Episode 17: Should Protected Income Be Part of Your Retirement Income Plan?

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. Today's episode features Michael Finke, a professor of wealth management and the Frank M angle Distinguished Chair in economic security research at the American College of financial services. He is a nationally known researcher in retirement income planning. And as a frequent speaker at financial planning conferences around the country. I think it was named one of the 25 most influential people in the field of investment advising in 2020 and 2021. By Investment Advisor magazine. You can't take it with you, but you can't spend it all either. Or can you? Our hosts, Wade and Alex discuss with industry expert, Michael Thinker, the implications of having protected income as you spend throughout your retirement.

Alex Murguia 01:24
I'm Alex and I'm with

Wade Pfau 01:26
I'm Wade.

Michael Finke 01:27
And I'm Michael.

Wade Pfau 01:30
We're happy to have Michael Finke on this week's show. Michael is a professor of wealth management at the American College of financial services, a colleague of mine there, and he runs the wealth management Certified Professional designation, as well as being a leading researcher in this country on anything related to retirement income planning. So we're very happy to have Michael here this week with us.

Michael Finke 01:51
Well, thank you. It's my privilege to be here talking with you guys.

Alex Murguia 01:55
All right. All right. Michael and Wade, something that I would imagine a lot of our listeners are thinking or at least the ones that are into retirement income. With hence the title of the of the podcast is how you two met. You know, you're you're both of your preeminent researchers in retirement income space. And

anytime you work jointly on papers. And you know, it's interesting, I think, to know what the story behind that is. Wade, you want to kick it off?

Wade Pfau 02:28
Yeah, sure. I mean, I, so I met Michael, around the same time I met you, Alex, which is going back to this whole process of I was living in Japan, trying to prepare to move back to the United States and making connections stateside. And Michael was a professor at Texas Tech University and editor of the Journal of personal finance. And Michael, I think we just, we had that opportunity to connect related to, I don't remember exactly if I had submitted an article to the journal that you were editing or what the case was, but I was able to invite you to Japan, and we got to meet in person for the first time in Tokyo.

03:04
Yes, we did. So Wade, you know, actually, I It's amazing that I remember something that you don't, I started out as the editor of this journal of personal finance. And when when you start out as an editor, it is the worst job in the world, you want people to help you with it. So you want to have an editorial board of people who are actually going to read these articles and provide feedback to me as an editor. And so I was looking for people who are experts in different areas. And I'd seen some stuff that you'd written on retirement income planning, and I sent you an email, absolutely cold out of the blue. And I said, Hey, Wade, would you be interested in being on the editorial board of the Journal of personal finance? And your response was so good, that I thought, Oh, my God, you know, this guy has to be like co-editor of this journal with me like, he's, he's better than I am. That's for sure. So that's, that's originally how we started out and we maintain a regular correspondence about retirement income planning in general. And Wade and I had the same philosophy. We're both trained as an economist. And we both sort of enter this field of financial planning as economists and we had a slightly different perspective on retirement income planning, then was the way that most practitioners approach retirement income, which is just to follow this 4% rule. Same size fits all. So you know, you there's no customization of your approach to building retirement income, it's all just withdrawing a certain amount of income from an investment portfolio. And that didn't make a lot of sense to an economist, I think, you know, from our perspective, you've got to take into account people's risk preferences. You've got to take into account the fact that risky assets are risky, and that means that you can't derive a constant stream of income from a risky portfolio that just doesn't make any sense. So I think our philosophy is aligned. And we actually did our first paper together back In 2012, is that right way before the Journal of Financial Planning? And it was all about this idea of how What does risk mean in retirement?

Wade Pfau 05:11
Yeah, that's right. I think it was published early in 2012. That I, we met also at one of the retirement industry conferences. Yeah, you were doing really interesting work with one of your graduate students at the time, Duncan Williams, I had just been looking at this, as you noted, this kind of safe withdrawal rate, 4% Rule type strategy, but it doesn't really give you any sort of sense of risk. And I think that's what you were starting to look at with Duncan back in 2011. And then I joined you on some of those later research efforts. But that was about trying to identify risk tolerance, and how people think about risk in retirement. So if you want to talk a little bit about how you approached how to and what is risk tolerance mean, for a retiree?

Michael Finke 05:54
Most people find most financial advisors when they think about risk tolerance, they think how willing is my client to accept volatility in the stock market? So Alex, we're going through a fun period, right? Now imagine that your your clients are really enjoying this experience.

