Episode 8: Making Sense of the Different Retirement Income Strategies Within the RISA® Framework

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 you think the difference between total return and income protection as a matter of perspective, then you've come to the right place. Our hosts Wade and Alex.

Alex Murguia 00:50
Welcome everyone to this week's episode of retire with style. I'm Alex Murguia, and I'm here with Wade Pfau. And today we're gonna talk in greater detail about the four retirement income strategies that derive from your retirement income style here. So it's a bit of a continuation from the last episode. But we want to really get into how these play with with each other. And as a quick starting point, the four strategies that were aligning here are going to be discussing our total return, risk wrap, income protection and time segmentation. If you want to know a little bit more about these strategies, the sort of primer was discussed in the last episode. So I suggest you, you check that out to get up to speed. And Wade, this is usually the part of normal podcasts where there's a lot of small talk and chit chat between us. But we we're not there yet. We're not experts at this podcast game. So you know, we just get right to the meat of the sandwich right way.

Wade Pfau 02:03
And there's so much content to cover that.

Alex Murguia 02:09
So, so here, what we're where we ended up last time is we were talking about, there's two strategies that have natural correlations. And there's two strategies that we feel are more behavioral strategies. And we kind of give a little bit of a preview there, where we discuss time segmentation being one of those behavior strategies, and, and we'll get that towards the middle end of this podcast. But I think it's really interesting. The this this idea of natural strategies. And yeah, and I'd like to really flesh that out a bit more. Wade. You know, let's, let's, let's go into it. So if you're, by natural strategy, I mean, there's some natural correlations here with some of these factors. And if you're, as we discussed, there are four quadrants, right? But really, you know, some of those seem to kind of fit a little better than others, such as if you're probability based, you tend to be optionality oriented. And if you're safety first, you tend to be commitment oriented. There's this correlation, and the correlation is in the 60s in the mid to

low 60s. So the reality is, is that there, that's a high correlation. But interestingly enough, they're still capturing two distinct constructs. Like I said, when we did the factor analysis on them, they weren't seen as one construct, there's there were seen as two distinct constructs here. So what what's kind of uncanny is that, you know, they're there, they're associated with each other, but yet they're distinct. They don't cancel each other out, which is, you see that, you know, quite a bit in terms of, you know, research, this is where accumulation distribution is that that sort of secondary factor kind of is canceled out, you know, once you want to account for these two factors, these two factors, though, highly correlated, though highly associated, still remained distinct. And what they're the variation that they're explaining sort of is not, is not cancelling each other out, which I think is really, really cool. From that standpoint. Wade, agree, disagree.

Wade Pfau 04:27
Right. I mean, that's getting into the heart of the matter with the fact that there are two distinct factors, but because they have that relationship, we still can talk about them both. And that's, it's more natural that you see it, this idea of what's the total return strategy and the income protection strategies where you see the natural correlations that if your total returns, you are more naturally probability based and optionality oriented and those we see more frequently showing up together rather than And showing up separately from one another. And then if your income protection, you're more naturally, probably safety first and commitment oriented. And those, of course, are the same way correlated with each other and become more of a natural strategy. And even going back to the past 10 years or so of the whole history of retirement income planning as a distinct field and financial planning, we do talk about four styles before there were three styles, it was really they have different names, but total protection. And then time segmentation was the hybrid between the two. We do think risk rap deserves equal footing with time segmentation as another hybrid strategy. But really, it was always the case that these other two strategies, the time segmentation, the risk crap, they didn't necessarily have those natural correlations. And that's where the motivation and discussing them was more behavioral in nature of putting together these preferences that aren't necessarily consistent. So when we talk about something like total returns, we talk about this optionality orientation as well as probability based. And I don't know, there's a lot of interesting ways we can discuss this further. But in the world of academics, there's this idea of the annuity puzzle, it's a mystery to academic economists about why annuities are not used more. And I think this retirement income styles can actually provide an explanation why for certain segments of the population, annuities just don't resonate. And it's because they want to keep options open. They're comfortable relying on the market, pulling from secondary factors. They maintain that accumulation mindset in retirement, they're focused on technical liquidity, they have that front loading preference, they really want to maximize their lifestyle as much as they can today and are less worried in general about the future, and also the the time based flooring instead of perpetual flooring. So annuities do not resonate with this crowd. And this total returns quadrant.

