Episode 132 YouTube Live Q&A Part 3

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SPEAKERS
Bob French, Alex Murguia, 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. We're gliding into a landing on this live stream recording with allocation glide paths. That's a really bad pun there, but there's also a whole lot more.

Alex Murguia 00:50
So we talked about the glide path on my answer on the one and a half. There's a couple of those, and that could probably take us through the show here.

Wade Pfau 01:01
Yeah,

Alex Murguia 01:03
I'll start. I'll read way I'll read row four. Hi, Alex, you're awesome. Thank you for the show. No,

Wade Pfau 01:12
you guys are awesome, not just you,

Alex Murguia 01:14
hi, yeah, hi, Wade and Alex. You guys are awesome. Thank you for the show. I have a question about how to implement rising equity glide path and value based equity glide path for someone who is one to two years from retirement, especially on the timing part, if my retirement asset allocation is 75% equity and 25% fixed income, what would be the expected allocation on day one of retirement. And the only caveat, Wade, Wade and I were looking at this one. We're going to assume by values based, you mean like a value tilt versus, like a growth tilt, as opposed to values based investing, like socially responsible and all of that. I'm not 100% certain, but I think that's what you mean. Yeah, I

Wade Pfau 02:00
think that the term value based asset allocation is not your moral values, but your

Alex Murguia 02:07
vision, your value tilt when it's done, like as a value stock, right? Not value based. But that's fine. That could be just an internal lexicon for us.

Wade Pfau 02:19
Yeah. And so to answer the question, so there's no just like there's no answer, what should your asset allocation be? There is no answer on how far should you tilt away from your in this case, strategic allocation of 75% equities. When Michael kitzis and I did that original research about this, our case study was you're generally comparing you're going to be 6040 eventually. That's 60% equity, 40% bonds. You dipped down to 30% equities at retirement, and then you worked your way back up to 60% equities. But that wasn't any sort of optimized answer. That was just a case study example. There really is no optimized answer. If you want to go down 10% 20% 30% you'd be looking at if ultimately you want to be 75% equities, you may not necessarily ultimately go below 50% equities in that scenario, but the idea is, figure out something to work your way down to before you work your way back up post retirement, 50% 45% 65% we really can't give you a precise answer, but it is a way to help manage that sequence of returns risk around the retirement date. Yeah, I

Alex Murguia 03:40
I didn't mind when I went through the other question. Okay, here's another glide path. One. Thanks for the show. I've learned a lot. I have a question regarding asset allocation across taxable tax defer and tax exempt. Oh, I don't think this is glide path. Hang

Wade Pfau 04:02
on. I mean, one slide path the, yeah, there's not a where's the other glide path one. There was another glide path one, somewhere on the list that

Alex Murguia 04:14
included RSUs, I believe, right.

Wade Pfau 04:18
Oh, maybe that was it. Yeah,

Alex Murguia 04:21
give me one second here.

Wade Pfau 04:25
So there's a few more glide path adjacent questions, but I don't know if we want to hit all those right now, a future episode.

Alex Murguia 04:38
Okay, that's fine. There's another glide path. Then I was I was wrong. We'll do asset location soon. But here's a one off question. Maureen, is listening live? Do index funds decline as an average of stocks in the index they follow? I don't quite understand yeah

Wade Pfau 04:57

and yes, the decline or. Hopefully increase on average. But yes, the you look at all the stocks held now, they're not just in equal proportions. Usually it's the larger companies have a greater share of the index. But yes, the overall daily performance of the index fund would reflect the weighted average of the proportion of each stock in the index and its performance. Oh,

Alex Murguia 05:23
I see what you're saying. Okay, yeah, Maureen, there's a couple of may expand upon that, because there's a lot of stuff out there that you hear in the media and the like. And I just want to make sure you pick up on the nuances. I think people, by default, say index funds now for anything that's sort of passively managed, if you will. But there's many different flavors of this, and Wade alluded to it earlier, yeah, they're going to decline as an average of the stocks in the index they follow. Or in couple of caveats, he had said, say it again, Wade, I'm