Alex Murguia 06:10
Enjoying is a is an interesting word. I guess it's a matter of perspective. But yeah, no, you're right. It's one of these things that, you know, the job of an advisor, if you break it down to its most common denominator is when markets are going down, you let them know, it's not always going to be like this. When markets are going in the other direction, it's not always going to be like this. And the underlying fabric of all of that is volatility tolerance. So yeah, absolutely. It's it's front and center right now.

Michael Finke 06:39
So I think a lot of financial advisors see that as their primary source of value that, you know, they're there to manage accumulation. And they're going to put their clients in risky assets, they're going to perform better in the long run, part of their job is to just get their clients to stick with that optimal portfolio. So you maybe give them a risk tolerance test, it shows you that they're risk tolerant, risk averse, if they're risk averse, then you put them in a higher percentage of bonds. And then you rebalance. And that's your job. But you know, when you get to retirement, it's a completely different way of thinking. It'll I think a lot of advisors never throw off that old accumulation mindset that all you're trying to assess is whether or not your client is willing to accept volatility in the performance of their investment portfolio. But really, when you think about when you use a goals based approach, which is what at the American College and our wealth management program, we take a very goals based approach to wealth management, in other words, you begin with the objective, and then you build your investment plan around that particular objective. And in this case, the objective is to live as well as you possibly can and retirement, and is that you actually have to spend the money to live well. And that's something I think a lot of people haven't really gotten through their heads is, it's not just managing investments and continuing to grow them in retirement. For most clients, and especially mass affluent clients, they're gonna have to start in a low return environment, they're gonna have to start spending that money down. And then your risk means a completely different thing. Risk means the possibility that if markets don't perform well, I'm going to have to cut back on my on our spending. And that's the whole, in fact, that's the title of our 2012 article that we wrote together. It's called spending flexibility and safe withdrawal rates. It's all about this idea that risk tolerance in retirement is different than you can't really measure it the same way that you measure risk tolerance during the accumulation stage. The idea is that you have to be more willing to accept volatility in your spending, if you accept a lot of risk in your investment portfolio. And of course, there's things you can do, you can actually move beyond a simple investment only approach, if you want to minimize that volatility in your lifestyle.

Alex Murguia 09:03
I would sorry, Wade, go ahead.

Wade Pfau 09:06
What? Sorry, I was just Yeah, to this point. I remember, I think one of the times that this article was referenced in the media, it talked about that we were suggesting people use a 7% withdrawal rate. And

that was confusing a certain detail of the article with. So you and I are both concerned about like the quote unquote, sustainability of the 4% rule. But indeed, in certain circumstances, and one of the case studies we showed where that individual had a lot of reliable income outside of the investment portfolio, we were talking about that quote, unquote, optimal withdrawal rate being 7% for that particular scenario, and I remember the details, that was that 7% withdrawal rate had a 57% failure rate based on the modeling that we were doing, but nonetheless, that was the withdrawal rate that gave the most satisfaction in spending power over the lifetime. And so I think that was really an important contribution that you and Duncan had been thinking about is, how do you further frame that conversation? So it's like the the 4% rule concept, it's kind of all or nothing, you can't ever deplete your investment portfolio. But there's really more to the story with that idea of spending flexibility and the capacity to make cuts to the distribution from your portfolio and, and whether that can allow you to spend more aggressively and or invest more aggressively, because your lifestyles not as jeopardized by a market downturn, because you have that outside reliable income as well.