Alex Murguia 07:10
I think you're 100%. Right? Wade, I think, look, if anyone can create this is the reset is just a framework, right? There could be another one out there, you know, to everyone listening, have at it. have added you know, you roll up your sleeves and see what you can come up with. But from our vantage point, the RISA framework is provides a very interesting just thought, in terms of how you want to view this retirement income puzzle, we don't think it's a puzzle, we think it's not a puzzle to be solved.

It just it is kind of what it is, you know, from that standpoint, because if you think about it, what are you really saying? When, when you're say weighing when your income protection, you're really someone and again, we referenced it in the previous episode, but you're saying, Listen, I want this floor approach. I'm going to do it by maximizing mortality credits, I'm going to optimize the risk pooling premium, if you will. Okay, works. Being out, what are you really saying? When your total return? You know, you're you're effectively betting on the market premium. Right? You're betting on that market premium? And if you look, historically, it's hard to tell somebody you're wrong. You know, I personally didn't look, you need a, you know, just because something worked previously, doesn't necessarily mean it's going to work. That's my own personal bias. But I can rationally see why somebody believes this, you know, from that perspective, and And interestingly enough, wait, I've heard you say this on occasion, and I think it fits here. Because notice, it's not just probability based it's optionality and so many critics of the 4% rule, effectively, it's kind of it's not really a strawman, because it's a valid point. But they say, well, again, a 4% rule implies that you're just blindly going to effectively have the same distribution year after year adjusted for inflation, the same nominal distribution wants the 4% is established. Right. And so you're in effect, you know, I think this is the scientific term you used, you're playing chicken with the stock market, right? You're playing chicken. And that's not the case. Because the people that really are in that total return cap, no one practically in their head thinks, Okay, I'm gonna take this amount, no matter what come hell or high water. This is the amount of taking until I take my last breath. That's just that was done for an academic exercise. Largely aren't advisors that follow anything like that to the tee. So it's interesting how it's a natural fit, right? This probability base and optionality kind of go hand in hand. Wade,

Wade Pfau 09:54
Right. Because that is that accumulation mindset. secondary factor is your dad is worried about having predictable income. And yeah, the 4% real concept, it has many simplifications. And ultimately, it's not a strategy that anyone follows directly. In this total return quadrant, you have flexible spending strategies as well, which reflect the reality of what people are doing, which is like, you're gonna run out of money, you cut back a little bit before that happens.

Alex Murguia 10:21
Wade, I'm stunned. You know, it's one of these things relative to the amount of write ups, specifically the 4%, relative to the amount of press that this gets. It's not commensurate with what's practically applied. It's just I guess, it makes a good headline, right? Oh, let me put the 4% rule. And it's always good to say the 4% rule doesn't apply anymore. Okay, so I'm just gonna read that, or it's now the 4%. And, you know, you're, you know, they bring you in all the time for quotes on this, but it's no longer the 4% rule. It's the 3.335% rule. Right. And it's, it just makes for good reading, or for good, like, popular press kind of articles. But the reality is, is that, look, it's just some reasonable sustainable withdrawal rate that we're taking. And we're putting it in context with my with my quote unquote, goals for retirement, knowing full well, again, the optionality component component that I realized that I will have to change if need be.

Wade Pfau 11:25
And that's where you get that optionality plus again, that the fact that you're not as worried about predictable income, so you do inherently maintain that flexibility. But I mean, yeah, the 4% rule, even it

ignores taxes, and just the reality is, even if your spending really was constant inflation adjusted spending, it's very hard to calibrate your taxes to also be constant inflation adjusted taxes. So yes, you can't use it in practice.

Alex Murguia 11:50
No, and, look, I've yet to meet somebody that does that. Maybe somebody does, but I have yet to meet that person. And but sustainable withdrawal strategies, you know, beyond that are quite interesting. And and that's something that we can flesh out. But you can see now I hopefully, we've explained it, how these kind of work, right? You got these opposites, you have a one on one end that you know, top right of this matrix, which is probability based optionality, you have this total return thinking, but it's dependent on a market premium, if you will, on the bottom left, more dependent on this risk pooling premium, and this contractual income vibe to it. And that just naturally appeals it seems academics love the bottom left. You know, everyone else, not everyone else, but you know, other folks are in the top right, you know, from this natural, there's that it's that natural, ying and yang, if you will, and it's hard. It's hard to say one is right, one is wrong, because, you know, they both reflect actually concurrent, you know, concordant better said concordant kind of thought processes, you know, probability optionality safety first commitment orientation. Makes sense? Very intuitive in that sense. Now, I think, go on. Sorry, Wade.