Wade Pfau 05:58
sorry, or increase. It's just the

Alex Murguia 06:02
assumption. Absolutely don't decline Yeah. And so what weight is, when Wade said equal weighted, or market cap weighted, so S, p5, 100, right? This is where the top stocks have a disproportionate not just they have Yeah, they have a disproportionate weighted of the index, weighting in the index relative to the smaller stocks. Because if Facebook, that's worth 100 whatever, it's worth a trillion dollars, versus another company that's worth $80 billion if they go down one person, one percentage point each, you know it's just gonna it's not gonna have the same impact. The smaller one is not going to have the same impact in the total decline for that day. It's market cap weighted. Now, what you do see a lot, and it's been being pitched as this sort of, you know, great discovery, are these equal weighted index because they'll come back and say, hey, look, we don't want meta. We don't want, we don't want the alphabet to have this disproportionate influence on the index. We want to just get the average treat everyone the same. You know,

Wade Pfau 07:11
Jones works. Well, that was price

Alex Murguia 07:14
weighted. It's like, it's a slight variation, you know, uh huh, Dow Jones is completely idiotic, the way that one's done, but that's for another that's for another day. If you're ever listening to the news, just ignore the Dow Jones. But you know it's true, right? And no one uses that professionally. So then you know, going back to the equal weighted index, what's happening is every stock has the same influence on the index going up or down. That's not necessarily a good thing. What you're doing there implicitly is you're you're taking size bets, you're taking small, small size bets, and you're taking value bets, you know, unknown, unknowingly. Yes, they they may perform better, but it's not because of the equal weighting. What's happening is you're just getting exposure to value and size, which have greater premiums than the market over time. You're just doing it in a very messy way. You're doing it in a way that that internal fund that's equally weighted is going to be full of transaction costs that you never want, and at the end of the day, you have to sort stocks on something. It wouldn't make sense for you to still sort stocks in an index just based on the alphabet. Well, that's kind of what you're doing when you're equally weighting things. You know prices, price does matter in things, and so the market

cap index is the way to go if you want value exposure and size exposure by those indices. But I would avoid these equal weighted indices. I think that's more of a market, not I think that's just a marketing, a marketing Gim to sort of to sort of sell something. And you see that all the time on CNBC, where they're shilling those things, and it's just it shouldn't be done. And I don't know if they know better, but it just shouldn't be done from that standpoint. But to answer your question, yes, a market cap weighted index, yes, it will follow the average just based on their weightings, whether they go up or down. And

Wade Pfau 09:13
more broadly, that's true for any mutual fund. Yeah, the mutual funds daily performance is based on the actual performance of all its underlying holdings averaged together to get the overall amount of assets and then the overall growth or decline for the day across the mall.

Alex Murguia 09:35
So there it is. Wade. How many papers have you published? More or less.

Wade Pfau 09:41
I just had to count this up for a CE thing. It was 66 peer reviewed.

Alex Murguia 09:46
Okay, so on average, waiting, I have published 30 articles each. Right? Doesn't make any sense, right? Well, that's your equal weighted index. I. Ah, how's that one? Is that a good

Wade Pfau 10:04
example, that's about the average depth of the river is two inches, but you can still drown because there's a hole that's, yeah,

Alex Murguia 10:13
never cross a river that's, that's on average three feet deep. That's an old stats thing. All right, so let's talk about the tax location here. We got a couple of those questions. Uh, let me, let me, let me start it off by reading it. I'll listen to you, and then I'll see. Let's see what can be added to it. Hi, Alex and Wade, thanks for the show. I've learned a lot. I have a question regarding asset allocation across taxable, tax deferred and tax exempt accounts, taxable being, you know, the normal accounts that you would do not to tax basis, like individual accounts tax deferred, those are like IRAs and 401, KS, 440, 3b, you know, those kind of things. Tax exempts, Roth, Roth, Ira, right. So I plan to live off my taxable account for 12 years after retirement. So they're going to tap into that first. It seems the asset allocation that I have in mind for the taxable account is 7030 equity to T bills using a rising equity glide path, or value based glide path approach. Is this a good plan for the tax deferred and tax exempt accounts? I can I have a more aggressive asset allocation, like 100% equity, my resa score, my resa profile is total return, and I only use low cost indexing mutual funds or and indexing funds