Michael Finke 10:37
Yeah, I think this is where our wisdom or our philosophy differs from conventional wisdom in or at least as it existed for a long time in the financial planning profession. We've seen enough volatility in the markets since 2000, that we can recognize that you know, what may have been saved back in 1994, that 4% withdrawal rate. In a world where stock prices are really high, where bond yields are very low, you can't assume that you can always generate, you can always Withdraw 4% safely from your investment portfolio plus inflation every year, there's going to be a certain amount of risk, if you take investment risk, you might have to cut back now, the what you mentioned is that when we use historical data, and we estimated an optimal withdrawal rate, we found that people who were very risk tolerant, they might be willing to live better, you know, you can and that's the downside of being overly conservative. Now, you you and I weighed have made a lot of, I think, points about the fact that the 4% rule assumptions are probably not the same today as they were in 1994. So expectations of asset returns are probably lower, people are living longer. That's another point that if you look at the data, there's been some really fascinating articles that show the improvements in longevity that men and women have made in the higher deciles of income in the United States. So in other words, people who make a lot of money in the United States have made huge gains in longevity, even over the last 20 or 30 years. That is an interesting phenomenon. But what that means is that people are living longer the likelihood that they're going to live beyond that threshold, that original threshold that was used to define a safe withdrawal rate, which was age 95, we're probably at a 50/50 chance for a lot of higher income couples, you know, and I've even talked to some insurance companies and they say, you know, for a premier class, or the highest class of health, that a couple has maybe, you know, a 59% chance that one of them is going to live to the age of 95, that completely changes that conversation about the safety of a withdrawal rate, and how much income you can create from your investments. And so, you know, one of the things that I have been thinking for a long time about is how do you actually assess risk tolerance or something that is meant to capture that sensitivity to the the willingness to accept variation in spending, but also some other preferences that would help define what an optimal retirement strategy looks like for you? Because it's not the simple way that we assess risk tolerance or have assess risk tolerance in the past?

Alex Murguia 13:24

Mike, what, what I would say to that, and even kind of echoes of it, and Wade, I think you're you're thinking probably around the same line as I am simply because we've been immersed in a certain line of thinking, but the whole accumulation turns into distribution phase. What we would say to put pose it a little bit is that assessing volatility doesn't really complete the full picture. And I think you're speaking the same language. It's there's new risks now in retirement, you just alluded to longevity and their spending shocks. And so how do you capture those kinds of concerns in a manner that that leads to a plan, you know, a bespoke planet? And and I think that's probably what that's that's at least from wait and our thinking, the biggest shortcoming with regards to retirement amount, not retirement, but with regards to risk questionnaires, they just don't sort of fit the bill, as you retire from an from a from the accumulation stage. In fact, we were in a meeting with a rather large institution yesterday, Wade, remember, and the question was, was asked of us, you know, where does risk tolerance fit into this? And you may, you may want to chime in, but our response was, it doesn't, at least from an order of operations standpoint, the first step is really accounting for all these concerns that you have in in retirement. And once you do that, then, you know, you can determine what the place for the portfolio is. And then it's a matter of volatility and all of that assuming that all these other assets options within the risk tolerance questionnaire are tenable. Which, who knows? Right? We'll just give them the benefit of the doubt. Wait.

Wade Pfau 15:07
Right. And so I mean, yeah, I think you're leading into with the retirement income style awareness we can do a lot more with with the manner of or with the issue of risk and retirement, but even going pre recess going, Yeah, kind of this 2012 generation? What was clear from that research that, you know, Michael helped to, to initiate was just this idea that, well, I mean, everyone knows this risk is not really short term market volatility, but specifically risk in retirement is simply if you have to make cuts to your lifestyle, and it's not even necessarily cuts to spending, but it's how does your spending translate into a quality of life or a standard of living? If you can cut your spending and still be just as happy? That's not risk? You're fine. It's risk in retirement is having to make cuts in a way that negatively impact your standard of living in retirement. And so then how do you approach that risk? Or how much capacity Do you have? How does market volatility impact that risk really becomes a fundamental question because you can only start thinking about asset allocation once once you've assessed every other part of the financial plan and get a sense of how market volatility would actually impact your standard of living in a negative way, or in a positive way. Like, if you want to go for that upside and enjoy an even higher standard of living view, would you get more satisfaction from being able to spend more are you perfectly happy spending what you're spending, and if you had more money, there wouldn't really be any particular use in mind for it that would improve your situation. So that's really how that earlier that 2012 Generation of Research was treating the issue of risk for retirement.

Michael Finke 16:55
Yeah, that the, the way that a lot of economists think about it is that retirement spending is a liability. And at the beginning of the sequence of liabilities, you have a pot of money. And then you have a lifestyle that you want to live, or maybe a lifestyle that you expect to live based on the performance of your investments. And that's another point that I think is very important to make is that if you take more risk with your investments, you do it because you hope you live better in retirement, or you have more money available to pass on to others. That's why you take investment risk, but when you take