Wade Pfau 13:13
Well just that, yeah. The the total return strategy is more of based on real world practitioner type experience, it doesn't really have an intellectual foundation and academia, the, the economists, economic models, going back to the 1920s. Really, when they solve their models, their solutions are always income protection. So that is the more like, academically grounded strategy, but at the same time, it's just different viewpoints, not everyone. Well, there's many assumptions that go into academic models. And so it's easy to just dispute some of those assumptions as not being appropriate. And that's where again, we get back to two different viable strategies.

Alex Murguia 13:56
But But interestingly enough, and maybe, you know, this is the wrong word, but so be it, right? There's a rationality to this. There's, there's a, there's an interesting flow to it. That seems to work. But that's that's all again, are you looking at the RISA matrix that's top right, bottom left? Now, what's interesting is, I think the RISA framework makes explicit what kind of has been an implicit assessment of both, you know, somebody's contextual reasoning for tilting towards our retirement income strategy and their style. Would you just say that's the case Wade?

Wade Pfau 14:41
Yeah, absolutely.

Alex Murguia 14:43
Great answer, great answer. No, it's true, right? I mean, Sorry, I interrupted you but think about what risk wrap is ultimately saying, risk wrap is when you have this probability based tilt and commitment orientation. What do you say at the higher level, what are you saying what with that strategy?

Wade Pfau 15:04
With risk wrap, it's, you're comfortable relying on the market. But there's all these other influences that make you not want to be fully dependent on the market. Whether that's you, you have this backloading preference, you're worried about outliving your money in a way that is more visual or visceral for you compared to someone with a front loading preference in the top half, or like a total return. And you're comfortable committing to a strategy, you believe in technical liquidity, and those are the main issues showing up in that risk rep world. So you want a different kind of solution, then you don't want the there's part of the annuity puzzles, why don't like why don't people like simple income annuities? Well, in risk wrap, you're not going to want to use a simple income annuity necessarily, because you don't want to make this irreversible decision. And you still want the upside potential of the market. And that's where other solutions, other types of annuities have been designed to, to better meet risk wrap preferences to and it's behavioral, it's give you a strategy that actually will work for you based on the preferences you had

Alex Murguia 16:17
And the reason the Wade that I think it's behavioral is because you're taking kind of somewhat discordant thoughts here. And I'm using that term a little too rigidly here, but you know, it's an it's more like that than not. And what I mean by that is, okay, you want this probability orientation, you want you believe in this market premium, and you realize, like, over the long term, that's where you want to be, that's where the game is, at least, you know, you have that kind of accepting viewpoint. But you don't even in terms, but there's that just in case, right? There's like, I want to I want to play, but I don't know that, that that kind of that kind of sense of it. And so you don't really see that a lot. And we'll talk about where people what the frequencies look like with regards to this. But here, if you're probability based, you're most likely going to be optionality it's a more natural feeling. But there is a nice significant subset of folks that are probability based, but tilt down towards this commitment orientation, because they want that put, if you will, for that it's the just in case that they can't get over. You know, we can talk about, you know, there are secondary factors that support this and the like, but that's where we're getting at you don't, you don't see that as prevalent as optionality and probability based. You know, these are folks that kind of take a little bit from the total return and take a little bit from the income from the income protection and land on the structured, if you will, products that give you this market exposure, but with protections.

Wade Pfau 17:55
Yeah, it's like they believe in the market, they want the exposure to the market upside. But they don't want their retirement to be completely dependent on receiving that upside. And so they ultimately, are going to assume the worst, and hope for the best, but assume the worst from the markets. And that becomes much more expensive in a total return context of trying to fund a retirement where you're not willing to assume much in the way of a market return. And that's where a risk wrap can define a worst case outcome for your retirement. So that you can you're happy.

Alex Murguia 18:29
You said expensive, but I think that's a consumption thing. Because you want to pay for that it's not, you know, it's a risk, you're paying for that risk off component.

Wade Pfau 18:38
You're wrapping that risk. You want the investment account, you want the upside potential, but you're wrapping that through insurance to have a downside protection on what the worst case scenario would be. Still giving yourself a lot of the upside, not as much of the upsets the cost is you don't have the full upside exposure anymore. But you still have a a portion in different products, different ways to strike this balance. But you still have some portion of the upside exposure, because you've now paid for the insurance to protect the downside risk.

