Episode 130 YouTube Live Q&A Part 2

Wed, Jun 12, 2024 10:31AM • 51:58

SUMMARY KEYWORDS
long term care, year, retirement, allocation, fee, wade, medicaid, retirement income, return, assets, bonds, income, invest, annuity, approach, investments, care, cover, wait, dividends

SPEAKERS
Alex Murguia, Bob French, Wade Pfau

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. It's part two of our non live live stream. And guess what? We're talking Long Term Care this time. It's your fault for asking the questions, though. Okay,

Wade Pfau 00:52
well, let's Yeah. Pivot to it seems like another theme coming in through the question the live questions is related to long term care type of things. All right, maybe again, trying to go in order a little bit on some of these long term care questions next. Okay?

Alex Murguia 01:08
And if I'm looking away, it's because I'm looking at a screen that has questions as they're coming in. We're not just, we're not looking at YouTube Live, because there's a seven second delay and it'll drive us crazy. But you know, Briana, Amber, Elizabeth, they're helping organize questions and shooting them into our teams channel. Into our

Wade Pfau 01:23
teams channel Kramer, who's watching Kramer? I thought you were when you were looking away. No,

Alex Murguia 01:30
I'm watching Power Lunch, that Josh Brown is my hero. Oh my, we get the whole podcast on that kind of BS, but that's another world. I we've got here. Bill, how about discussing ways to handle long term care? He's 65 now when health conditions, chronic inference, chronic illnesses, prevent us from qualifying for long term care, insurance does episode 115 cover this topic? I don't know the episodes by number, but Wade

Wade Pfau 02:06
Well, let's talk about it. Now. I think we did some of those long term care episodes. Did discuss this, although maybe not so explicitly. But yes, traditional long term care insurance is the hardest to qualify for, and if you've developed chronic conditions, you're probably going to

struggle to qualify for traditional long term care insurance. So what other options do you have? Some of the new hybrid policies are easier. So a hybrid life insurance with long term care, or annuity with long term care, they're still they have underwriting, but it may be easier to qualify than with traditional insurance. That might be something to look at, or just simply, if you're looking for more of a protection based approach, an idea we talked about that's not perfect, but it's use a deferred income annuity that's going to start income later in life, because that will approximate the time you may need more funds for long term care. So whether it's the qualified longevity annuity contract inside of your IRA that you can put in up to it's this year, I think with secure act 2.0 they changed it. It's now increasing for inflation. So I think $205,000 this year is a premium, and then you can have income begin at age 80 to 85 just trying to approximate that's when I may need some more spending power to cover long term care. That can be an option. That's kind of the giving through all the potential safe ways to fund long term care. So beyond that, it's just a general matter of self funding. And there were some other questions, asking about how to invest for self funding. So we may come back, put a pin in that for a moment. And then, of course, the Medicaid possibility as well, that if you do get into a situation where you've spent down your other resources, at some point, you may be able to qualify for Medicaid, not Medicare, and we stress that a lot in the the arc on long term care, but Medicaid, once you've depleted other resources, which how that's defined, varies state, state to state, but yeah,

Alex Murguia 04:13
and then could be a I've got good news and Bad News kind of realization.

Wade Pfau 04:21
So there's more on long term care that have been coming in. Live here.

Alex Murguia 04:25
Let me, let me scroll down

Wade Pfau 04:26
there on this theme. Let's see, oh, oh, yeah, oh, we did talk about long term care.

Alex Murguia 04:34
We have one from Mike. Did we address the mike One? is having enough guaranteed income to cover all expenses, minus long term care costs, is that being overly conservative

Wade Pfau 04:45
to cover like all so just reading the question plus lifestyle, your entire retirement budget covered with guaranteed income except unpredicted long term care. It's

Alex Murguia 04:57
not a long term care question. I just saw Long Term Care in there, so I just. Kind of my eyes went to

Wade Pfau 05:03
finish that one we're on it the safety first approach. Well, if you view all your expenses as really being essential and not flexible and not discretionary, you could approach it from the direction of having everything covered with guaranteed income sources, but that is a rather conservative approach. The safety first approach, generally tries to break the retirement budget into essential

expenses and discretionary expenses, and then looks to have reliable income sources to fund the essential expenses, and allows for a more diversified investment approach to cover discretionary expenses, where you've got flexibility to make cuts, if you don't have any flexibility to make any cuts, then and you have that safety first commitment orientation, then you may be looking to potentially use guaranteed income for all expenses. But I think that would not be such a common approach to take,

Alex Murguia 06:05
okay, and wait all these that I answered just as an FYI, I'm giving them a thumbs up on the teams channel, okay, as a shortcut that we've we've addressed it. Okay,

