Episode 37: Retirement Distribution Strategies: How is it REALLY done in a professional setting?

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. If less than 4% of financial advisors actually apply the 4% rule. Is it really a rule?

Wade Pfau 00:47
Hi, everyone, welcome to retire with style. I'm Wade.

Alex Murguia 00:51
And I'm Alex. And we're here with recurring guest, Brian Bass. Brian, you want to give a little background about yourself just for folks that are maybe listening to you for the first time?

Brian Bass 01:02
Sure. Like Wade said, Alex said, I'm Brian Bass. I'm one of the lead advisors at McLean asset management. You know, I came to come clean first and foremost because of my my relationship through wade through the American College, obviously, studying for my CFP and getting my masters and doing the RSC RCP program through American college got to know Wade very well. That's the path that kind of led me to McLean. So here we are.

Wade Pfau 01:30
Yeah, sure.

Alex Murguia 01:34
And to resolve that Brian didn't know me before he got to McLean hence, he remained. That way, yeah, but he's still here. Random off. Yeah. Yeah. Pending pending, was gonna say one of the reasons we wanted to bring Brian in, is because, you know, we've been talking at length about sustainable withdrawal rates, and specifically the rules based system and even you know, and it has to do with constant spending strategies, but variable spending strategies, assuming that you fall into the total return preference, from the resource standpoint, your probability based and optionality focus. And so we've been going down this arc about sustainable spending strategies, soup to nuts. But what's missing is really what's the practical application of this? Because I would envision there's a lot of individuals that

are listening to this. And they may be wondering, okay, I hear this now I need to put it in, into into use. And so I think it's a great opportunity to bring in Brian, and discuss, you know, what happens, you know, step one through step x plus one, what happens here with regards to this process? And Wade, do you want to kick it off?

Wade Pfau 03:00
Yeah, I mean, so we've made the point in the podcast series about how this whole like just the simplest example of the 4% rule for retirement spending, it's more of just a theoretical construct that it's only use in real life is really to maybe calibrate expectations a little bit about what's reasonable, but whenever you look at any real world financial plan, Brian, do you apply the the 4% rule? Or some sort of variant of that? Or is there really a different approach than even talking about what is the safe withdrawal rate for retirement? I think that'd be a great place to start the conversation.

Brian Bass 03:40
Sure, you know, we absolutely use 4% as the starting point, you know, the the inflation adjusted spending, that's where we start our planning process. Obviously, there's 1000 variables and 1000 different directions to drill down into that. But for us, it's really a feasibility check. You know, is we start with the client spending or what are you? What are you spending currently? What is your retirement goal look like? If we take that and plug it into the system and run it out at 4%? inflation adjusted every single year, does it work? Yes, no. Okay, great. Now we start to really drill down into the, into the questions of, you know, the different ways we can go with with structuring the the investment portfolio or even really, you know, the retirement income plan itself. But as far as a realistic way to manage money and manage retirement, really, the 4% rule doesn't have a whole lot of, of legs. It really is more of just for me, anyway, is a feasibility check of how do we how do we start this conversation?

Alex Murguia 04:39
And you're saying 4% rule, but I just think you're kind of grouping all sorts of distribution rules into this bucket.

Brian Bass 04:49
A little bit, a little bit, you know, whether it's guardrails, whether it's the spinning smile, whether it's you know, any of the the, the things that have been done on the academic side In reality, the the day to day management of a retirement, you know, when you create an income for someone who would current income plan for someone, unless people just really, really like to get down into the weeds of what's going on, no one really wants to think about that. Especially, I have to go to someone and say, Okay, well, we had a bad year and markets. So let's, you know, we're gonna have to reduce your spending this year by 20%. You know, a lot of people have, have kind of benchmark themselves to the spending of last year and this year and the years before, and they don't necessarily want to think about taking a spending hit. And so we have to manage that with their go into the educational piece up front of these are the realities of this strategy. You know, some of yours are gonna get a bonus, would that make you happy would make you you know, what would a 20% bump in your income make you happier? Or would you feel worse about the 20%? Cut back we have to take when markets don't do well? So it's a lot of conversation, it's a lot of education, on the strategy itself, and what that really means. And a lot of times people just don't necessarily want to deal with that.

Alex Murguia 05:58
Okay, so it seems to me, then you use the spending rules as that starting point, as you said, as that starting point for the planet, it's almost like you have to pick a number to begin with. And so you can ask the person, how much do you want to spend? But I would imagine folks have trouble quantifying that. And so you just take their portfolio value, and you just arbitrarily say, Okay, what's 4% of that, and let's see if we can even let's see if we can even spend from that. And to me, you're you're putting words in your mouth, because you're trying to interpret it. So please, correct me hear what you're, that gives you that initial baseline. And from there, the planning starts, but I don't, I don't get the sense, you're thinking, Okay, it's, this is a first year and then in the plan, I'm gonna, you know, adjusted based on the market, and etc, etc, and do all these mathematical calisthenics around what the distribution is going to be in year 2, 3, 4, and 5, it's really more planning focus, you kind of contextualize the distribution relative to what they want to accomplish in the plan. That's, that's a lot that I put out there. And I want to make sure I'm being accurate, at least directionally.