Alex Murguia 19:14
And Wade, I think you you said this before, and I always found it. It's interesting. This again, these are things that I think had been implicit. No, no one's like, we discover anything. It's just one of these things that were making more explicit or better said we didn't create anything. They were already there. You make a point to say that, Oh, yeah, this makes sense. Because over the last, I don't know, 20 some odd years, you're seeing products that kind of tackle this particular sub quadrant, you know, not some perpetuous quadrant. You want to talk about that a little bit how sure there's markets there's, they're straight up stocks and bonds total return and they're straight up, you know, buy a personal pension, you know, easy peasy, you know kind of thing, but then you start seeing and I think this while you're using the word hybrid, you start seeing these products that start or solutions, however you want to refer to them, you start seeing that these things sort of surface up to really accommodate for what's been implicitly acknowledged.

Wade Pfau 20:13
Yeah. And it's really been just since the 1990s, that there have been financial tools that accommodate the risk grab style, and it was the actuaries and insurance companies recognized. People didn't like the irreversible commitment and the lack of upside potential inherent with a simple income annuity. And so how could we design some product that can provide a lifetime income protection, but without sacrificing the liquidity of the underlying asset, as well as the growth potential of the underlying asset. And so to the extent that people don't like making the irreversible decision to annuitize, the contract, they get add these lifetime income protections, guaranteed lifetime withdrawal benefits to some sort of a deferred annuity, that gives them the lifetime spending protections, while also providing them the technical, not true liquidity, but the technical liquidity for the asset, and the upside potential for the asset. And it's just been since the 1990s, that these have existed. So it's where risk wrap is a hybrid strategy or hybrid strategy, a behavioral strategy. And naturally, the financial services world developed solutions to fit the types of behavioral preferences of those individuals.

Alex Murguia 21:37
No, you're right on. Then from that vantage point, on the other side, and we spoke about as we started a preview in this in the last one, the next sort of hybrid strategy. And again, there's that anchor, total return income protection, you take certain parts of each, you come up with risk, right. But let's say you take different parts, you still combine them, but you take different parts of each and you come up with time segmentation, because what are you really saying here? With time segmentation, in my view, you're saying, you know, I want the safety of contractual income. Heck, even if you keep things in cash, you know, in a CD, you know, that's, that's a contractual sort of obligation that you have with with the bank. I mean, it could be a really short term ladder that they're doing for you. But effectively, it's, you

know, you still have that contractual income. But you're saying to yourself, but I don't want it all the time. Right, I want the contractual income, but not all the time. And that's tough to do. Right? Yeah, you know, contracts sort of imply this longer term commitment. But you're, you're you're kind of saying all of a sudden, I want the liabilities of my, my central expenses on your balance sheet. And, you know, I'm gonna take them as needed, but I want them on my term, I don't want them over the long term, I want to be able to call when, you know, in a major way, because over the long term, I still kind of believe in this regression to an unknown mean, if you will. And, and by that, I mean that you're going to need to replenish the short term buckets, and you aim to replenish them with, you know, market, and you're, you're betting kind of a little bit still on this time diversification to come through and save the day. And, you know, that's, that's, that's, it's not wrong, but if you really think about it, this optionality and safety first is not as smooth as safety first and commitment orientation. Wade.

Wade Pfau 23:39
Yeah. And so it is a hybrid strategy as well. And time segmentation really has just developed since the 1980s is a few different and it's also from the practitioner world. It's not a traditional like academic approach. But you have in the 1980s different people noting, well, this idea of this controversial idea of time diversification, which is simply this idea of stocks for the long run that if you hold on to stocks and can leave them alone for X number of years, you feel more confident that you'll get a positive performance that stocks will outperform bonds, and time segmentation. Most practitioners of it really have a strong belief in time diversification that you by having those short term buckets, you're giving yourself a runway to benefit and to not have to lock in losses and to not realize sequence of returns risk. And to have a an outcome that's, well, some people argue better, a better way to invest, but other people just simply say a comparable way to invest, but a way that gives people more confidence that they can understand why they have the asset allocation they have which is covering expenses, stocks, providing growth for the long term,

Alex Murguia 24:57
and their nuances around this. I mean the reality is is that even? How do you decide to? Excuse me? How do you decide to replenish these buckets? Let's say you have your you're doing this over a three year periods. And every year, a small bucket sort of is used up, do you use sort of in that year replenish it? Or do you wait till the final year three, you know, there, there's many ins and outs, you know about how to handle this. But, you know, ultimately, the the fact remains is that you're still kind of betting on time diversification. So yeah, and if you think about the matrix, there's, you know, you're sure you're in this year in that safety first quadrant. But you know, there's everything's on a spectrum, right? There are still echoes of, of this, betting on the probability that over the longer term, the market will go up, you're just not dependent on it on a shorter term perspective.