Wade Pfau 06:17
yeah, there is another one here on this theme. Oh, there's Jeff, I think right. So dementia care are elders put on streets to be homeless or put in subpar care units if they run out of money and have no family to care for them? Well, that that's where Medicaid kicks in. Now Medicaid the quality of care through Medicaid, it's not if you can self pay and you can pay a higher amount, you may get higher quality care, but Medicaid still does a reasonable job. So this may be a little bit pessimistic in its outlook on what happens to individuals who cannot self pay. However, with the demographic situation in the United States, more and more people over age 65 relative to younger ages. We do face constraints that there's just simply not going to be enough people to work in long term care facilities to provide that sort of care. There's estimates that by 2050 the number of Alzheimer's patients may triple in the United States. And if we just simply don't have enough people to care for them all, and we haven't otherwise invented other technologies, which that's a whole nother angle. Maybe robots will take care of everyone at some point. But wow, barring that though, Hal 2000 Yes, everything else being the same, you may prefer to be able to pay for your care, either self pay or through insurance, relative to having to rely on Medicaid. Hopefully we never get to a point where Medicaid is really subpar in terms of what it can support, but there is, there's a potential risk for that

Alex Murguia 07:56
Wade There was a we talked about in the podcast. Maybe you want to talk about it like, is it better to be in a care facility while you're on Medicare, before it flips to sorry, before you have you know why you have money, and then you know eventually you may need Medicaid. Yes,

Wade Pfau 08:13
that may be helpful to get it, even if having a small insurance policy, the care coordinator benefit that's common with those policies may help you get situated in a facility. They may know about the rules of that facility better. What happens when you can no longer self pay? Do you get pushed to a different part of the facility that may not be as glamorous, that sort of thing, but yes, if you can enter the facility before claiming Medicaid, in many cases, that may lead to a better experience than if you already have to apply to Medicaid before entering the facility. And again, Medicaid, the rules vary by state. Some states allow for more allowances, especially if there's a spouse. Other states, you really do have to be destitute before qualifying for Medicaid. So the rules vary by state, but Medicaid is the resource that once you're deemed to no longer be able to afford to pay for your care, Medicaid will step in and pay for long term care once you qualify through the needing help with at least two activities of daily living and so forth.

Alex Murguia 09:18

I'll say this, and I think this is my own personal situation. And the caveat is, anecdote is not evidence, right? I I hate the fact that Bob is the one that first said that, by the way, and it stuck with me. I wish it wasn't Bob, damn it. He's got me, man. But no, it's very true. It's an awesome phrase, anecdote is not evidence. So understand that, right? But for my own situation, my dad is not,

Wade Pfau 09:48
it's not. It is evidence. Actually, that's technically well, but okay, it's

Alex Murguia 09:54
shut up. Yes, thank you. Wade. Thank you. Wade.

Wade Pfau 09:58
There you go. You have a note on that.

Alex Murguia 09:59
Yeah, but it doesn't meet the parameters of the central limits theorem, so I can't use it in a stats whatever.

Wade Pfau 10:08
Maybe I had 28 samples.

Alex Murguia 10:10
I can make that claim. But going back to this, look, my dad is on Medicaid. He's in a facility in Miami, and it's a great one. It's actually, they, they treat him. He's like 96 my dad's on the older side. He's like 96 men don't usually live that long, especially from his generation. So he's like the mascot over there. But they treat him great. And he and he's Medicaid, so it's, it just depends on how you you look for it now, is he in dementia care? Yeah, he's effectively in a perpetual slipstream at this point, my mom, she's going to transition into Medicaid very soon, but she's she was able to get into an assisted living facility in Miami, and I'm very fortunate. They treat her like family there. They love her like a family member, and it's a matter of just doing a little bit of due diligence and making sure that you know, you know the folks that are there, but where there's a will, there's a way around that stuff. Now, unfortunately, it takes work. It's not a matter of just, you know, picking up a phone and calling the local services. It's who do you know that knows who you know like anything in life. But there is, you know, you dig deep enough and you could find a solution. Now, the caveat there is, that's Miami. That's a city with 5,000,005 you know, greater Miami, five, 6 million people. So it's different to be in a town of 10,000 right? So I don't know, you know, with regards to is everything you know all is lost. I don't think so. I think you, you'd be surprised on the upside, what? What's available?

Wade Pfau 11:52
Very good. Yeah. And then actually, Jeff pointed out, when I was trying to come up with the list of long term care funding mechanisms a few moments ago, I missed mentioning the reverse mortgage. So what about a reverse mortgage in place to address long term care needs absolutely now, it does need a caveat. Once you leave your home, you're no longer eligible to borrow from the reverse mortgage, so you can't necessarily use it to pay for institutional living. But people want to age in place. They want to age in their homes, and a reverse mortgage can be a great way to pay for in home care. There was just in the newspaper this weekend, and I

can't remember I read The Dallas Morning News and The New York Times. One of the two was talking about a survey that, again, emphasizes this point. Wait, you read The New York Times and The Dallas Morning News. Hi, there everybody. There was a it was talking about how just this point, that it's already well established. But another survey, another data point, people want to age in their homes. They don't want to move to institutions. This article was more about aging in place to like build in the ability to have a wheelchair accessible entrance or have a bathing facility on the first floor. But the same concept then also applies to long term care paying for in home care. People don't want to move to institutions, and so if you treat your home equity as a funding source to help support staying in your home and supporting in home care in your home, long term care in your home. Absolutely, that's another great potential approach, not even, I mean, we're talking about when you can't qualify for traditional insurance. But you may also look at this as an alternative to traditional insurance as well.