Brian Bass 07:12
No, I think that's accurate. We do illustrate the 4% rule. So we do illustrate, you know, the spin goes up every single year by 4%, from the baseline at the beginning. And we show them, you know, obviously in the year 10, 20, 30, that the numbers are very, very big relative to where we started. And that all kind of plays back into the stochastic modeling of we know, we're gonna get in our plans, we build that a specific investment portfolio, we know the risk and return. And we kind of plug that in and play with, you know, the variability of the return streams. And does that make sense? Because I don't want to say if the worst case scenario, but from a spending perspective, the slope of that line stays consistent at the 4%. And it gives us a it does give us a baseline of is this even possible? You know, in to going back to the original conversations, you know, that it usually goes one or two ways. It says, Okay, here's my portfolio, what can I spend, or here's what I'm doing right now, here's my budget, this is what I'm spending a year, I want to kind of stayed around this number. This is kind of where we've built our our happy retirement place. Is this feasible for the next 25 years, 30 years, whatever the case may be. And those two conversations obviously go very differently. So the ones that come to us with a portfolio says What can I do? The 4% rule is kind of where we start.

Wade Pfau 08:25
And that's an important point as well, this idea that, do individuals really have an idea about their retirement budget, when they come in to talk with you? And do you have a sense of how common it is to have the budget in place? And therefore you can use that as a starting point? Or is it more the question, how much can I spend in retirement? And then you could say, well, 4% of your investment portfolio? Is this. How does that sound to you? And is that something you can work with it? How do those conversations generally go in practice.

Brian Bass 09:01
It's a mixed bag. The people that are closer to retirement, or the ones that have already entered retirement, kind of have a general idea and can do a little bit better job of providing a budget to us. The ones that are 10-15 years out, really have no idea. And so what we kind of would kind of do on that front is look through and it's in it's a great exercise for them to is encouraged them to kind of put

together the last 12 months of spending and see what the see what the actual outflows look like. And then categorize those and see what opportunities we have to let some of those expenses fall off. Obviously, as kids get older, and they get through school and they get through college, you know, there are a lot of things that fall out of the budget that we know won't be around to retirement. So we can kind of spit ball and put together kind of a really loose idea of what retirement could look like. Some people like to go that route. Other people say you know, I want to spend $200,000 a year plus tax or $250,000 a year and we can kind of back our way into you know, where you are now? What is the savings goal, and something you've done a lot of work on as the safe savings rate plans, and figure out and help them figure out the way to get to that, you know, ultimately, it's not about the the beginning value of the portfolio so much as it is just creating a plan to get to that point where we know we have income streams that we can turn on a retirement.

Alex Murguia 10:21
So, so Wade, this, he said something that that struck me, I don't know if it hit you? Oh, he was saying that. But this falls in line with a research that we've done recently, which, to me, I never, I didn't really expect it. And this, this has to do with expectations of what a retirement income amount will be. And I think the anxiety that follows through with that, in our research, Brian, we we look at, you know, how anxious you are about your retirement spending, you know, do you think it's gonna outlive? Are you going to outlive your assets, that kind of thing, and we come up with a longevity aversion score, if you will? And, and wait, you know, remember how that it was actually the younger folks are the folks that were further away from retirement were more anxious about this, than the folks that were nearing retirement. And I think it you know, and I'm hearing this from from Brian, as well, anecdotally, would you agree with that? i It seems to me, once they they start in that retirement phase, reality hits. And obviously, it is what it is. And so this Acceptance comes into place, and they kind of back into well, this is the standard of living that I can do. And this is how it turns out. Whereas if you're younger, that fear that unknown, is actually quite accentuated, is I'm getting that sense from you in terms of what you're saying.

Wade Pfau 11:50
Yeah, I think you do see that a lot. Even our friend of the retirement research community, Fritz has that he had a really interesting blog post about this whole concept of when you're still pre retirement, you're you're not sure what to expect, and you're more concerned, but when you actually get to retirement, suddenly, it does look like things are going to work out. Okay. And so maybe that longevity risk aversion, that idea of I'm worried about outliving my money starts to subside a little bit. But I know, Brian, I don't know that might apply in some cases. But probably there's still maybe a group of people who will academics call it the retirement consumption puzzle. Its people don't seem to spend as much as they could in retirement. And it's not clear why that's the case. It might be partly, well, both retirements, two L's that might be they're using a total return strategy when it wasn't the right one for them. And therefore they're very, there's continue to be worried about outliving their money and so forth. But But do you see that Are there cases where where or maybe what's what's kind of the more common scenario, you have to talk the client out of spending too much, because it looks like they are on an unsustainable path or the opposite. They're not spending and even with very conservative assumptions for the plan, it looks like they could be spending more than they are. And you're trying to

give them the okay to go ahead and spend more do you kind of have a sense of how that plays out in practice.