Wade Pfau 11:41
take it away. Boss, yeah, so this question, right? You got to make some compromises in real life, so let me quickly mention the general asset location guidelines, but then talk about how that gets complicated when you then overlay distributions in retirement. So the general guidance about asset location is in your taxable account you want tax efficient assets. So that's generally stocks are more tax efficient than bonds because part of their returns are the long term capital

gains, and then you only have to pay when you sell you only have to pay in the gains when you sell them. Bonds are tax inefficient, because everything comes out as ordinary income, the interest payments, I guess not everything, if there could have capital gains, but usually it's a big chunk of that is interest income, which is ordinary income, taxed on an annual basis. So the guideline is you put your your bonds or your other tax inefficient asset classes in the tax deferred account. You put your stock index funds that are the most tax efficient in the taxable brokerage account. And then for the Roth, this is going to also be more growth oriented assets if you have tax less tax efficient growth oriented assets, like if you have an emerging market index fund, or if you have a small cap value index fund, where the long term expected growth rate is higher but they are less tax efficient. That sort of thing can go in the Roth and again, the bonds and the tax deferred and then the tax efficient stock index funds, in the taxable brokerage account. That's the general guidelines. Now that gets the complication is, then, if you're following a conventional wisdom withdrawal ordering sequence and or even if you're doing tax efficient Roth conversions and things, it's going to have the same problem you spend your taxable account first, and you're doing while the taxable account remains. You're doing Roth conversions as well, but you spend on the taxable account first. Let's have if you have a lot of stock index funds in your taxable account, and your tax deferred account is filled with bonds that might give you a declining equity glide path as you go in through those early retirement years, and that's not really what you want to do. So you have to create some sort of compromise. And that's what this question's ultimately getting at. Is trying to strike some sort of compromise there, putting T bills into the taxable brokerage account, maybe because they have a lower interest payment so they are relatively more tax efficient than other kinds of bonds. And as a way to then, when I do this withdrawal order sequencing, I'm also selling some bond or some T bills, in this case, to pay expenses in those early retirement years. And that's more my cash bucket in my brokerage account, because I'm going to spend it in those early retirement years. So of course, I can't fully assess the whole case study in terms of if this is the best approach for the individual to take, but at least it does touch on trying to find a reasonable compromise between asset location and I. The reality of withdrawal order sequencing overlaid on top of the asset location.

Bob French 15:08
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Alex Murguia 15:38
All right, let me see if there's another one that was interested, or let me take it on this question, and then we can continue with the one below. Give me one second. Wade, we're just trying to I'm just trying to organize for those listening in. I'm just trying to make sure we're curating this properly. Give me one second. All right, so that one's for the glide path, anyone similar ilk, questions that we have there?

Wade Pfau 16:12
Well, there's more tax efficiency questions, there's more glide path questions, I guess we can.

Alex Murguia 16:18

Okay, this looks like a one off one Hi Alex and Wade, my financial advisor recommended that I convert my Vanguard growth indexing mutual fund to its equivalent ETF for better tax efficiency. The conversion doesn't incur capital gains or losses, but after comparing the fees, the mutual fund is one basis point higher than the ETF and yearly dividend distributions mutual fund is one of the I don't see a big benefit for doing this. Is there any real benefit for doing it? Thank you. I don't know if I'm being completely you know, in Canada, all I am right is candid here, I don't like the Vanguard growth index fund, or I don't like, I naturally don't like large growth as an asset class. There's no necessarily, long term premium for investing in growth stocks. You pay for that privilege through through lower returns. Now you could have areas, you know, the four horsemen. You could have time periods that are sustainable, where they've outperformed, but strategically, that's not an asset class that I like very much. I think advisors or individuals do that simply because, hey, let's cover all our bases. But if you look at, you know, long term returns and sources of return from the stock market, the growth asset class isn't one of them. If you're going to do that, you might as well put in like the SMP or some sort of total market. So you know, at that, I have trouble. So I again, I'm not a big fan of that to begin with, the fact that your advisor doesn't know. That is probably more of a of a concern for me, whether it's go to the grand Vanguard growth or the equivalent ETF. Now I would also ask if you're if I have a client and, and, and the the client is saying, hey, you know, I don't know if this is nitpicky or not, to be honest with you, and I'm trying to be respectful, but you may not be ready for an advisor. Frankly, if you're looking at it and thinking, Oh, this is one basis point higher, and I don't want to do that and and this and that, that would be a headache for me as an advisor, not because I don't want the client asking questions, but it just strikes me as as I, you know, like, is this person gonna like, be like this all the time, and that's a hassle for me, as opposed to, from a big picture standpoint, you know, just the fact that you have a growth index fund would be enough for me to say, look, we don't, we don't need that. Let's go elsewhere. You know, does it matter? Switching? Probably not. You know, would be my point. But my larger question is, why have that to begin with? Wait, yeah, this