Alex Murguia 13:42
You've said it, man, look a big picture. You have to think of assets are fungible. Assets are fungible, uh, long term care, you know, comes at a cost. If you can use the equity that you have in place and turn that into liquid money, why not? Right? Assets are fungible, and you should take that sort of agnostic view on things. Okay, all right. Wade, we got about five minutes left on the hour. We're going to answer every questions, all the questions that are here, and the ones of the write ins. It's just this is kind of like a more natural rhythm right now, and so we probably got time for one more. I

Wade Pfau 14:24
think we we booked two hours for this actually. Oh, it's, oh, I'm

Alex Murguia 14:28
sorry. I was thinking podcast. Oh, then we're good to hurry, yeah, then we're good, then we're good. But

Wade Pfau 14:34
for anyone who is listening in and this is going to get longer than you can handle, I guess you on YouTube. You can watch the whole recording later, but we will also distribute this as podcast episodes in the coming weeks as well, so you'll have a chance to catch the whole conversation if you do need to leave at any point.

Alex Murguia 14:53
Okay? So, yeah, I've got one from bill that's kind of are we done with? Uh, yeah,

Wade Pfau 14:59
I think. We've covered the long term care related ones, at least the live questions. Let

Alex Murguia 15:03
me see if there's any big ones we have. Let me look at the Excel sheet where we have those. Give me a second income bridge, glide path. No, the closest thing would be the HSA question.

Wade Pfau 15:25
Yeah, that's okay, long term care one. No, it's not That's it, just how to invest your long term care assets?

Alex Murguia 15:33
Oh, yeah, like the book. Okay, you're right. It was, where

Wade Pfau 15:36
was that on the list? Think was

Alex Murguia 15:38
in the Excel. Think was the last one in the Excel. Well, while you're looking for it, yeah, but row 16,

Wade Pfau 15:44
yeah, I'll read that question. Okay, yeah. Well, we're on the long term care theme. So in a recent episode of the podcast, you mentioned setting aside if you're self funding long term care instead of buying an insurance product. For example, Wade shared his family's amount of 500k

Alex Murguia 16:01
how? Sure wasn't 5 million

Wade Pfau 16:03
that would be tough. How would you recommend someone invest that portion of their money during retirement? I realize everyone's situation is different, but do you have any general guidelines or rules of thumb? Thank you. Okay, so this, this is fundamentally a tough question, and it gets partly into so on the one hand, there are those individuals who have the more technical liquidity mindset, which is, you just have a big pot of assets that you'll draw from as needed for different expenses, and you're really thinking about, well, what's the asset allocation for my overall pot of assets. If you're taking that approach, you're not really thinking about this question in the same manner, because you're not going to carve something out to be your long term care reserve assets. You're just going to have this big pot of assets that you draw from. Now, if you have more of a true liquidity mindset, that is where you start to earmark, okay, this asset is for this purpose. I need to invest it. That other asset is for that other purpose. And so then you are thinking about the present value of my future long term care. If I 500k may be more like the future value, but the present value hopefully you don't need, well, depending on your age, but you may not need that much set aside at the start of retirement. That being said, suppose it is 300 to $500,000 that you've said, Okay, this is my reserve asset year mark for long term care. How do I invest it? It's a hard question to answer, because you fundamentally don't know when you're going to need to tap into that. You could have an accident and need the money tomorrow. It may be 30 years before you need it. You may never need it. And so I think that does make it harder to follow the sort of idea that, well, I might need this money tomorrow, so I have to invest it conservatively. That's a lot of money to have on the sidelines for potentially the next 30 years. And to the extent that it is more likely you do have a long runway before these funds are needed, I don't think you necessarily want to invest it overly conservatively. You may have your general some sort of cash bucket that may not just be for the long term care, but in general, I want the next year of expenses in cash, something like that. Then you can say, well, if I do have the long term care event, I've got that cash ready. But the rest of my long term care reserve assets, I do want to hold in a more diversified investment approach, just because the reality is, it may be a long time before you need to tap into that, and if you hold it in cash throughout the entire retirement, you're potentially sacrificing a lot of return on that asset. So I

guess to this, it's not a rule of thumb or anything, but I would lean away from investing it too conservatively, if it doesn't seem like you're necessarily going to need to tap into those funds soon,

Bob French 19:06
yeah, if you're looking for more personal advice, take a look at this episode sponsor, McLean asset management. You can learn more at McLean am.com that's m, c, L, E, A, n, a, m.com McLean Asset Management is there to help you on your path to the retirement that you deserve. And don't forget to check the show notes to get your free ebook on retirement income planning.