Wade Pfau 25:53
And with time segmentation, if you just ask 1000 different different practitioners of it, how it works, you will get 1000 different answers. So yeah, sometimes they haven't really thought through that issue of how do you sell from the growth portfolio to prolong the short term buckets? And if they haven't thought through that carefully, they might run into some troubles with it, but the more thoughtful versions of time segmentation definitely have accommodated for how do you replenish your short term buckets from your long term buckets?

Alex Murguia 26:26
Yeah. And, you know, I will get to this when we really talk about time segmentation, like which one is better, or what do they do relative to the others? But again, you know, and this is where I would say I personally don't subscribe to time segmentation. Myself, I speak for Wade. I know he doesn't either. But we're willing to acknowledge wholeheartedly that this is a viable strategy for many folks.

Bob French 26:54
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Wade Pfau 27:16
Right, right, it's time segmentation really depends on that idea of time diversification. And I can definitely exist in the data that if over longer holding periods, stocks are less likely to have a bad performance. But I somehow can't bring myself to stake my retirement outcome on time diversification. And that's why personally, it doesn't resonate with me. But it resonates with other people. And that's fine. It's one of the viable retirement strategies.

Alex Murguia 27:44
Yeah. And so the good news is, you know, at the end of the day, I don't think it was intentional. I think markets work, right. And so you come up with these solutions. And so where we land on this is that they're clearly different preferences for how folks want to source retirement income, I don't know, if you can, if you can see, you can see the data, and it's just there. But interestingly enough, the good news is, is that the financial industry has developed strategies to effectively accommodate everyone, which I think is fantastic. I really do. Because this this idea of, of empowering the individual investor, I think the first step to that really is finding out where they're coming from, how do they want to source retirement income? And the reality is, is that you can accommodate, you know, those strategies. Do you agree or disagree Wade?

Wade Pfau 28:40
Yeah, yeah, I mean, any of the strat any of the styles can be accommodated. And that's where there's, I once I looked at just what are different retirement strategies that have been offered? And at that time counted 37, like, either software packages, or books or something that promoted a specific retirement strategy. But yeah, I mean, ultimately, it's just a matter of degree are they all sort of fit into one of these broader styles, whether it's time segmentation, total return, income protection or risk graph.

Alex Murguia 29:15
Now, what's interesting now is how do people if we go on, and this is where, you know, with the Alliance for lifetime income, they sponsored a national study for us, and we were able to look specifically for folks that are, you know, 50s, all the way up to what was the 80s or something like that, you know, you know, right there, the cut off, you know, where are they where they are, you know, where do they land on this, you know, from that stamp on and why did we start at 50, or we really

wanted to look at folks in which entering retirement, it was beginning to be the salient concern. You know, okay, I'm getting there. It's one thing to ask, you know, how you feel about heights. You know, from the comfort of a one storey house, it's another thing to ask somebody how they feel about heights. As they're just, you know, near some sort of precipice, if you will. And so when we look at this national study, we found something, actually I thought was very interesting. And that was that consistently, there's this, there's this, there's this distribution of 35% of the folks, our income protection 35% of the folks our total return. And, and the rest, the remaining 30% is split between 15% risk wrap, and 15% times segmentation. And so that that really fits nicely with what you would expect, actually, you know, if you can make the case that I can totally see why there's this, there's this concordance between optionality probability, I can see this same thing being said about safety first, and commitment orientation. Makes sense. And that's where most of the people are right? In those two categories. And then, you know, to support that sort of behavior argument, okay, this is where there's kind of, you know, there's there's competing is too strong a word, but there's these, there's these two styles that don't blend naturally, if you will. They're they're meant to accommodate. And here, risk wrap, while we just discussed there, why it's why they're, they're somewhat not as smooth the the ideas that you have, and time segmentation. And you see this pretty consistently. And Wade, what was your reaction just on a personal level, when you saw hey, look how people are, are falling in the in the recent matrix?

