quote unquote, failure for that retirement.

Alex Murguia 37:42
Okay, 4.88. I'm liking it. And again, that's no good. That's the steady number.

Bob French 37:50
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 retirementresearcher.com/eight tips. That's the number eight tips.

Wade Pfau 38:29
Yeah, then with a 2%, fixed Cola, spending your conservative numbers 2.73, the moderate 3.8%. It's getting closer to the 4% Rule number. Now this is this is still 2% Cola, not true inflation adjustments. It's a coincidence. Well, not I mean, it's some relationships. But 3.8 is the number that Morningstar recently came out with, well, 3.8% is my moderate number for spending with a 2% Cola. And then the aggressive number is 4.24%. The inflation adjusted spending now that's the one that's really the 4% rule assumes inflation adjusted spending. And before seeing these numbers just explain a little more. The simulations I'm doing here, start from today's inflation levels, interest rate levels, primarily they use the historical stock market risk premium, and then they allow both inflation and interest rates to evolve over time. So when we look at like, what do the yield curves tell us? Over the next year, the markets are expecting inflation to be around 3.4% and 2022. Inflation was 6.5%. But inflation is expected to come down quickly over the next five years. The average inflation rate implied by the markets is only 2.3%. And we talked about this as well in last week's episode,

Alex Murguia 39:57
And you actually have in the dashboard when we're We're probably not going to discuss that today, because we did last time. But if you go to the bottom of the dashboard, we kind of, we kind of show how how to calculate sort of an expected inflation rate.

Wade Pfau 40:12
That's just the difference between treasury yields and tips yields.

Alex Murguia 40:16
We wanted to make it sound like it was a lot more than that you and you say it's just simple, simple subtraction,

Wade Pfau 40:21
You're trying to please people to listen to last week's episode.

Alex Murguia 40:25
There's no entry man.

Wade Pfau 40:28
I spoiled it sorry.

Alex Murguia 40:31
Things don't need to be complicated. It's simply subtracting up the tips by the equation.

Wade Pfau 40:39
But there is a sequence of inflation risk. And that's just because inflation is higher at the beginning, that's going to make this inflation adjusted number a bit less than the 2% goal and number quite a bit less than what it would have been in the past when inflation started from a lower point. And so well, the conservative number is 1.9%. The moderate number is 2.93%. And the aggressive number is 3.38%.

Alex Murguia 41:06
Okay, so So in your in your world. And we get these these interviews all the time from Munich journalist, what's the new 4%? Roll? You would kind of say? 2.93%. But all is not lost.

Wade Pfau 41:20
Yeah. Got close to the - mhm.

Alex Murguia 41:24
alright, but it's not lost Wade, I would say sorry, just I want to get this point across. Because, you know, go, you mentioned Blanchett, right, we don't spend, it's not realistic, we don't spend like the 4% rule, you spend, like with a blend of all of these things above it as well, that 2% COLA, sometimes you don't pull the full inflation. And sometimes you don't put any inflation growth. So I would say, you know, somewhere between 2.93 and 4.88. And a, you know, moderate portfolio is kind of what you would be looking at, because the reality is no one just locks in on something and flies blindly. There's constant calibration that happens year to year. And it's some sort of blend of that.

Wade Pfau 42:06
And also, as Bob was talking about last week, the six and a half percent inflation rate for 2022 is kind of a historical artifact in that most of that inflation happened in the first half of the year, inflation was a lot lower in the second half of the year. And I didn't make any sort of adjustment for that. But to the extent that maybe inflation is already coming down, that would help bring that 2.9% number of hire,

Alex Murguia 42:30
to the grocery store, did you go to the grocery store this week?

Wade Pfau 42:32
as the exception? No, I've, I've seen some restaurant menus have 50%, inflation rates and so forth, it's kind of wild. But overall, I would be comfortable like that 2.9% Number quite a bit lower than the 3.8%

that you get with the 2% spending cost of living adjustment. I'd be comfortable really saying something that's closer to the 3.8% number. I mean, it's got to be a little bit less than that to account for this.