Wade Pfau 19:37
You agree?

Alex Murguia 19:38
Thumbs up. Yes, right. No. I mean, look, there's a lot of variables. I think the first one is what you said, What's your Where do you stand on liquidity? True, liquidity versus technical liquidity. You know, do you want it earmarked, or do you want it inside of a big pot, where other things you can draw from? That kind of thing? There's no right or wrong answer. Where, where your preference is for that. And then from there is, you know, what the allocation is, should be somewhat of a Goldilocks allocation, not too aggressive, not too conservative. When it comes for, for that, that aspect of the money, it's going to be probably a lot more difficult if you use an aggregate allocation approach, you know, to determine, Okay, where is the the sliver coming from for long term care eventually. And so you to keep yourself honest. From a behavioral standpoint, you probably want to have, you can, you can look at the household allocation, but you want to probably have it into some sort of separate account, if anything, just for behaviorally, be being able to see that and to give you solace in terms of, if anything happens, this is where it will come from. That's the only other caveat. I think I could add Wade other than your answer, which there's only so many ways you can say what

Wade Pfau 20:56
you said, right? All right. All right. All righty, back to the live questions here.

Alex Murguia 21:04
Oh, we got some more. Okay,

Wade Pfau 21:06
hang on. Well, there, yeah, there's a couple. These are maybe a little bit miscellaneous ones. Let me see if there's any. Okay,

Alex Murguia 21:13
I can do the one about the the fee only planner, because that's kind of an odd one. Why you looking for other ones? Alex, excuse my ignorance. Are you a fee only planner? I suspect you mean McLean. We used to be in Napa. We used to be the, you know, which is the fee only Association, up until three years ago, wait, something like that. The reality is, we moved away from it simply because, if you look at our writings, look we do believe contractual income has a role in the portfolio. We've always actually believed that. And we would refer out a lot of that, a lot of that business, frankly. And we would tell a client, come in and the financial plan required some sort of annuity, because that's what that person wanted. And we would refer it out. From a

logistical standpoint, it becomes dicey because they're making they're making it, you know, the person would make a new relationship with somebody else, and we didn't know how they would be treated for that transaction and the like. And so we just ended up doing that in house. From a workflow standpoint, it was just much easier, you know. And and you add to that, everything that we've written on about contractual income and how there is a role for certain folks. And how we talked about the RESA, which is effectively what we find is two thirds of the population wants some role of contractual income. We were being stupid, frankly, internally ourselves not to consider that as part of the purview of our services. And so within that, we let go of our fee only piece. Now, the underlying question to all of that could be, I don't know how you're asking it, but just for folks listening in, is okay, your advice is conflicted. Look, everyone has conflicts of interest with regards to compensation. I think the key is transparency, and allowing that transparency to take hold. I mean, Michael Finke just did a study on fee only advisors and how they actually, more often than not, mistakenly, I think, asked people to claim such Social Security early. You know, that's financial plan wise, that's not, that's not a great, a great outcome. You know why? Because, well, that leads to greater investable assets. Greater investable assets you can, you can charge on those right from an AUM standpoint. And so I'm not a big fan of folks that waive this banner of moral superiority based on, oh, this is this, this model, and this model is significantly better than that model. I don't think so. I think actually, we hang our hat on transparency, and we hang our hat on the preference of how that individual wants to source retirement income based on the RESA, and we go from there, frankly, in terms of how our recommendations are and so whether you're asking it this way or not, the answer is we let go of that, because that doesn't allow us to actually really put the client first in terms of what their best interests are, of how they want to source retirement income. I don't believe that one compensation model is better than the other when it comes to things like that, simply because even if you take the annuity, right? Okay, there is a higher upfront cost for the client, right? But that will probably, if you compare that on Apples to Apples to a an AUM based model, after six, seven years, it's a break even, you know, from that standpoint, because you know, the company, the Aum, you're probably paying 1% a year, right, in perpetuity, you know, for that particular issue. And so frankly, our clients are with us. The good news is we have planned for a long time when we don't, it's because there's a death or there's a divorce or, you know, some sort of event that wasn't necessarily a nice thing. And so what I'm getting at is. Yes, it's more than seven years. It's usually more, it's usually 1520, 25, years that we have clients. And so even from that alone, you can make the case which is better, right? But I'm not even coming at it from that. I'm really coming at it from that, if you function from the standpoint of what's in the client's best interest based on how they want to source retirement income, and you're transparent about, you know, how you came up with that? I'm fine with that. Wait, just because you get way, gets hit a lot with this, and maybe I'm going off on a little bit of a tangent, but there was something on the podcast or somewhere right way, where your question like, Well, it's obvious, oh, that article that was written, right? It's obvious that Wade is gonna recommend this, yeah, because you're a chill for insurance companies, you know? Yeah. I mean, what? I mean? Those are kind of dilettantes that talk about what's going on without really knowing what the hell they're talking about. But Wade