Brian Bass 13:24
So we actually recently had a client meeting where we went to them and said, you know, you're, we've used really, really, really conservative numbers and your plan, you know, extended longevity, we've covered all your bases, we have everything checked in this way, every box checked in this plan, and you know, the success rate is is forecasted 100%. And we said, you know, you can spend X dollars more than you already currently are every single year for the rest of your life, or for the rest of the duration of this plan, and everything is going to be completely okay. And they both kind of sat back and were like, you know, our lifestyle is what it is like, we're very happy. We don't feel like we need anything. We don't we don't want to do that, you know, we're fine. And then we kind of shifted gears that conversation to Okay, fine, you know, if the if the utility of the next dollar is not, is not high enough to make you happier than let's not spend it. Let's figure out what what your other goals are for your money, whether it's, you know, bequeathed bequest goals, or charitable stuff, or, you know, however you you see, using these dollars, let's figure out how to make you happy in that route. You know, other than just going on taking another vacation or buying another car. But there are absolutely people on the other side of that spectrum to where, you know, the plan is less than ideal. And it looks like, you know, we may run short Well, before we need to, you know, and then what are we gonna do about that? And it's, it's a lot more challenging to have those conversations when you're 10 years into retirement than it is, you know, 10 years before retirement? No, but those are the realities of the different people that we work with, I guess,

Alex Murguia 14:57
a couple of points from the From the first from the consumption puzzle, and Wade, you know, jump in here as well, the way you were saying that I thought the three points that I think could be relevant, and they don't all apply to everyone. And I'm curious how you see this. The first one could be maybe it's not a positive way, maybe, you know, the risk is relatively new, this retirement income style is relatively new. And maybe they were engaging in a total return approach, right, which is a credible strategy, I want to start like that. But perhaps their longevity fear is such that it's the just in case like, listen, I get it, I'm on track, and I got 100% on Monte Carlo probability. And incidentally, for our listening audience, that's, that's that's very difficult to attain 100% success rate, that's

Brian Bass 15:48
it's very rare,

Alex Murguia 15:50
like nuclear scenarios, that you're that you're surviving, you know, if you will. But you know, that being the case, that even that doesn't, it's not good enough for them. And so they still need that cushion, I would venture to say, they're potentially in the wrong strategy. You know, it sounds like they would have benefited from, like an income protection approach, because maybe that's their true Retirement Income stuff. I'll get to that later. I don't want to unpack that right. Now, I just want to point out that's, that's a potential there. The other two issues. And I think the second point that the point that I'm about to say is probably relative applies to the client that you're speaking about, I know him, and he loves fly

fishing and the like, and he's living the life, but you're creatures of habit. You know, if you've accumulated, you know, you know, very meticulously very discipline, through 40 years of your accumulation phase, it's hard to just turn that off. It just is, it's just hard to turn that off. And so you know, he's not going to spend just to spend because it just doesn't feel right. So I'm curious, how much of that dissonance you you experience from people that it hurts them to spend more, because it almost seems profligate at a certain point. Right. The other so there's that first one being late, I don't think I'm in the right strategy. I need to reconcile that. And I know as we've been doing the research, we've come across those situations. The other piece is, hey, I'm a creatures of habit. I'm a creature of habit. I have that longevity aversion. It's just, you know, it's like the movie Brewster's millions as I think I said it the other day where they just can't spend the the other point that I think we come across, and this is Brian, point nine, he comes up with this phrase, and I love it. I've mentioned it on previous podcasts, it's the term funded contentment. It's not a behavior thing. It's just listen, they have enough right now that they can comfortably underwrite their retirement, you know, even within a total return approach, you know, 100% success rate, they can comfortably underwrite their retirement, and they're living to the standard of living that that that accommodates them. And they're done. You know, I'm curious what, weighed yourself. I'm curious what you think of those three points, though. They're in their own strategy. There's creatures of habits, it's hard to change that behavior, because there's this dissonance that takes place. And I think that was important, frankly, because, you know, they don't they're not really enjoying their retirement to the fullest. And who am I to say they're enjoying it or not? Right. But objectively, it's, it's not that difficult to make that case. And the other piece is some people just funded content, contentment, they're good.

Wade Pfau 18:30
Yeah, I think the related analogy there is about the ants and the grasshoppers to where if you've been an ant your whole life, which means you're saving and preparing for winter, and so forth. Traditional retirement advice is telling you to switch and become a grasshopper post retirement. And if that's not who you are, if you're an ant preretirement, you're not going to switch to be a grasshopper and just enjoy life and spend profitably and everything else post retirement. So there, there could be an element of that forgetting. Yeah, I mean, it's just, we think the more you spend, the happier you'll be. And maybe at some level, that's true. But the the marginal change in happiness could be so minor, or it could just be a hassle, it could actually be negative utility from spending more that at some point, you just you don't need it. And then that could help to explain the retirement consumption puzzle, or that could just lead to okay, maybe developing a gifting strategy or thinking about some of those other kind of legacy related comments that you made Brian, as well as an alternative to just simply spending more and going to the fancier restaurant or whatever it is that causes you to run up the tab on your annual spending bill.