Alex Murguia 43:03
Especially considering that if you look at the expected long term inflation rate, you know, absent what's going on right now with Powell is gonna raise is gonna you know, those kinds of daily market machination, you're looking at, we look below five year projection to be somewhere like two and change. 2.3. Right. So I agree with you, 100%, with what you're saying that the current 4% rule, it looks like it's 2.93, because that's it's taking the year and inflation number went? That's kind of a little bit of a anomaly.

Wade Pfau 43:37
Mm. And I don't want to make those kinds of judgment calls where I completely just ignore the methodology is he used last year's inflation number, I don't want to start parsing that out into a justifiable assumption. So that's why...

Alex Murguia 43:52
to be consistent and leave it there. But yeah, I get it. There's a caveat to this.

Wade Pfau 43:58
The caveat again, being probably you could use a little bit higher than that 2.93%, because it does look like inflation is coming down. And we're not going to have anywhere near the 6.5% inflation rate for 2023.

Alex Murguia 44:14
And then we had three more of these.

Wade Pfau 44:18
Well, what if you had a buffer asset, so when

Alex Murguia 44:20
Now we got time segmentation. Whenever

Wade Pfau 44:24
Well time segmentation was somewhat with a bond ladder, the buffer asset would if you had outside of your portfolio, five years of spending available, it could be a reverse mortgage line of credit, it could be whole life insurance, it could just be a big pile of cash that you don't count as part of your portfolio, then you just have to be careful that well, if you move cash out of the portfolio, maybe you can use a higher withdrawal rate on your portfolio, but you have less money in the portfolio now so you're not necessarily any better off there. But just maybe at this point sticking with the moderate assumptions to know don't have so many numbers to talk about. If you're looking for that 2% spending adjustment on the inflation, and you had a five year buffer asset on the sidelines, you could start with 4.7% out of your portfolio, and that's 4.7% of the portfolio, not 4.7% of the portfolio plus the buffer asset. So that increased it from 3.8 to 4.7%. Having a buffer asset can have a big impact equivalently, with the CPI adjusted spending

in the moderate scenario, that the number increases to 3.62%. So it went from that 2.9 to 3.6. With having that five year buffer asset, that can help in an audible way or noticeable way to support a higher spending distribution rate for the retiree. And then the guiding and cleaner numbers, as we talked about in the past episode, when we looked at variable spending, these sorts of strategies can dramatically reduce the initial spending rate. And they just do that by incorporating the ability to make potentially dramatic spending reductions later on. But the moderate number can get up to 5.44%. If you follow the guidance and cleaner decision rules, so and that that's not inflation adjusted spending, that's not 2% Cola, that's I'm going to use a variable spending strategy that will typically involve making cuts to my spending throughout retirement. And by knowing in advance that I'm willing to make those cuts, I can start at 5.44% as my initial distribution rate in the moderate, so that's 50% stocks and a 90% chance you won't have money left after the guy didn't cleaner rules do allow you to deplete your portfolio unlike some other variable spending strategies.

Alex Murguia 46:53
So Wade is it fair to say, you know, you're looking at the investments, you know, it's a year end starting of the new year, you're looking at your quarterly reports and year end reports. And there's just showing investment returns, right? What's more interesting to us with these kinds of adjustments that we make is the context. At the end of the day, especially in retirement, we're not just thinking about accumulation, is how do you source retirement income. And so relative to potential time segmentation strategies, as we mentioned, with the bond ladder examples that we gave income protection, as, as we discussed with buying a personal pension, if you will, through his PA, or even total return with, with this with these distribution rates, whatever that strategy is that sings to you, I would take a gander of you know, of this dashboard, just to make sure that the distribution that you're taking kind of aligns with something like this, and it's not off by orders of magnitude, at least on the up on the on the higher end, simply because that you want to make sure that you're, you know, that you're not like out of whack with with the realm of reality, if you will. And so that's how I that's if I'm a consumer listening in, I'm kind of looking at it like that I'm looking at whatever my money I'm taking up, be it the rolling ladder, this or that and just getting a sense of, okay, this is what I'm looking at. Obviously, if you're getting ready to retire, you can also just take a look at what the economies of these things are, and and know what you're getting into, you know, from a realistic standpoint. If I have a question, oh, Wade, oh, sorry. God