Wade Pfau 26:01
fee only planners. That's kind of an approximation for investment management and financial planning. Alex mentioned AUM that's assets under management, charging a percentage of assets to manage the investments and or there can also be like retainer based or hourly planning fees, that sort of thing. Historically, annuities paid a commission, rather than having a

fee set, having you pay the fee to the advisor directly at the commission, paid the advisor so that could create conflicts with retirement. Though it is difficult to ignore annuities, and there are fee only annuities. A lot of great opportunities in the fee only annuity space, but because that area is small, there may be 40 fee probably more than 40, but whatever, there's like, many more, right? There's many more commission based annuity options out there than there are fee only. And so even though fee only should be cheaper, because they don't have to extract the commission from the annuity. Given the higher competition on the commission side, you can find better opportunities there, so just being able to best serve clients. But as Alex was explaining, McLean Asset Management shifted away from that NAPFA fee only kind of arguing, fee only is the best model, because there's no conflicts to really trying to be as comprehensive as possible, and that may mean accepting a commission on an annuity sale, but, uh, being clear in how that's being, uh, transparently done. So fee based would be the the term for what we're talking about here, and rather than the term fee only,

Alex Murguia 27:42
all right? And there's a follow up here. How do you determine if you have enough assets to make it worth engaging a fee only? Planner, right? Ideally, what you'll see is, I think, you know, there's a reason Ken Fisher and his commercials sort of hate annuities, but then the caveat is, only call us if you have more than 500 grand to invest. Well, the

Wade Pfau 28:08
other idea is, he's willing to pay your surrender charges on annuities, and he's not a charity. So what does that? Yeah,

Alex Murguia 28:16
yeah, exactly. Oh, and, and add to that, if you have below 500,000 via condios. What do you do? Let them eat cake, you know, kind of thing. And you know, that's why annuities can actually be a good solution, because it automates the retirement income. But what I would say to this is, look an advisor, you know, to run an advisory firm. You know, it costs money, right? And from that vantage point, probably anything below 500,000 which would equate to a 5000 a year, sort of asset management fee, is starting to get dicey for that person. You'll see many, many established advisors won't go below a million, and they're looking at a at a retainer, or, you know, Aum of about 2000 because sometimes people will say, Well, I don't want aum. I want to pay your retainer. They're just going to back into a retainer. The advice is going to back into some sort of retainer cost that's more or less like what the Aum is. So it's kind of a look at the birdie kind of kind of vibe. But you know, when you think it's you think it's cost effective, you're probably looking at anywhere from five to 10,000 as a minimum. Anyone that charges you less than $5,000 as an advisor is probably starting their firm, and there's nothing wrong with that. You know, you got to start somewhere. I get it. But there's also the as a client. There's also that phrase, no one wants to be your first client, and no one wants to be your biggest client. And so there's that yin and yang. But you see that if you're looking at an hourly planner, that's usually more for planning, they may look at your assets and say, you know, I'll charge you just for this amount of time, you know? But those, those folks in my world, are secret. We just waiting to turn to AUM advisors. They're just like biting their time. And there it is.

Wade Pfau 30:08
Okay, well, we've got some other questions, but a brand new one that just came in as maybe while we're on the insurance themes briefly. So what are your thoughts on buying whole life

insurance for teenage children? You want me to take that one? Yeah, so I did get a whole policy, and I was explained to me why I should also get them on my children. I did not bite on that. Of course, everyone's situation is different, but the basic logic in favor of getting a permanent life insurance for teenage children is to protect their insurability. If something happens to them and they're no longer insurable, they develop some sort of condition or have an accident, something you want to have, so that when they're adults, they have the ability to get life insurance. I kind of figured that was somewhat of a low risk and so ultimately, I was not personally persuaded to buy permanent life or any life insurance on my children, but that being said, if it is something you're concerned about, maybe an option. There is just a small policy that has that guaranteed ability to increase it at higher ages.

Alex Murguia 31:21
Okay, are there any challenges that you see this a lot on Tiktok and all that kind of silliness about whole life insurance that are it's kind of sold as this panacea to something that it's not really meant to to be.

Wade Pfau 31:39
Yeah. So the research I've done is about using whole life insurance and retirement, and it's completely different you're talking about. You actually wrote it here. There's like, infinite banking or invest like the Rockefellers. There's all these different things that are out there. I've never really gone too deep into any of that sort of thing. So kind of a that's not a retirement question, that's more how to manage your finances pre retirement. So and

Alex Murguia 32:04
for the most part, we think that that's like a bunch of silliness. To be honest with you, you're just lending money to yourself and then charging yourself interest. You know, kind of thing. I don't, I don't, we don't get into that. All right, okay, what else in terms of

Wade Pfau 32:20
so here's a question you can handle. Okay, I'm about 1.5 years out from retirement. What strategy is recommended to lower risk during this time?