Brian Bass 19:45
Sure. Some of the things I mean, that we've seen, too, as you know, obviously your your highest earning years are right before retirement. And so it it's very easy for lifestyle creep to happen in those last five to 10 years. Just once the kids are out of the house and all the, you know, those, those expenses really fall out of, of your cash flows, it's very easy to see, when people get that lifestyle creep, and now they start going out to eat a little bit more. And now they're traveling a little bit more because they have more time. And it's hard because the, if you don't have the assets to continue that livestock

going into retirement, it's very difficult to put that genie back in the bottle. Because it brings in a whole bunch of emotional problems where, you know, you feel like a failure, you feel like things aren't as good as they were when I was working. And then you start to feel guilty about retiring at all, and so that there's a whole bunch of emotional things that go on in that last five years before retirement, that really, as we start to uncover and have those conversations, filter into how we really start to design that retirement income plan. You know, and sometimes it does, it does take creating that retirement smile, where we give them a bigger budget at the beginning of retirement, because they just they can't see themselves in a lower lifestyle, going into retirement, that the point of life where we're supposed to be, you know, enjoying ourselves and having fun and doing all the things that we've dreamed about our whole life. And then you can't do them. Because you know, we have to go and use a strategy that just isn't built that way.

Wade Pfau 21:10
Yeah, so And ultimately, there's, there's so maybe just simply said with the research on this, we ever had a case where maybe last year, the couple or households spent $100,000, last year's inflation rate was 5%. So let's do the calculation there this year, it looks like you could spend $105,000, maybe and maybe you're not even getting into the issue of adapting to what's gone on in the financial markets, maybe you got an average market return as well. Is that ever coming up? Or I think maybe what might be more common as well as people latch on more to the nominal spending numbers so that if I spent $100,000. Last year, I'll spend the same amount this year. I won't worry about having an inflation adjustment and and then ultimately as well, when do the raises come in? If markets are doing well? Or when did the cuts come in? If markets are doing poorly and it's probably not applying one of the precise spending rules that various financial advisors have developed but but how do those conversations actually go and in practice?

Bob French 22:21
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Brian Bass 23:07
Yeah, I mean, in, in practice, very few times have I ever discussed any kind of inflation adjustment or any kind of program spending cuts or raises? It really just goes into, you know, as we have our quarterly meetings or our annual meetings, it's, you know, how are you guys feeling? How's your how's your lifestyle? How are things going? Are you happy? Are you not happy? Do we need to adjust your spin goals? If people will tell you like, No, I'm really good. Like, we had a great year, things were great. You know, I really had a good time. You know, markets are down, but I see my plan is okay, like, I'm okay. Like, and it's our job then to say, Okay, does it make sense to continue to use the same spin goal? As markets are down? 20 30%? Whatever they are? Are they is that still? You know, is our plan still working? As we use those same goals when markets are not cooperating? And again, this is in total

return? We're we're completely reliant on the market portfolio to do its to do the job of creating the spending for us. And to are you comfortable? Like, how is this Ben, how was? How was 2022 been for you? Like, this has been a really rough ride? No, bonds are down, stocks are down, everything's down. How are you guys feeling? And some people go, Oh, my God, this is crazy. Like, I don't want to be in this anymore, like helped me out of this total return. And so we were like, Yeah, that's great. It's gonna come back, it's fine. So it really is just it's uncovering the stones and really diving into the emotional side of how are things how is this you're treated you?

Alex Murguia 24:28
Interesting. So I get the sense then. And you said it. So there aren't any, you know, systematic raises built in based on inflation and the like, which, and this is at the core of many of these most unsustainably most of the time. I guess Social Security as you know, covers that that to some extent. That inflation adjustment Yeah, you're getting it there and it's automated. But is it fair to say that if there are changes in someone's distribution, it let's say some of the it's a that person Just getting 50,000 a year, right? And all of a sudden there's a spending shot. And they come to you with, Hey, Brian, I'm gonna add an extra 10,000 this year because whatever, a wedding, a bar mitzvah, remodeling, remodeling and more than 10,000, but that kind of something like that, and then effectively you put that into the plan, if it works great. And then the next year, you either maintain it or you don't, but I'm getting the sense that raises don't come across systematically, they come across from a planning perspective. Is that a fair comment?

Brian Bass 25:37
It is, is

Alex Murguia 25:39
like, again?

Brian Bass 25:42
Yeah, I mean, a lot of times, people will tell you, hey, you know, we're bored, we want to take another vacation next year plan for 10,000 bucks, we're gonna go to Europe, do you know backpack across Europe or something like that, and we build those in, you know, our ask is always Hey, you know, if you know, there are things coming down the line spending shots aside, like those things happen. If you know you have a big ticket item coming up, just give us you know, six to 12 months, let's figure it out. Let's make sure that works with the cash flows. And we can set aside those in an advantageous way. versus, you know, obviously doing it this February, March, when markets are severely depressed, we obviously don't want to do that if we can help it. But the spending shocks are what they are, you know, things happen air conditioners, break heaters go out, like things like that happen. And then we have to adjust so.