Wade Pfau 19:12
may be a collaborator, but it seems questions, sorry, yeah, but

Alex Murguia 19:17
if you're collaborating about the wrong thing or they weren't. Yeah,

Wade Pfau 19:21
you're answering things that were not asked. No one cared.

Alex Murguia 19:26
Fair enough. That's fair. That's fair. It was

Wade Pfau 19:27
convert your mutual funds to their equivalent ETFs for better tax efficiency. The fee part, there's only a one basis point difference, I think, and I Yeah, generally not, not a big deal either way. I tend to just go with whatever is available. But I guess if I have a choice between ETFs and mutual funds, I do pick the ETF options. But if there's any real strong reason for this, ETF tend

Alex Murguia 19:59

to be more tech. Sufficient. But maybe this Vanguard fund in particular has some quirk that makes it Uber tax efficient that I don't know about offhand. Sometimes you see that with DFA, where it's almost equivalent as ETF, but you can make the case the trading, daily trading. Maybe, you know, money needs to be extremely liquid. ETF could be a little better. You know, it's one of those things that it's not a problem until it is. You until it is, but I'm not, I'm not too familiar with

Wade Pfau 20:26
them. Any sort of behavioral biases that lead you to watch the price as it fluctuates during the day and that sort of thing. Mutual funds can be the better protection, because they're only priced a couple hours after the market closes, and you can't track their movements during the day, so you just waste less time and effort. But if you ignore the daily fluctuations anyway, then that's not an issue,

Alex Murguia 20:52
okay? But you're right. No one asked me my opinion on the final opening Wade, I found an opening. I made my own.

Wade Pfau 21:07
Let's see the question, but I'm gonna answer it completely different. Let me tell you what I think.

Alex Murguia 21:15
All right, why don't I do this one? Since this, this is an interesting one, and it takes us off the glide path and all of that you want to do that tax planning one about the software?

Wade Pfau 21:26
Yeah, we could do that one, because it's a one off, and

Alex Murguia 21:28
that could be a 10 minute answer, you know, if you give it its proper treatment. So I'm counting on you way to see if we can take us, take us home here in april 2023, very precise our readers to a price acquired retiree Inc, a firm led by William Meyer and William reichenstein that offered innovative retirement planning software to create smart withdrawal strategies for retirement. Are there any comparable withdrawal strategy software packages that are available to individual retirees for purchase without being a client of T Rowe Price or another investment advisor. I laughed when I read this, not because the question. The question is a great question. It's a good question, but Wade and one of the Williams to be named later, you know, have had back and forth on tax philosophies, right? Wade, no,

Wade Pfau 22:26
it wasn't even that. No, I agree with them on the tax philosophies. It was more