Alex Murguia 32:31
Okay, hang on, where? Just to make sure I see that it's from the Excel. Say it again.

Wade Pfau 32:38
That question came from Dan at 12 or I guess 1:33pm Oh, it was live, yeah, one of the live questions, yeah, there's still some live questions we haven't covered yet. Oh,

Alex Murguia 32:49
Dan, Oh, I see, I see, I'm about a one and a half years from retirement. What strategy is recommended to lower risk during this time? Well, a couple things on risk during this time, right? Five years before retirement, and five years into your retirement, you're in the fragile decade, right? And what that means is you can't control what economic cycle you're effectively retiring into. That's the one thing that's out of our control. Well, there's a model things out of our control, but that's one of the things that are that's out of our control. And so this is when you start really giving a sense to, oh, what's going on? Because not only are you entering that, that cycle where your human capital is transferring to investment capital, you probably your investment amount is

probably the highest it's ever been. And so from the standpoint of stocks for the long term, that's fine and dandy, but you already gone in, into that long term phase, and you don't know, but you don't know what's gonna happen the next few years. And so you may be taking undue risk with the highest investable assets that you've ever had, as you're entering an economic cycle. That is random, right? And so that's risky. Hence, there's the fragile decade, right? Five years before five years into now, I don't know, I forgot what the actual number is, but it has a disproportion that the returns during that time period will have a disproportionate effect on your overall success of your retirement plan in the high 70s, way eight or something like that. Then the high 70s, the R square on the fragile decade, and

Wade Pfau 34:27
oh yeah, something like that, right? Something like that.

Alex Murguia 34:32
And so there's a flip side. Someone goes, Yeah, but it could be up too, right? You can't control that kind of stuff. And I don't want to leave like your retirement to a flip of the coin, but stick

Wade Pfau 34:41
with it. Goes both ways. Your it's yeah, it goes both ways of outcomes, both directions.

Alex Murguia 34:46
But you don't want to live 35 years just to have heads instead of tails at the at the end of that, right? So there's that piece and and really, I would start it off with the retirement income style awareness, which is what your. Preparing yourself for right? You're preparing yourself for retirement. So the first step in retirement, I hardly believe I'm going to go out on them. Wade wholeheartedly believes this is take the RESA. It's the first chapter of his book. You know where we write, where he writes about the study that we did on the RESA and how it took off. So you first have to identify how you want to source retirement income, and that's, are you a total return? Investor, are you a risk wrap? Investor, are you an income protection investor, are you a time segmentation investor, I'm going to spare anyone going through you know the definitions of each maybe Wade. You can do it quickly when I pass it to you, but effectively, you want to know where you stand and how you want to source retirement income. Once you've determined that, you have to pick your strategy before you pick an allocation, whatever, once you determine that, then you can start moving deck chairs around, right and, okay, let's just say you end up being total return. What you want to ask yourself, What's the allocation that will give me a sustainable withdrawal rate that can withstand the slings and arrows of outrageous fortune, right? And you know to answer your question specifically. You know, if you need to lower your risk, you lower your risk, and it's a stock and bond question at that point, if you're taking the total return, look bonds within an investment portfolio are there to balance the risk. Equity is where you absorb the return. The biggest mistakes we see with folks that are total return is they start trying to juice up the dividends. You know, over the long term, stocks and bonds have a correlation of like in the 30s, right? But during moments of market like craziness, there's a dislocation that takes place, and that correlation breaks, and the and then stocks and bonds tend to move very highly, high, you know, in a similar manner. So all the diversification benefits got lost, except high credit quality bonds, right? Those are going to be yielding the less, but they kind of provide the balance during those times. So if you're thinking from a stock equity standpoint and your total return, you obviously increase your allocation to fixed income bonds, right? That's it, high quality bonds. That's how you would play. If it's time segmentation, you can do kind of two things,

because I strongly feel that a rising glide path has a time segmentation quality to it right, and so you can get an artificially lower allocation in equity than you normally would. Let's say, if it's decided based on a plan that look when I retire, I think a 6040, allocation is, is what I what I should be, and that's what the the analysis show, funded racial Monte Carlo, etc, right? Once I've retired and I'm willing to retirement, well, you're one and a half years away. You're in that fragile decade. Why don't you begin with 4555 portfolio, 45 equity. I'm sorry for 5545 portfolio, 55 bonds, 45 equity, and then you just eke it up. Let's do five percentage points every year until you land on the 6040 I think I said it the right way. Did I? Did i inverse the stock, the bond,

Wade Pfau 38:23
you want to get up to 6040, so you're

Alex Murguia 38:25
trying, the point is 40% if you are naturally going to be 6040, stock, the bonds, then start 4060, yeah, I'm just saying that. And then creep your way up. You know that way during the fragile decade, you're kind of giving yourself that lower volatility in that portfolio to make sure that you can get in the right way. You know, another piece of time segmentation is start creating ladders, Bond ladders, bucketing strategies where you have your income covered for a first few years, right? And while you have that income covered, you can let the stock market run a little bit. The expectation is, through time diversification, that the stock returns are going to be able to replenish the buckets as they empty. But this is why, I think it's very similar to glide path. Because if you look at your aggregate allocation, as soon as you get those cash buckets, think of that as a fixed income allocation. Right? Kind of is right? You're just not like earmarking. You're earmarking it more than just putting in a generalized allocation. So that's another way to go about doing it. The other piece, and I'll let you handle it, Wade, is building an income floor of your income protection, you know, or build in guardrails if you're protect or if you're a risk. Rep, Wade, you want to chime in on those? Yeah?