Alex Murguia 26:27
So ultimately, it seems you can have all of these sustainable withdrawal strategies, be it again, constant, nominal adjusted for inflation, standard percentages every year from a portfolio with certain guardrails. But ultimately, I think those are initial starting points. And this could be too strong of a phrase, they kind of fall to the wayside in year two, three, and four, because planning provides the

context of future distributions. And by planning, I mean, you know, you're putting that economic overlay relative to the distribution, and you run a Monte Carlo, which is you're saying stochastic, but let's just say, for our listeners, Brian is referring to a Monte Carlo sort of simulation, which we've discussed on previous episodes. And if it results into a number that's economically viable, such as 85%, success rate, 86, you know, whatever, then effectively, you give them the thumbs up. I'm, you know, I'm generalizing. But that seems to be what you're talking about in terms of how you interpret these sorts of rules. I agree with that. Okay.

Brian Bass 27:35
And a lot of times, you know, the, I think, on paper, the 4% rule is great, the guardrails are great, they all make a lot of sense. Academically, they make sense. But in the real world, you know, to your point, the spending shocks happen. And that kind of blows everything apart, right, you're still you're not going to get, you're not going to get a raise on top of, you know, a good market return, you're going to get raised and spending when you had a 10 or 15, or $20,000. Oops, that showed up out of nowhere that you weren't expecting, right? So it's great to model those things out, it's great to have a benchmark where we know we're okay, if we do X, Y, and Z. But in the reality, like, life happens fast, and it happens all the time, which is why we have, you know, meetings basically every at least once a year just to figure out where things are and what's going on. Just because life changes, our goals change what we are enjoying changes, everything changes. And so having a strategy that you put in place for 30 years, doesn't necessarily work in practice.

Alex Murguia 28:34
Yeah. So are you upset that you spent all this time studying about all these withdrawal rates? And all of that, well, you know, weights curriculum in the RACP. Were you like, afterwards? Or better said in another way, while you were studying this? What was your thinking? If anything at all, were you thinking, Okay, I'm going to have clients and this is how we're going to do this. I like this spending strategy best, this is going to be my go to, you know, and then was there a little bit of a, of a reality shock? In terms of oh, this is really how it works in practice?

Brian Bass 29:09
No, because I think as conversations come in, is every new client and every new relationship that you start working with, you're able to see things from all different angles. You really can, when someone comes and says, you know, something that off the wall that I know is not going to work, I know why it's not going to work. And I can plug it in through through that lens of what did I learn from waiting? What's What are the academic saying about X, Y, and Z? I know this isn't gonna work, but I'm going to show you why it's not gonna work and we're gonna explain it and then we're gonna figure out a way around that and figure out how to make it work or these are the changes that we need to make to make that work. So no, absolutely not not disappointed with the education piece at all. I think learning all the different ways to do it. Just made me a better planner because I can see things from different angles

Alex Murguia 29:56
Yes, perhaps it identifies levers that you can pull it doesn't have to be systematic Levers as they're presented, you know, in terms of taking an exam, but the reality is, you know, what levers you can pull from? What do you think wait? Because you create these curriculums What, what's your balance,

Wade Pfau 30:12
it's a framework that you won't actually need to follow the rules precisely as they are. But if you kind of base it around one of these decision rules that, as Brian notes, it's, you're not going to follow the rule. But what you're experienced in retirement may approximate the rule in that, in some years, you might spend more another years you might spend less. But the reality is, you'll do that in a more ad hoc fashion. And maybe after the fact that does look like you followed some sort of rule that that's really all the research is able to do is to provide some sort of parameters around the retirement and a framework for thinking about how you want to approach those distributions. We certainly don't want the RSP to be an academic exercise. And it's meant to be very practical. And most advisors do say it is one of the most practical education programs they went through where they can learn something in the same day, apply that with a client. But yeah, I guess, at some points, the real world is messy, and you need a model. And that's where the decision rules are other variables bending or any sort of systematic distribution strategy is a model of reality, that can give you some idea about reality. But reality is always going to be messier.

Alex Murguia 31:33
And you said a good phrase, it's a model. And by definition, a model isn't a reflection of reality. It's a, it's an approximation of it. And so I think that's, that's, that's, that's how you should take it. You know, from a practical standpoint, and you folks can chime in, I mean, we were bringing in Brian, and to some extent, we're using Brian as a representation of the advisors that are out there. But I don't know, offhand. And I've been in this business for quite a while. And I know a lot of advisors, more than I can count. And I don't know any, that actually do a straight up distribution rule. You know, as opposed to doing something along the lines of what Brian said, which is less than that, as a starting point, it helps us base things on reality, what up on what an approximation is, and then helps us back into a number. And then the planning takes over from there. And I'd love to take, you know, I'd love to find out if you folks concur. Maybe there is some advisor in the wild that actually does this and nothing else. But I'd be hard pressed to find an advisor, that follows to the tee any of these rules as as the standard.