Alex Murguia 22:30
he caught you on something that he wasn't right on. I

Wade Pfau 22:33
forget. Yeah, everyone's just calls it tax bracket management. But even though that's not what we're talking about, because we're talking about Social Security and Medicare surcharges, but

he was just hammering, oh, they call it tax bracket management. That means they don't know what they're talking about. That sort of, it's kind of a non issue that became an issue. But yeah, we'll not answer different questions. So are there any comparable withdrawal strategy software is available to individuals who are not working with an advisor. And I recently started doing a deeper dive into different software. So one thing that covis That's Joel Sasser at covisom, he developed tax planning software for advisors. That's kind of the caveat here. You can't really get it direct as a consumer unless you're willing to pay for the advisor license, which may not be cost efficient, but it does a great job with the tax planning. So any advisor using that, that can be a great resource. I started looking into some of the consumer facing tools, and was a little bit surprised that at least the tools I looked at did not approach this sort of philosophy of tax planning in a very effective manner. Now, the one I haven't dug deep into is maxify. So I I know that's popular with folks I don't know maxify. I would hope maxify Does it right? But I did not have experience with, if you name, what are the other planning softwares that consumers like to use? I was not impressed by how they do their Roth conversions. The problem is, so you've got the conventional wisdom, which is, you spend taxable, then tax deferred, then tax exempt, and then the question is, should you do Roth conversions on top of that? And two of the softwares I looked at, they just overlaid the Roth conversions on top of the conventional wisdom, which made Roth conversions really inefficient because it just sped up the process of having only a Roth account left, and it's really tax inefficient to have only a Roth account if you don't have other taxable income sources, because you don't even get to take advantage of your standard deduction. So these other software programs, they didn't really recommend doing Roth conversions, because you got no benefit out of it. What software has to do to do this correctly? Is not managing some sort of tax rate just to determine if you should do a Roth conversion. But then once your taxable account is depleted, it also has to continue to manage that tax rate to decide how much comes out of your IRA, in excess of RMDs, and then the rest of the spending comes from the Roth. And that's where I have not to answer the specific question, is there consumer safe facing software that will do this? Right? I have not seen it. Maxify may be an exception, but otherwise, the main packages you can name, I was not impressed with this. They did not blend the distributions from the tax deferred and the tax exempt accounts after the taxable account was depleted, and that leads them to make really uninformed type of answers about how you should do a Roth conversion strategy. So unfortunately, kind of the answer this question is no, there's not really any comparable software packages available to individuals without being a client of a planning firm. Yeah.

Alex Murguia 26:08
Now you could ask, what about this one? What about that one? And we've looked at the well, Wade has looked at the top ones. I know he has. We don't want to go into it, because we know them as well and name but, yeah,

Wade Pfau 26:20
we don't want to get if I have not looked at but the ones you might name, I probably have looked at, yeah.

Alex Murguia 26:25
And the other piece, just because the question you could be thinking is, why is that? And then it just becomes just a practical issue. Look, it probably cost to create a software in earnest, with the Securities and this and that, and everything that's needed. You know, you're looking at multiple millions of dollars, even though there's no code environment and all that kind of stuff.

Look the reality is it's going to cost you into the millions. And there's just, believe it or not, there's not a lot of market for for do it yourselfers with this particular question. There's just not enough to justify that cost if they're doing that. That's why there's a lot of like Monte Carlo, things that consumers can use and over that's that's easier to do, but these, these cost more money, and they can't recoup their costs in a manner that will merit the the investment into it. That's why they usually go right to advisors for this. Because there is a market for advisors for this that will make it quick. Because if you, if you create a software like this for consumers, the Q and A's and the help desk, yeah, the support will be out of control, and so you just don't see it for that very reason. Now, again, you this is where the person asking this question, you may be better off just going in an advisor and doing a one time financial plan that's specific into this, that's specific to this, and relative to the cost and and the advice that they're providing. You know, from a tax perspective, this, if it's going to set you the right way to, you know, to withdraw efficiently, and, you know, manage your taxes, it's probably going to be well worth the cost as a one time endeavor, as opposed to trying to recreate an Excel risk, getting it wrong and the like, and spending 300 hours, 400 hours, when you really get down to it, on creating it, you don't see the consumers. You're not I don't think that's going to change anytime soon because of the investment needed to build it and to support it. And so you're probably better off just looking at a one time tax plan from an advisory firm. Honestly, I, and I'm trying to pitch anyone, I just think that's, that's just probably the cheapest way to do it. Wade,