Wade Pfau 39:42
So in those years preceding retirement, if you have income protection or risk wrap as a style, you want to assess whether you have an income gap. So after accounting for Social Security, any pensions, do you still have more essential spending that you'd like to have protected beyond those other income. Sources. So just if I have $40,000 of protected income, I'd like to have $50,000 protected I've got a $10,000 gap, and with income protection or risk wrap, the way you may prefer to think about filling that gap is with some sort of protected lifetime income, which is available through commercial annuity products in the United States.

Alex Murguia 40:25
Yep. Any questions?

Wade Pfau 40:28
There are a couple more that are still on the theme of investing. While we're we're going along here knock them out. So yeah, the next one I want to invest, or, sorry, I want my investment funds principle to grow at the rate of inflation and only spend the amount above the inflation return. Do you have any system or strategy to accomplish this? Okay,

Alex Murguia 40:50
where is that? Where you're seeing that way, where's

Wade Pfau 40:51
I'm still in the live questions. This was asked at 1:21pm from Ron. Okay, I can go ahead and I mean the the basic I just put it off and I'll jump in just so I can read it. Yeah, if you really were strict that you want your investments to grow at at least the rate of inflation and only want to spend the amount that exceeds inflation, that's what tips do treasury inflation protected securities. If you're getting a 2% real yield plus inflation, that effectively means without tipping dipping into your principal at all, you could have a 2% distribution rate off of that, and then your nest egg will still grow at the rate of inflation, you're able to spend whatever the tip shield is approximately 2% and I should actually look up, because I haven't in the last Tip seals are, yeah, and

Alex Murguia 41:41
that would be what that would be like, the Z, the Z Bodie approach, which is what Wade, Wade was saying earlier. The only thing is, you don't see this a lot in practice, because folks just don't have this amount of money on them to be able to cover their entirety of their expenses with just tips. You need to have that question

Wade Pfau 41:57
more specifically that was looking, oh, it's actually tip shields right now are over 2% so around 2.15 to 2.2% that would be the distribution, distribution rate you could support while still preserving your principal growing at the rate of inflation.

Alex Murguia 42:16
Do you want to you probably do eloquently than I am, since you've probably explained it before. Do you want to give folks the mechanics on how tips work? Simply because it could be one of those things that we're just throwing terms around.

Wade Pfau 42:26
Yeah. So traditional bonds, you get interest rate, the yield, the coupon rate, and then the yield to maturity, the yield you get out of investing in bonds, is not connected to inflation. Say it's 5% you don't know what your real return will be. The real return is what return you get above inflation. If you're getting a nominal 5% return, and inflation is 1% you've got a 4% real return. If inflation is 6% you've got a negative 1% real return. You never known nominal return. You don't know what the real return would be. In 1997 the US government introduced tips, treasury inflation protected securities that, quote, a real rate of return, and then you don't know in advance what the nominal return will be, because it's a real rate of return plus the inflation rate. So back to the scenario if tips yields are 2% and inflation is 1% I'll get 3% for the year. If inflation was 10% I'll get 12% for the year. It's that real rate of return plus a variable inflation rate. And so that's why, the way this question was worded, that's what tips are able to do. They're able to preserve the inflation adjusted value of your principal while kicking off right today, if you're to do this today, a yield of around 2.1 to 2.2% real.

Alex Murguia 43:54
All right, wait. Can you talk about how the stock market works and what it is

Wade Pfau 44:00
ownership stake in a company that gives you a promise to receive future profits derivative,

Alex Murguia 44:06
the derivative share of the profits. All right, we got one here. It's investment e so we'll knock it out. This is George. Thanks George for these questions. And these are great questions, by the way, I'm not just saying that

Wade Pfau 44:22
saying that, now that you said it, I'm not just saying

Alex Murguia 44:26
that to be nice. I'm actually a nice guy, naturally. So I say that. No, no, no, they're good. They're engaging. So Thanks, George. Your views on dividends and capital gains reinvestments for a 74 year old, reinvest or take to offset RMDs.