Wade Pfau 32:44
So I think it's hard in practice to just because the rules are all assuming this is gonna guide your after tax spending. But the reality is you have to pay taxes as well. And taxes can be quite messy and fluctuate quite a bit from year to year. And so if you're talking about pre tax spending, if you're following like constant inflation adjusted spending for a pre tax spending goal, it's going to lead to volatile spending post tax. And that that in and of itself makes it almost impossible to use a simple spending rule as a practical real world guideline. Yeah, consider every other issue.

Alex Murguia 33:23
That's a good point. And if you think about this, from a payroll standpoint, because you're effectively giving yourself a salary. I mean, right now, we're all in our working years. And we'd like the consistency of a paycheck and the amount of that paycheck. And if there wasn't, obviously you'd like to trend up, you know, pick to inflation, and performance and the like, but you know, that aside, it's the same thing in retirement. And if it was really jumping up and down, it'd be a tough sort of check to swallow year after year, I would think, Brian, do you think that's correct? Do you think folks like that consistency,

even if they're doing the total return approach, I mean, they get the joke from the standpoint that if the market drops, and you have five years of negative return, just to paint an, you know, a poor scenario, they know that they may have to accommodate their spending, they may have to adjust their spending to accommodate the reality of their network. You know, they know that that's what they signed up for. But by the same token, they still appreciate a consistency of of having a paycheck of the same amount is that accurate?

Brian Bass 34:28
Yeah, that's very true. Again, going back to the people just don't want variable paychecks. So it's, it's very, it's a very, from our conversations. It's a very uncomfortable feeling to think about next year may not look like this year spending and I kind of get used to the things that I'm doing I kind of used to my lifestyle, and these are the kinds of things that I want a need to know whether you're gonna section that out to needs versus wants is another question. Thanks for that sometimes, you know, ultimately they were ultimately we're crafting no retirement to live Like what they want it to look like. So if if vacation and travel is not on the needs list, it's on the, or it's on the ones that sit on that news list, like, so be it if we can plan for that and make it happen, great. But those all go into the conversations, you know, if if the variable piece of that if markets down 20, and I have to take $10,000 out of your spending, and that eliminates that vacation from you. Now, how does that feel? Like what does it look like for you? And two, I just want to touch on a point to like, from the emotional side, we can, we can build these beautiful 4% roll these spending rules, all these beautiful plans. But if it's the wrong strategy, and you get into it, and the market does what it did in March of 2020, right? If we're down 20 30%, or we're down, we have a 2022 scenario where we're down, you know, 20%, right out of the gate in January, and you jumped ship, right, that's a that's a really, really bad outcome. And so it's important to kind of think through all these things beforehand to figure out, you know, is total return right for me, or, you know, what mix of stocks and bonds is right for me so that I can actually, I can actually survive this strategy, because it is very, very uncomfortable sometimes, if you're not prepared for the volatility market. So two points. And that's I think we're Alex, to your point where the reset comes in is, you know, really uncovering the stones of the emotional side of investing and retirement income is, what do I need? And how do I build this, this plan so that I can, I can weather the 2030 40% downturn in markets and still sleep at night?

Alex Murguia 36:28
That's a good point, from the standpoint of, you know, within our firm at McLean, but the Reese is a relatively new construct. And so it's not, it's not like we've been doing this for five years. And every new prospect that came in, we gave them a Risa and we put them in the strategy. You know, the reality is five years ago, you know, science moves forward. And we did you know, we were predominantly a total return approach, wealth management firm. And so we've been having conversations with existing clients, and who've been in a total return approach, and we give them the Risa walk us through that, what happens if it doesn't have to be? It's not a problem until it is kind of conversation, what happens forget market turmoil, even if it's an irregular, because we've been doing this as par for the course, as clients come in for their reviews, giving them the reset? What happens if somebody isn't a total return approach, and all of a sudden, you realize, hey, this person is actually more gravitating towards an income protection, and we should layer that in to that strategy. What's the reaction?

Brian Bass 37:35

Um, it's been a mixed bag. Obviously, you know, when you're when you introduce new concepts and new thinking, there's, there's always going to be some pushback, and some, you know, why now, kind of thing. But it really is, it's been amazing to see people's reaction to the plan itself, when you look at mitigating downside risk, and mitigating longevity risk when we're using things like annuities or time segmentation to kind of offset some of the volatility. And we can obviously dive into the weeds of what those two things are.

Alex Murguia 38:04
Well, we have different arcs for that right now. Or later. Yeah, exactly. Wade, there's more. It's been interesting.