investment risk, there's always the possibility that you're going to get unlucky. And if you do get unlucky, you're going to spend less so in other words, that liability in the future is going to have to get adjusted downward because information. And that's another thing that's not really part of the 4% rule is that realization that there needs to be constant adjustment based on the reality you have expectations at the beginning of retirement, you have expectations that stocks are going to return, you know, 8%, or bonds, or we're going to return two to 3%. But in reality, that may not happen. So at the first day of retirement, your likelihood that you're going to be able to fulfill all of those spending obligations, all of those liabilities in the future might be 90%. So you have a 90% chance of success, you're gonna say, I'm gonna go ahead, and I'm going to spend this amount of money every year. But after that first day of retirement, the probability of your being able to fund that specific liability, it changes, if the market goes up, then now you may have a 92% chance of being able to fund all of those liabilities. If if the market tanks like it's been doing recently, all of a sudden, and this is one of the things I'm afraid of with a lot of people who have retired over the last year is that they had this big pot of money, they expect it to be able to fund the more generous retirement in the future. Now they're having to readjust that. And the likelihood that they're going to be able to meet all of those future spending liabilities has just decreased. Maybe it's gone from 90% possibility to maybe 75% possibility that you're going to be able to fund all those future liabilities. And you're faced with this choice of either adjusting those liabilities downward or accepting the possibility that you could run out prematurely.

Alex Murguia 19:26
Hey, Michael, there's two points here. And Wade, you may want to chime in. As I'm hearing this, there's I'd love for you to comment about liabilities but broken down by essential and discretionary expenses. If if, you know there's some folks thinks that it's all it's all the same, you know, that kind of vibe. I'm curious as to your thought and wait as well. You may just throw that in in terms of how you think about spending from a liability perspective, because obviously, there's an essential piece that you need and then there's the the discretionary the second point that I think Michael bears mentioning and I heard you say this last week. And you know, it's come up on other occasions. But I think it's quite important when you talk about these rules 4% spending rule or something like that, that obviously, volatility has a huge effect is the difference of the strategy. You apply the same strategy, somebody retired six months apart, you know, and it's, it's an extremely different outlook, love the person that retired day one market drops 30%. What's he looking at? You know, you would never, you would never have that same distribution. If that person if a new person came to you that six months later, you know, that that kind of that kind of scenario where it's sort of tolerate paradox. Yeah. Where it's like, why, you know, that kind of thing. I think that's, I think that's kind of interesting. But again, that's two thoughts there, you may want to Wade, you want to just kick it off.

Bob French 20:53

Wade Pfau 21:15
Sure, so you really maybe one of the ways Michael came across me was I had that article on say, savings rate that touches upon some of these concepts, especially it was the idea was to focus more

on just consistently saving in worry less about the idea of what is the withdrawal rate you'll use in retirement, because if markets were doing very well before retiring, you'd have a lot more money. But historically, this kind of after a bull market, there tends to be, you know, markets returned to where they were. And so that's when the lower withdrawal rates happen. If markets had been doing poorly before retirement, there could be more of an expectation of in returning to long term averages, you might be able to have a higher withdrawal rate post retirement. And so that's the concern today, with as Michael was saying, people who may have retired because we've had this big run up in the markets well in everything related to the pandemic. But now with the downturn in financial markets, that's impacting the sustainability. And to your point on this, the safe withdrawal rate paradox is this idea of if you believe in the 4% rule, and no matter the situation, you're always going to apply 4% for your retirement spending, I suppose it's like, you can use 2008, as an example, like somebody retires at the beginning of the year with $1,000,000.04 percent tells them they can consistently spend $40,000 plus inflation throughout retirement. Suppose the market dropped 40% That year, somebody now retires at the start of the next year with $600,000 4% of that is 28 24% 600,000 is gonna be I want to say 20,000. But now I'm 40 to 40 to 24th. So anyway, it's a lot less than we can agree with that. But the person who retired a year earlier still gets to spend the $40,000 plus inflation, even though since they already retired, they're gonna have even less money left at that point than the new retiree who's now being forced to told according to the 4% rule, to spend much less starting at this new retirement point. And that's a paradox, or I don't know if it's a paradox. But why is one person allowed to spend so much more than the other? It happens because of just applying the sort of universal constant on the quote unquote, safe withdrawal rate? When the reality is, there is no such thing, just using the worst case scenario from a limited us historical record, doesn't really tell you the whole story of where interest rates at the start of retirement, where were the market valuation levels? What is the inflation experience and inflation had been low for a long time? We don't know at this point, if it's definitely higher now. But is it going to consistently stay higher, it does seem like markets are starting to build in instead of being a long term 2% expectation, it may be two and a half to 3% as a long term expectation, that also puts more pressure on increasing the distributions to cover that spending meet. And so that's this whole issue of if you're going to blindly enter retirement, using applying a withdrawal rate to an investment portfolio. You don't know what you're going to do with that or you don't know how that's going to necessarily play out. I think that's ultimately the the issue here. So you had two questions.