Wade Pfau 31:38
Yeah, w ell, it wasn't necessarily what I would have guessed. But yeah, it was really fascinating to see that and then to start to recognize that 35% of people are total returns, but so much of the consumer media seems to be like, total returns is innocent until proven guilty, or that it's, it's the default strategy. And, and anyone who's trying to say one of the other styles is, is viable, really, they have to overcome a significant hurdle, because it's, everyone's default should be total returns. So it's really interesting that we then see, really only about a third of the population really is resonating with total returns for for four essential expenses of any strategy includes investments, for discretionary and so forth. But for the pure essential spending, if you have a gap after Social Security, and any other pension you may have, how do you feel that gap. And the 4% rule tells you you fill it with an investment portfolio of 50 to 75% stocks.And that's only resonating with about a third of the population.

Alex Murguia 32:49
Yeah. And I think that's fascinating, I think, I think, you know, you start the whole premise of what we're here, you know, talking about is retire with style, right? You start with how you want to source retirement income, according to your personal preferences. There's a strategy out there for you that can accommodate that. But interestingly enough, for whatever reason, we get the sense that everyone thinks no, the starting point is always this investment portfolio, because blah, blah, blah, right? And it makes a lot of sense, and so forth. And that's where you should start not starting, there is a mistake. And that's just not the case. In fact, interestingly enough, I you know, it seems like things are coming full circle where you can make the case, let's say 20 years ago, folks, were saying, hey, annuities are sold, not bought, you know that that kind of vibe? Well, I think you can make the argument right now, that total returns as a strategy through model portfolios are sold, not bought, simply because I think a significantly greater proportion than 35% of the folks are in that strategy. And don't get me wrong, I think it's a completely viable approach. I have no issues with it on a on an academic analytical level.

But I do think, you know, it's like saying, we have any quote you want, as long as it's green, kind of thing. Nothing wrong with a green coat coat. But not everyone wants a green coat kind of vibe, Wade.

Wade Pfau 34:18
Yeah. And so that's really where we're at in terms of, you know, we are agnostic, but because we're agnostic, advocates of particular strategies will accuse us of bias. And so I don't know where is the true bias is if you're telling everyone they should be in a strategy that only resonates with a third of people? Are we the ones who are bias to point out you may not really be offering the best solution for everyone? Or maybe are they the ones who are bias because they are so adamant about this idea that in the case of total returns, market risk will pay off and you don't need anything else. It's not clear that it's just going to work for everyone in a way.

Alex Murguia 35:01
And if you think about it, and if you think about a Wade, and well, let me take one little step back for our audience, we probably have a fair share of professionals and consumers listening to this podcast. And so, you know, maybe, maybe we start thinking, we start saying making a statement for advisors or, you know, 30 seconds later, we make a statement that may apply to a consumer. If we do sorry, just work with us here from that vantage point, but, you know, I think, I think you're right, on many levels, and part of it is, right now, the only issue we have with total return is not from a credibility standpoint, or from a, from an analytical standpoint, it's rather from, Hey, guys, this isn't the only strategy there are others. And just be aware of that that's really what we're getting at with here. You know?

Wade Pfau 35:56
There are others that are viable.

Alex Murguia 35:57
And there are others that are viable. In fact, if you look at if you look at now from a professional setting, I mean, there's a huge movement right now. I mean, Eric Clark says this a lot and and he's in the, in the profession with regards to, you know, one of the luminaries in the investment management profession, and he gets added, and I agree with him, the investment issue, the investment problem has already been solved. And what we're working on is really the behavioral aspects of it. Now, when you look at it within the total return construct, I see that 100%, because if folks have been misaligned, and been led to a total return strategy, when that's not what they resonate with, then I can see them having issues maintaining that strategy, especially during periods of market turmoil, you know, and so then the value all of a sudden becomes, hey, let me walk them through this volatility, you know, because this too shall pass kind of vibe. And we'll get through this together. You know, my, my, my comment to that would be, that's fine and dandy, but maybe they shouldn't have been in that strategy to begin with, because that's not that's not what they resonate with. Wade.

Wade Pfau 37:09
Yeah. And that's a danger that if you accept a style, that doesn't resonate with you, that you then make changes to it inappropriate times. And so, indeed, part of that behavioral coaching might be misguided in the sense that is trying to coach people to stick with a style that doesn't resonate, rather than trying to find a style that does

Alex Murguia 37:30
And this goes both ways. This could be the person that was sold on an annuity when he didn't need to be risk off. You know, he didn't need it. You know, he didn't like he didn't like want to source retirement income that way. So it goes both ways. 100%. Now, sorry, I interrupted.

Wade Pfau 37:48
Yeah, I mean, it's just so much of the consumer media has driven towards total returns as a starting point. But this yeah, the same critiques can apply to any style, whenever somebody is sold into a style that's not appropriate for them. We hope to do what we can to help.