Brian Bass 38:13
We've had, we've had quite a few clients that have said, hey, you know, I really liked the idea of a risk wrap or a safety first kind of thing. Let's look at, you know, can we take a look at our bonds and see, you know, is there is there a place to add, you know, an annuity instead of some of these bonds? And how does that look? And what does that going to do for me, and they've, some have really liked it, and some have not so much. And we've gone different directions with different clients. But it's, it's very, it's been very eye opening on both sides to see reactions to the recent in the recent results, and, you know, seeing how they are now starting to open up to the idea of retirement income and what that really means, versus, you know, hey, give me some money out of my stock portfolio, it's done. Well, what does that great, what's that going to do? So is it still gonna work. And it really just kind of defines the context of retirement income and gives them something to grasp onto, like, I know where my spending is coming from, I know what my social security net looks like, I know what my guaranteed income piece looks like, I know what my, my volatile piece looks like. So it's been a really, really good experience. And it's been a I don't want to say, a steep learning curve, but the introduction to some of the clients has been really, really good and really, really welcome. And we spend a lot of time on the implementation really figuring out how to, you know, take that total return portfolio and, and transform it into a way that that people a Can I guess, tolerate that had been in it for 3040 years, and be make it to where they see the benefit of what we're trying to do.

Alex Murguia 39:41
And the reason I brought that up because I want to kind of under the under the water. Bring up that it's not just about portfolio market volatility, risk tolerance. It's about taking longevity aversion off the table, taking spending shocks off the table, which are these new risks that you have in retirement. And thank you for sharing because, you know, some folks, we did a total return and, and it it was in our best interest just to make sure that things are reconciled before it can become an issue. You want to be proactive on that. Wait, I, I'd like to talk about and chime in as well, Brian, but I no way loves looking at, you know, you hang out in the vanguard, you know, chat groups and things like that. I don't know what your alias is. I think it's a Wade. One.

Wade Pfau 40:30
I'm just I'm actually Wade.

Alex Murguia 40:32

Oh, yes, you wait. Because one of the things I wanted to take away for folks listening in, especially the do it yourselfers is I get a sense. There's way too much conversation about the intricacies of the Sustainable withdrawal strategies, like way too much as much as they talk about what's the risk premium going forward. They talk about what's the actual withdrawal rate that's safe going forward? Or you know, all these levers that that decrease? I just think there's a lot of chatter in that. With regards to what is actually done in reality. And look, look, this is best practices, what we use just heard Brian safe, it's contextualized to the plant, if no one follows this, this thing robotically, you're 56789. And so what advice would you give to folks that, that maybe, you know, at the risk of coming across? As you know, whatever? What's the what's the advice you would give to consumers that are listening that or do it yourself? Or is it are really potentially over engineering these things?

Wade Pfau 41:38
It's a good question. Now, it's an it's I'm certainly guilty of this too, in terms of over engineering, what's the safe withdrawal rate and everything else. But yeah, at the end of the day, it's not, no one's going to mechanically follow those rules, you're going to spend, what you want to spend, and you want to have a sense of whether you're on a sustainable track. And you can inform that with some of the models and spreadsheets that you create. But at the end of the day, it's if you want to spend an extra $500 in the spreadsheet says Know that you're you've gotten outside of your guardrail, you might go ahead and do what you want to do and make an adjustment later if necessary. Don't Don't be the victim of just following this spreadsheet too much. Don't overdo it with some of that analysis.

Alex Murguia 42:33
And Brian, does anyone come to you with these preconceived notions? Or, you know, stick to the question what what advice would you give to folks?

Brian Bass 42:41
I think the I think the quote, don't don't quote me on this quote, I'd rather be vaguely right. I'd rather be vaguely right and precisely wrong. Yeah,

Alex Murguia 42:50
that was Wade, who-

Brian Bass 42:52
That's about, I think that's about in the ballpark. Some of the things I've seen, there's just, there's paralysis by analysis, there's so much information, and there's so much stuff out there. And you get bogged down in withdrawal rates, and you get bogged down in the investment side. And then you get bogged down. I mean, I've seen some micromanagement of the portfolio down to just I mean, two pennies in it. It really doesn't. It really doesn't matter, it's more of am I in the ballpark? Like way to your point? Is it $500 More than what I'm trying to spend? Is that really going to kill me? Can you save $500 After spend going next year to offset that? Or do you even need to like, those, those minutiae is where people get lost in this. And that's where errors happen. A lot of times, you know, the portfolios get adjusted, because I have a hunch or because, you know, someone on picker network said this, and that about the economy. It's so much noise out there in all aspects of the financial planning realm and the investment management realm, that it's it really is it's understanding what you're trying to do with

this financial plan. What do these numbers really mean? What is the strategy trying to do, you know, at the core of it, and then just working around at the margins? I mean, that's, that's really the best advice I can give is just, you know, don't get caught up in the minutiae of the actual strategy from an academic standpoint.

Alex Murguia 44:12
Yeah, I agree. I think getting caught up in what's the optimal, sustainable withdrawal rate is not too dissimilar. And Wade, I'm thinking about this, as I'm, as I'm saying this, which I often did, so please correct me if I'm offered this analogy, guys, but it's almost like creating a portfolio. And what I mean by that, and I'm sure Bob would agree, the biggest decision you're gonna make is your stock, the bond allocation. It's Wade did you think I was gonna say the market doesn't know your retirement or something like that?