Wade Pfau 44:43
Okay, so we're inside of your IRA at this point, and you're 74 so you are already paying RMDs. Your RMDs are due by December 31, of the calendar year, and they're based on the account balance at the end of the previous year, December 31, of the previous. Year divided by an age based factor, which is connected to your age at the end of the current calendar year. So that's the amount you're required to take out to cover your required minimum distributions. You might want to wait towards the end of the year to take that out. However, there's always a risk that if you pass away in December and you haven't taken your RMD yet, your family has the stress of not only managing everything going on, plus, they have to get your RMD out or they're going to get penalized. Although the penalties used to be 50% and they're lower since secure act 2.0 not the end of the world, but generally. The point is, you don't necessarily want to wait until the end of the year, and so therefore, just the mechanics of it. Whenever there's a distribution, a dividend payout on the investments, rather than reinvesting that and then having to sell it again later in the year. You might think about it, okay, whenever there's a dividend payment, I'll take that out. That will help offset RMDs for the year. If all the dividends cover my RMD great. I don't have to take anything else out. Otherwise, I'll take out the difference later in the year. Yeah, I think that's a fine, behavioral, easy way to think about it. Let's just distribute dividends as part of the RMDs for the year. You don't strictly have to do that. You could just reinvest the dividend and then later on, sell shares to take the RMD either approach works mechanically, but if you're comfortable with the idea of, let's take out the dividends to cover RMDs, I think that's a perfectly acceptable approach to do that.

Alex Murguia 46:41
A quick aside here, and not the question, but it's more you'd be surprised how many times this has come up when clients have transferred over and they thought, This is how the game works. But RMDs, you can take out what you need for RMDs, pay the taxes, and you can kind of reinvest it. You know, some folks were like, oh, once they take it, once they take a certain amount up for RMDs, that they don't reinvest,

Wade Pfau 47:02
yeah, reinvent a taxable brokerage account, yeah, yeah.

Alex Murguia 47:05

Like, just once we're on it, it comes up. It's not like a frequent thing, but it it comes up more often than not that folks are unaware that they can reinvest in a taxable thing. You just have to pay the taxes on it is all Yeah,

Wade Pfau 47:20
the paying the taxes on it is the annoying part, because it may require a bigger distribution than you want to spend, but Right, it is important to emphasize you are allowed to reinvest. Wait,

Alex Murguia 47:30
it's happened more than 10 times in the last 10 years where someone just has cash and they and you ask them, Why so much? Oh, because I had to take it out. You know that that kind of thing. Oh, this is the question of the day. Yeah, I think you've been dreading it. Yeah,

Wade Pfau 47:52
I'm off the wagon on there.

Alex Murguia 47:56
What are we up to as number of push ups being done in one day.

Wade Pfau 48:01
Yeah, wait, why

Alex Murguia 48:02
did you begin it? I've

Wade Pfau 48:03
been a naughty boy. I've not been doing push ups or pull ups. I need to get back on track.

Alex Murguia 48:10
You stopped what happened?

Wade Pfau 48:11
I just one of those things. No, I

Alex Murguia 48:14
don't know. I don't know one of those things.

Wade Pfau 48:16
I didn't what happened? I didn't want it bad enough.

Alex Murguia 48:26
Your wife wasn't your wife wasn't in comment, Hey, wait. Can you pick up this toolbox for me? I can't open this. I can't open the jar mayonnaise and display

Wade Pfau 48:35
feats of strength.

Alex Murguia 48:40

Well, Jeff, I wade is not alone, but I, my experience is, I think better, it's still an excuse. I had the knee surgery. I've talked about it, the partial knee surgery, and so I did it up until then, which was like seven weeks ago, I think at this point, and I you, I can't like plank at all, although the last two weeks I've kicked it back up again. But I'm not starting at 100 I'm like, at 75 I'll work it back up where I was. And I divided by four and whatever it is, it is, you know, kind of thing, you know, a little less than, like, 17 or whatever. And then I just top off. But we'll get there, man, we'll get there. All right, push ups. I think I maxed out at eight, nine in a row. I gotta work it again. Wait, are you committed to it? Yeah, yes or no. Wait, yes

Wade Pfau 49:32
or no. At least later in the summer. I may have a gap here still, but later

Alex Murguia 49:38
in the summer, that's a no, everybody. That's No, no, that's fine, man. So Jeff, you went right you like you like, pierced us right in the heart. You went right for the jungler on that one

Wade Pfau 49:52
on the neck. We need accountability. Yeah, we

Alex Murguia 49:54
need an accountability partner. Can you email this to us every day,

Wade Pfau 49:57
to me and use my accountability. Ability partner, and who is Jeff? Who asked the question? Yeah,

Alex Murguia 50:03
Jeff, Jeff, we're counting on you now. All right. All right, I

Bob French 50:09
think that's a good place to call it for this week. But we'll be keeping you in suspense for the third and final part of the live stream, because next week we'll be going topical and talking about how elections impact the stock market in preparation for retirement, researchers upcoming webinar the election and the stock market understanding the effects on your investments. No one said we were great at naming stuff, but if you want to attend, head over to resaprofile.com/podcast to register. Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, 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 risk, including Risk of Loss past performance does not guarantee future results.