Wade Pfau 48:33
was before at Santa Maria, you're gonna wrap things up? No, no,

Alex Murguia 48:35
no, I wasn't gonna wrap it up. But going

Wade Pfau 48:41
from ending the episode another this the dashboard was created before we had the retirement income style awareness. But the there is also an example here of the income protection strategy, which is, so we're back to the scenario of 2% spending growth. If we're thinking were moderate, we're looking at a 3.8% withdrawal rate. If we thought about well, what if we build a floor of lifetime income with 30% of our assets, in an immediate annuity with a 2% COLA, we'd have a 5.1% payout rate there would have having that reliable income in place makes us feel more comfortable with our remaining investments to

then shift towards the aggressive approach, use a higher stock allocation. Be comfortable with an 80% success rate instead of a 90% success rate. That would also let us bump up to it 4.24% withdrawal rate from the investments when you blend 30% in the annuity 70% from the investments, you're looking at an overall distribution rate of four and a half percent. So the 3.8% Moderate spending number was able to increase to a 4.5% spending rate blending and me Be an annuity with a more aggressive investment approach for the remainder of the funds. So that's another way you might think about this as well.

Alex Murguia 50:07
Yeah, you're a magician, man. It's a good point, you're just bringing in, think about your preferences and how you can kind of blend them. The other piece what I was going to mention, and you may want to give it some, some thought here for everyone as a parting thought is, if you're looking at these numbers, and they just don't work for you, beyond what you said, what are what are some things you could do and where I was going with this, and you we started talking about a little bit, but just, you know, including integrating insurance into the investments, you know, starting up higher with a variable rate, knowing that you gotta be willing to come down. And it's not unrealistic, because your spending doesn't go up as you get older. Or even, you know, using buffer assets, you kind of started with the reverse mortgages. But there's, there's many ways to begin to go about kind of helping you with this.

Wade Pfau 51:03
Yeah, yeah, there's definitely approaches they can get you above 4%. Now as a distribution rate, and so if you've got that 4% rule in mind, not everything will get you above 4%. But certainly, with some flexibility, and with some kind of combining different approaches, you might be able to get to a position where you feel comfortable with a number like that, for spending in retirement.

Alex Murguia 51:29
Where to get a little bit of bad news. Because of the inflation you I think we're gonna get a lot of write ins for you to update this. For the end of the quarter. What do you think?

Wade Pfau 51:42
It's not that hard to update, I could do it more frequently. So we'll see here, maybe every that was the original.

Alex Murguia 51:50
We need content, like for the podcast, we'll update it. And then we can

Wade Pfau 51:54
Right. If we got to show somebody somebody listens to this episode in the future. They'll say, wait a second. Now these numbers match up. Maybe because we updated it the since January 2023.

Alex Murguia 52:05
But again, for us, this is what we mean when we say okay, what what do the stock market returns have in play for us? We don't look at it from like an investment point of view of you know, forecasting some magical thing. We look at it from the point of view of what does this tell us from a spending standpoint, you can do more with that. And ultimately, that's more of the end game for why you're investing

anyways. So I strongly encourage you to check out retirementresearcher.com forward slash dashboard, or like Wade said, just go to retirementresearcher.com resources dashboard, and you'll you'll figure it out from there. So thank you for that on my end. Wade.

Wade Pfau 52:46
Yeah. Thanks, everyone. Hope you have a great week and thanks as always for listening to Retire with Style.

Alex Murguia 52:52
All right, take care.

Bob French 52:55
Wade and Alex are both principals 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.