Alex Murguia 24:44
One was, I know we can actually the first one doesn't seem as important now. It's kind of the moment has passed a little bit. And it was just about the whole distinction between essential and discretionary because when you're thinking about pulling money out, maybe there's more optionality around discretionary and essentials. You they want, like, locked down. But this may lead to a conversation that we had, you know, pre meeting here. And Michael, you were you were discussing just the whole importance I believe, of structure, you know, contract in, you know, income that's a little more secure with regards to this whole sort of dynamic and how that plays into what an advisor is thinking and what their proclivities may be.

Michael Finke 25:26
Well, let's, let's take this example that we just started. So let's say at the beginning of 2022, you had a million bucks, this is a lot of baby boomers were in this situation who decided to retire early, let's say

that they lost 25 or 30%. This year. So let's say they lost 30%, because bonds and stocks are both down at the same time, which is right sucks. So they get to the end of the year.

Alex Murguia 25:50
By the way, it's,

Michael Finke 25:52
I mean, they just, we all knew it was a bad time to retire. And you know, yet people just can't get beyond this dollar illusion thing that you once they've hit that dollar threshold, now they have enough to retire, despite the fact that we knew that bond yields were incredibly low. And a lot of people were reaching for additional yields by you know, taking greater investment risk on bonds, or, you know, investing in longer term bonds or buying fun stuff like crypto, whatever, they were trying to get a little bit more out of their portfolio, we knew there was a big risk there, they get to the end of the year, now they have $700,000 in their investment account, but they now have to take they took out $40,000 Now of $660,000. And they need to decide whether they want to up their spending by the seven and a half percent inflation rate. So they want to decide whether they're gonna spend $43,000, the next year. And so now they're sitting on $660,000, they want to decide if they're gonna spend $43,000, the next year, they have to make tough decisions. Wade said, if you had retired that year, you might be only be spending $26,000 a year. So you have to decide, do I want to spend $43,000 A year or $26,000 a year, where this becomes really difficult is if you spend $43,000 a year you may have an extremely low probability of success. But if you spend $26,000 a year, then you're cutting spending so much that you might actually be cutting back into essential expenses. So you built your lifestyle expectation on spending $40,000 a year plus inflation. But maybe what we found for our research, maybe two thirds of that is inflexible. So that's property taxes, that's food, that's insurance, that's you know, basic expenses, putting gas in your car, and you cannot cut back that much. Which means that your choices are either to cut back to your basic and flexible expenses, maybe to 28 or $30,000 a year, and still accept a lower probability of success. Or you can't I mean, because that cuts all of the fun stuff out of your life, your flexible spending. So that's, you know, dinners out with friends or vacations, you got to cut those out. Is that how you want to live in retirement? You know, and are we assessing with the risk tolerance assessment instrument that financial advisors commonly use? are we assessing that sensitivity to the sensitivity to having to adjust your lifestyle, and also sensitivity to preferences that are related to solutions for building a stream of secure income to be able to fund those essential lifestyle expenses. And that's where I think something like the ERISA really is interesting, because not only does it assess lifestyle volatility, it also assesses preference related to how you solve that problem of funding those spending, liabilities in retirement, your essential expense liabilities, your your flexible expense, liabilities. And that's what retirement income planning should be all about. It's a sophisticated approach that involves blending traditional investments, and financial products that get rid of idiosyncratic risks in retirement like longevity risk, and building a plan that doesn't force you to have to cut back on your lifestyle so much, that you're actually cutting to the bone. You're losing the lifestyle that you expected to live, you're having to cut back on things that you think are essential expenses. And this is also a part of that conversation, I think that a lot of financial advisors don't have with their clients, which is how much can you cut back? And how much of your lifestyle Do you want to insulate? In financial markets? You know, it's it's, you know, when you when you talk about utility or lifestyle or happiness in retirement, spending as part of it, but as Wade said, it's not all of it. Part of it is peace of mind. It's, you know, it's

peace of mind that has $1 value. Get the peace of mind of knowing that those essential expenses are always going to be covered no matter what happens in the market. There's a lot to be said for that.