Alex Murguia 38:04
Yeah, it's more than just to show folks that they're you. Individuals have significantly more say in how they want to source retirement income than I think they realize. And this really reinforces that. And there's nothing wrong with going to a professional and saying, Listen, this is, this is my style, this is this is how I want to begin to look at sourcing retirement income, obviously, you run the numbers, and you do the plan and see where you land. But this should be the starting point, not just the chance outcome of you walk into the door, and the advisor happens to subscribe to a certain philosophy. And the same thing with reading, you can be a do it yourselfer, and you choose to read certain things, you know, if you're Boglehead, you know, the world of total return awaits you. But if you're beginning to learn about about things, and you just happen to get on those forums, you're gonna think that's the only world that's out there. You know, and that's not necessarily the case. And so I think it's incumbent upon the individual to realize that now something that I want to stress with regards to this because I think it's cool, this 35/35 15 and 15 distribution, you see that across different age cohorts, you see that across whether your pre retirement or post retirement. So there's this consistency of style, that you know it because you can you can say to so what did you switch? What if all of a sudden I'm this and that, you know, that kind of thing? Well, interestingly, we didn't see that. We, you know, other than doing, you know, other than following somebody one person for 30 years and doing that 10,000 times, it's hard to answer that question. But if you look at different age cohorts, you know, 50 year old fit 50 To 5555 to 60, etc, etc, etc. You don't see you see a consistency and style, you see and you can look at it continual data, you can look at it and just segments. And interestingly, you see the same thing with retirement status. It's the same consistent, it's not quite 35/35, you know, so sometimes it's 36/37 14 and 16. You know, that kind of thing. But you know, I don't want to give a we don't want to give a false sense of precision, you know, for the most part, there are no those statistical differences between these groups. You don't see it between pre and post retirement, all of a sudden, pre retirement, you thought you're going to be told to return you retired aye guess what? I'm going to be now, income protection, you don't see these group differences. And that implies that these are pretty stable profiles in terms of your retirement income style, because if you really think about it, you're asking these personality trait questions. As we discussed in the previous episodes, when we talked about probability based and safety first. And optionality and commitment orientation, you want to get it,Are you asking about states? Or are you asking about traits? And again, that's the underlying that's how we come up with the matrix. So it's very important to look at these factors, right. And state again, is I'm in a state of anger, I'm in a state of excitement, those things, you're listening to this podcast, I may be in a state of boredom, right? But, but those things, stick with us, stick with us, but, but those things, you know, they they dissipate,

they, you know, they you move on from that a trait is more evergreen, if you will, it's you know, I'm an introvert. I'm an extrovert, like, yeah, maybe there's differences. I'm an introvert in class, but in a party, I'm an extra, you know, but I think you you folks get where I'm going with this. It's more trade, like it's more consistent, if you will. Now, interestingly, so that's if you're following someone that's answering the question, do I change over time? Data doesn't show that is the best way we can answer that right now. But another thing to ask is, hey, but are there group differences? Just in general, are there group differences? And yeah, they are, you know, when your higher net worth, you kind of see, you know, instead of 35/35 15 and 15, that 35 and 35 between total return and income protection goes to 50% total return and the difference goes to income protection. So, you know, those with higher net worths you know, there's there's a little bit of a split there, those with lower net worth, actually, the 50% flips, and it goes to this income protection. And so how we read that is there's somewhat of a I'm gonna mispronounce this Wade to please help me here. And, and endogeneity issue I was reading it syllable by syllable and I was screwing it up.

Wade Pfau 42:46
Was it the chicken or the egg?

Alex Murguia 42:48
Yeah. Which came first? Right? Think about it, how do you develop a higher net worth? You take risks, you know, and you do that professionally? And once you have that higher net worth, you can begin to self insure a little bit more so than not. Wade, do you want to maybe comment on that a little bit?

Wade Pfau 43:05
Well, or I mean, it's just if you have a higher net worth, it may just reflect the fact that you it's not everyone who takes on risk is going to be successful. But those who do who were successful probably did take on more risk. And so there's just maybe more of a natural tendency for higher net worth individuals to have an underlying trait of being a total return thinker

Alex Murguia 43:31
they took, they took the probability and optionality risk on their on their human capital potential,

Wade Pfau 43:37
because in some cases, it pays off. And that's how we identify people with higher net worth.