Wade Pfau 28:35
yeah, it's, it's hard to provide this really detailed tax planning software directly to the end consumer. So some point, hopefully we'll see new developments. But right now, it's, it's kind of unfortunate that there is no good answer to provide here. Yeah, and an end hour note, well,

Alex Murguia 29:02
let me see. Do we have an easy Do we have a quick one? Let me see here. Oh, you. Oh, you want to knock out that? HSA, one about 20 employees, okay, and one end on that one, so it's on an up note,

Wade Pfau 29:20
yeah, there you go. All right, okay, if you work for an employer with greater than 20 employees, can you wait to apply for Medicare after age 65 so you can keep contributing to your HSA account and well, double check with your HR department, but yeah, generally, that's the the 20 employee actively employed, you or your spouse actively employed at a firm with at least 20 employees, that health coverage from that employment not it's not just I'm employed at Firm A, but I still have a health plan through Firm B. That doesn't work. You're getting your health insurance through this employer. They have. More than 20 employees double check with HR, but generally speaking, the answer is yes, you do not have to apply for Medicare when you reach age 65 that employer plan can remain as primary coverage. Now, the quirk on this is, as soon as you sign up for Medicare, you can't contribute to the HSA anymore, and it's even retroactive. You can sign up for the previous six months. So if I'm already past age 60 not pre age 65 but if I'm 65 and six months, and I sign up for Medicare, my tenant Medicare will be active since I turn 65 for those previous six months, I cannot make any contribution to an HSA once I'm in Medicare and Part A, for most Americans, if you've if you're going to get a Social Security benefit, you don't have to pay any premiums for Part A for the hospital insurance. So a lot of times, even if you are actively employed and have employer based coverage. You still want to sign up for Medicare Part A, just because it's a backstop. Could provide some additional

benefits with a hospital stay and so forth. The downside, though, is just you can't contribute to an HSA at that point, so you have to be careful to make clear you do not want to sign up for Medicare Part A or Part B because you want to contribute, continue to contribute to an HSA, and then you should stop making contributions to the HSA once you're within six months, subsequently, of a signing up for Medicare.

Alex Murguia 31:35
And that's a wrap, everybody. Thank you so much. Wade and I are going to hit the push ups and pull ups and make sure we can answer this with her head held up high next time. And we expect you to who's our accountability partner again? Jeff, Jeff, you gotta come strong and keep us honest. And, oh, you have one here on right capital? Yeah, we like rec capital. This is for the extent we don't get into too much. But yeah, we use it internally as well. At McLean asset management, we like it, you know, as a general matter, though,

Wade Pfau 32:12
they may also bear the issue of not really getting this tax planning part. Yeah, I have

Alex Murguia 32:19
no idea if they're consumer facing. So I don't want they're not, they're not

Wade Pfau 32:23
consumer facing, but they, they don't blend the tax deferred and tax exempt distributions. Well, they should, truthfully,

Alex Murguia 32:29
we have it to the degree that we use that for goals based planning. But you have to understand, as advisors, and you may be one, I don't know, I thought my head, but we these all in one solutions generally fall short of the mark, so you end up using specialized programs for specialized answers. Yeah, that's the bottom line,

Wade Pfau 32:49
right? Covid, 19. Covid, some software is not that comprehensive planning software. It's specifically a tool to do the tax planning and that that's right, any generalized tool may not really get the precise answer you're looking for, so you do have to tap into other tools as well. Yeah,

Alex Murguia 33:07
and I should have said this earlier this because we're new at this game. If you're there's, there's about 25 people on, if you're still on, or maybe you left it and left the room, but smash that like button.

Wade Pfau 33:22
Subscribe Like and subscribe to our Yeah, hit,

Alex Murguia 33:24
like and subscribe. If you don't mind. It's good for us, which we should have said at the beginning. Way, damn, we're terrible. But thank you everyone for listening. It's much appreciated, and we'll catch you in the next Q A session. And remember, retire with style Every Tuesday we release it.

Wade Pfau 33:41
That's right. Thanks, everyone.

Alex Murguia 33:46
Take care. Wade and

Bob French 33:47
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 you