Wade Pfau 30:11
So it sounds like you're talking about something other than I recently on a discussion board, a financial advisor, made the comment to me that the role of the financial advisor is to provide behavioral coaching to their clients so that they're comfortable maintaining 100% stocks at all times, even in retirement. It sounds like you may be taking a different perspective on the role of a financial advisor there.

Michael Finke 30:40
You know, there was higher hour

Alex Murguia 30:44
about you before you get that. Does everyone see what a nice guy Wade is? Here pick up a nice guy. Wade, is

Wade Pfau 30:55
it now it's just a preference fine. But I didn't know that everyone's comfortable.

Alex Murguia 30:59
But it also speaks of the point of view, like the viewpoint that the advisor takes is just as challenging. But But Michael, you're you're gonna go on a row, though, but I couldn't help but Wade's grades. Very. Are you ready for politics, right?

Wade Pfau 31:16
That's just a good example of, you know, a lot of financial advisors may come from a perspective that we don't have to worry about these types of risks, the stock stocks for the long run, stocks will always grow. And so really all you need is to have that investment portfolio in place. And what we're talking about right now is, I guess they might acknowledge there's a chance someone might have to make cuts to their lifestyle. But that chance is so minuscule that it's not worried. Yeah, even worth reflecting. They

Alex Murguia 31:44
just need to control the anxiety, if you will, of the client. But Michael, go ahead.

Michael Finke 31:49
Yeah, you know, there is in financial planning, this religion of the equity risk premium. So what is the equity risk premium? It's this idea that stocks are always in the long run going to outperform bonds. To an economist, that doesn't make any sense, because the only reason anybody should ever get rewarded for taking risk is if there's a possibility that even in a five or 10 or 15 year time horizon that stocks may underperform bonds. And if you actually look at the data over say the last 30 years or so, holding period return of stocks, reverses different categories of bonds, what you see is that the historical outperformance was super high in the 20th century, especially the first half of the 20th century. But stocks have not outpaced bonds as consistently by as much of a significant equity risk premium as they have in the past. So I think my feeling and the feeling of a lot of other economists is

that the reward that investors get for taking investment risk is smaller today than it has been in the future. Now, there's a lot of great reasons for that. I mean, one is that it's a lot cheaper to invest in stocks now than it used to be. So the premium doesn't need to be as high taxes are not as high on stock investments. So people don't require as much of a higher equity risk premium. A lot of advisors in the market right now. They haven't experienced a downturn in the stock market to them. The stock market is just a thing that continually goes up, you know, wait, you and I Well, I'm older. So Alex and I, you have experienced periods where we're the elder statesman here, we've experienced that joy of seeing, you know, our 401k get dumped during the tech bubble. And also during 2008, we understand what can happen with equity investments, there is risk and risk is real. And you know, your your job is not just to maintain the greatest amount of investment risk. I mean, if you were to put them in 100% equities, why not just go all the way? Why not just put them in a leveraged equity portfolio, and then you're always they're good, they're gonna be billionaires. You know, that's, that's not the way to approach retirement income planning, that's for sure. You can't rely on that equity premium to boy, your higher lifestyle consistently. And especially since retirement is a finite time horizon, and especially since the first 10 years, the performance you get is so important in terms of sustaining that spending liability in retirement. It's, you know, I think it's financial malpractice to put someone in a higher equity portfolio than they are willing to withstand in terms of their lifestyle flexibility, because if you do put them in a heavy equity portfolio, and stocks tanked the first year of retirement, and they never recover the way they did in March of 2020. The Fed doesn't step in and and you know, essentially bail out the market so that retirees who are patient are able to withstand that At short term volatility, there's every chance that equities could go down and stay there. So stocks are so much more expensive than their historical average, that even if they were, let's say, you know, 50%, above their historical average, you would have lost a significant amount of wealth, the very beginning of retirement that may not recover for another 20 years. That's always a possibility. And if if your clients can't accept that possibility, then you can't be giving them that as a solution.