Alex Murguia 43:43
Now, there are differences with with gender, frankly, men tend to be slightly more not to fit the present. And you know, as opposed to 35/35 split, it's like 40 split, you know, it's statistically different, but it's still in all these, the rest of these are all these in the same neighborhood, men tend to be more total return oriented than women, women tend to reflect more a little bit more income protection, and slightly more time segmentation than its counterpart, risk wrap. So you kind of see that when it makes sense. And I, you know, there's many reasons you can give it if you you know, asked me, you know, on the fly, What is your reason? I would say, I think, you know, life life expectancy has something to play with this. What are your thoughts Wade? Why would men and you know, there's a general men are more confident in

terms of their ability to garner outsize market returns than women? I think you've seen that over many studies, but I think those factors play into why you see a slight differences there.

Wade Pfau 44:45
Yeah, I think that makes sense. And otherwise, it may just be some behavioral by biological explanation about like, whether testosterone leads to more risk taking or I mean, I don't know that I think there's nature in that.

Alex Murguia 44:58
In our study. They didn't let us do the blood draw. But we'll see where we're applying for an NIH grant to take this to that next level man. And relationship status. Unmarried folks tend to be more income protection, time segmentation. And married folks tend to be slightly more in that actually, no married folks tend to reflect the aggregate distribution just the same. So it's really more of your single you kind of tilt towards a little bit more income protection and time segmentation, you're really going to the left on that, on that safety, first side of the quadrants, if you will. So it was just kind of interesting to see. But like I said, You really, when you when you break it down by by all these things, that 35/35 15/15 is still generally the frequency that you see. And you see that, again, across age groups. And at least the ones we started, and you see that across retirement status. And again, we kind of talked to this, you know, when we were going through the strategies and frequencies, but the larger implication to us is, for 65% of the folks that are nearing retirement, they're really resonating with retirement solutions for their essential expenses that have some sort of contractual income component to them. And I would say beyond social security, everyone gets Social Security. So you can kind of control for that in the question, I would say, beyond social security. And I do think we're kind of almost oversold, these model portfolios that can be turned into this total return approach. And then, you know, and it's been framed, I would say, even in commercials like, this is your kind of steady retirement paycheck. And I don't think that's the case. I mean, Wade, you've said that before you see all of these kind of retirement paycheck, sort of commercials. But at the end of the day, what's the punchline?

Wade Pfau 46:58
One, one, ad really drove the point home to me? It's one of these robo advisor type places, but they talk about, oh, there's all these new risks in retirement, the longevity, the sequence of returns, and so on and so on. And then what's the solution? We give you a total return strategy? And it's like, yeah, which,

Alex Murguia 47:18
I mean, yeah. It's like saying, hey, there's all these new risks. But don't worry about it. We've got, we've got strategy that ignores them. Yeah. But now there it is, right. But again, even then, we would say there's many credible strategies we're not, we're not Poo-pooing total return, it's more, we just think they're over represented relative to what we're seeing. That's ultimately what we're getting at, you know, but there are many credible strategies, but we think the data is just pretty clear that people have distinct preferences and those preferences signal, certain approaches, you know, and right now, if Wade, and I were to get on a soapbox for anything, is that individuals need the right tools to make the right decisions on how to identify strategies that resonate with them. And that's where we really are,

that's what we're about. And we really want to, we really want to stress that and, and frankly, all these episodes up until now have kind of been leading to this punch line, if you will. Wade.

Wade Pfau 48:26
So I think that's probably a good place to wrap things up. We're running a little long here, but we will have more more coming your way in terms of what are the next steps of the conversation. Alex, we're gonna get into some of that, comparing the RISA to traditional, like risk tolerance measures and so forth.

Alex Murguia 48:43
Yeah, I think, you know, I, you know, you asked me why, why these things are, why there's why the representation of what's being practiced, isn't that 35/35 15/15? I think it has something to do with there's an agency issue at play. I think so. That's just my our thoughts around that. But we'll also get into loss aversion and how that potentially plays a role into this. And, you know, could does that work in developing a retirement income strategy based on your personal preferences? We want to look at the RISA with regards to loss aversion, and maybe, you know, bring up some agency issues. Why, why perhaps not everyone's getting the full the full spectrum of what's available to them from a retirement income perspective. Wade, this was a longer one. We're 48 minutes in. So thank you, everyone. I'll say my goodbyes and as always, Wade, take us home.

Wade Pfau 49:39
Thank you. Have a great week, everyone. Catch you next time.

Alex Murguia 49:42
Bye.

Bob French 49:46
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 program are for general informational and education. 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.