Wade Pfau 44:45
I'm sure Bob will agree with me, I thought was

Alex Murguia 44:50
that really happened. But no, no, he says this a lot. I mean, the biggest decision you make is what's your stock, the bond allocation, right? And so that's akin to To what strategy? Are you going to engage in total return income protection, risk wrap or time segmentation? You know that that that what strategy one engages? It's kind of like, Okay, what's your stock? The bond allocation? Because from an investment portfolio standpoint, stock, the bond allocation is the big one, right? But then people get caught up in Okay, now within that within my equity allocation, okay, what's domestic? What's International? What's real? What small cap value? What's large cap value? Do I put technology stocks so that, you know, they over optimize that portfolio for that perfect, you know, risk return scenario, when the reality is, listen, once you got the stock, the bond allocation down? Yes, you get a healthy slug of everything. And although the phrase healthy slug than the same scientific, that's kind of as good as it gets, you know, and I think that's very similar in terms of these distribution strategies. Once you decide, okay, total return is my wheelhouse. You've kind of accomplished a lot in terms of going forward, whether you want to do the guardrail that has a 10% drawdown versus a 5% drawdown versus a 3%, drawdown, etc, etc, etc. I'm not so sure that's in your best interest. You know, it's good as a starting point and get a framework as Wade was saying, but, you know, you know, if you love spreadsheets and knock yourself out, but know what you're getting into, would you say that? Am I on track there? Wade, I just said that off the cuff. But that's kind of what I was thinking about while I was listening to Brian talk.

Wade Pfau 46:33
Yeah, yeah, there's definitely a parallel universe of over engineering, your asset allocation over engineering, your withdrawal strategy. And at the end of the day, you can simplify both. Right?

Brian Bass 46:51
No, I agree. And again, going back to the noise, there's so many people out there screaming from all different sides, you know, is it active is a passive? Is it ETFs? Is it mutual funds? Is it picking stocks is, you know, what's the most efficient way to create these return streams? Like, honestly, like, I mean, there's, as long as you're not getting caught up in doing crazy things, and tiny markets and trying to do

things, because, you know, you hear him on TV, you know, the 6040 5050, whatever portfolio mix you're talking about with stocks and bonds, you're probably going to be okay, you know, is it it really is people get caught up in trying to do the most optimal thing to your point, Alex, that, that's where you really get run aground is you're trying to do all these things at all different times and just doesn't, it doesn't have to be that way, you can simplify it down and focus on the planning. And just make sure that the engine of this boat is, you know, the equity piece that's going to drive the returns. Now, that's where things need to be put in place correctly. And the bonds are there to control the ups and downs. Yeah,

Alex Murguia 47:48
I mean, that's a good point. And I know we're nearing on 45 minutes. And well, we're past that. And that's kind of wait in our queue dependency, we can put a bow on this thing. But you said it again. And I agree. The plan, you know, this is good, what we just all the previous podcasts that we've had in this arc, it's good for the framework to how to think about this and a sort of a sanity check. And there and knowing what levers you can pull if need be. But this preordained sort of systematic withdrawal rate that just doesn't reconcile with reality. What does reconcile with reality is contextualizing it to the plant, we spent one or two episodes just talking about funded ratio as that initial plan, and how the funded ratio went, if you're going through the if it's total return, if that's your calling, if that's your style, then a Monte Carlo plan can provide a nice reality check on an ongoing basis if you're on track or not. That's what I would want to that's what I would want all everyone listening in, to come away with not trying to memorize all these and picking the perfect one for them in terms of the Sustainable withdrawal strategies, but 8000 feet in the air, this is kind of how you should be looking at. That's my sort of parting thoughts there. Wade, and Brian, just to take us home you want to give yours?

Wade Pfau 49:04
Yeah, I guess that that's a good theme for the podcast, it just, you know, reflect reality. And there's some broad levers to think about do you? Are you someone who wants to front load your spending or backload your spending, which means maybe you will be more aggressive early on understanding that there may be cuts along the way? How much volatility Are you willing to accept for your annual spending? How much adjustments do you want to potentially make in an average market environment versus good versus bad? And that might help you to develop some structure around how your spending will evolve. But then yes, indeed, the reality is, look at what you're wanting to do, if it's within the realm of what's feasible, based on the framework. That should be enough and you should feel comfortable doing that you shouldn't have to be concerned about, well, spending too much a little bit too much or a little bit less than what you were targeting had to spend as well.

Alex Murguia 50:03
Brian and you thought we weren't gonna get past 20 minutes?

Brian Bass 50:10
No, I agree with both of those takes. It's finding the right thing for you that makes you comfortable that plays within the bandwidth of what you have and where you're going. And it's kind of kind of live there. And we're going to work around the margins and it's going to be okay.

Alex Murguia 50:25
All right, everyone. Thanks for listening in. That concludes today's episode.

Wade Pfau 50:31
Thank you, Brian Bass from the McLean Asset Management for joining us and thanks, everyone for listening.

Alex Murguia 50:35
Yeah, Brian, thanks a lot, man. And obviously it was... Yeah, obviously we're gonna have you on future episodes man.

Brian Bass 50:43
Looking forward to it.

Bob French 50:48
Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with the risk including risk of loss. Past performance does not guarantee future results.