Alex Murguia 35:29
I think this I 100% agree. And this also echoes a little bit without getting too much into it, because it could be a conversation in and of itself, because you had mentioned the Fed, sort of bailing folks out. But this goes back to Bob French, and I, you know, we have these go to phrases, a lot of times when we're thinking about things, and the one that's always stuck in my head, and I think it's West Wellington over at DFA for it's used it, and I never forgot it is the market doesn't owe you a retirement. That's not what it's there for. It's a financing mechanism. And we're riding on the coattails of capitalism. That's it, you know, and when it when it becomes the sort of overall dependency across the entire retiree population, then you get phrases like the ones you said about the Fed bailed retirees out, which I don't think that's in the Feds mandate. And now you start mixing things in and, you know, I again, just fully agree, I don't think people really recognize, yeah, the market is not some magical place that you have $100, you put it behind the curtain, and you give it to the Great Oz, and you get back 110, three days later, because that's how it is. It's not it's not that at all. It's a form of financing. It's a capital market mechanism. It's not, it's not meant for your retirement. And when you start thinking like that, I think dangerous things can happen. But Wade,

Wade Pfau 36:53
yeah, I was I knew you're gonna.

Michael Finke 36:57
I'm not as nice as Wait. He just

Alex Murguia 37:00
He says it with a smile. Wade, says it was a smile. So I feel like I feel I feel comforted.

Michael Finke 37:07
That's when you know you're in trouble.

Wade Pfau 37:11
But it's absolutely right. It's just, yeah, the market is not. I mean, it's, we do believe that markets will grow over time. But when you have this specific sequence of returns issue for your retirement, you can't be assured that everything's gonna play out as, as you're hoping for those types of situations.

Michael Finke 37:31
You know, I think a better way to think of the market is exactly as you said, Alex, it's a way of taking risk from people who are not willing or able to accept as much risk and transferring risk to whatever people or institutions can can afford to take greater risk when it comes to their outcomes. And the amount of risk that you can take when it comes to your outcomes is entirely a function of those spending liabilities. It's what you want to achieve in retirement. And if you believe that the appropriate people to accept the risk in this economy are retirees with a finite time horizon within flexible expenses, then who should be taking no risk? I mean, if any population should have a basically all that's all the market is doing is allocating risk to those who are best able to accept it. And retirees are not necessarily in this society best able to accept risk, I would say a 20 year old investor is better able to accept risk than someone who's 70 years old in retirement.

Alex Murguia 38:30
No, I agree. Wade, sorry.

Wade Pfau 38:33
Yeah. I mean, to kind of close out the conversation, I think we're really coming full circle with your comment there, Michael, that I mean, it's this idea of going back to that idea of spending flexibility that if you have other resources to cover those inflexible expenses, and the remaining expenses truly are flexible. That's where you have that invitation that if you want, you can take risk for that. But you do want to be cautious about how you approach this ability to fund the liabilities that are more inflexible in nature, where it is more difficult to make cuts without impacting in a very negative manner. Your standard of living for retirement.

Alex Murguia 39:11
Okay, well, thank you Mike.

Wade Pfau 39:13
the conversation is going so well. Yeah, we probably want to bring you back for another episode.

Alex Murguia 39:16
Like, we'd have five minutes and like, I can get into trouble.

Michael Finke 39:24
Michael and Wade side note here. How did it feel being interviewed by Wade since what you know? Wade is usually the one being probably interviewed with you? Was there ever? Oh, look at this way. It's asking me questions. Oh, no, we've been on plenty of panels together. So I think we're all pretty good. Yeah.

Wade Pfau 39:41
I've been on Michaels. We should mention Michael has his own podcasts. Well, yeah.

Alex Murguia 39:46
We'll do that podcast question. So Michael, how can people find out more about you

Michael Finke 39:52
I got to promo the podcast. We should also mention David Blanchett here because David has Been a co author with Wade and I, a lot of these papers, we operate sort of independently sometimes and collectively other times, but we all have pretty much the same philosophy. David and I have a podcast podcast called wealth managed through the American College that people can listen to. It's it's a, I think you'll enjoy it. It's like this one. It's we don't take it too seriously. But we talk about important stuff.

Alex Murguia 40:24
Yeah. And it's only 20 minutes

Wade Pfau 40:27
20 minutes at most per episode. Yeah, that's right. Nice.

Alex Murguia 40:32
We doubled up there. All right. Thank you, everyone.

Wade Pfau 40:37
Yep, thanks. Have a great week.

Michael Finke 40:39
Take care.

Alex Murguia 40:40
Alright, bye

Bob French 40:46
Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this

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