Episode 159 Retire with Style Live (not really) Q&A Part 3

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SPEAKERS
Alex Murguia, Wade Pfau, Bob French, Briana Corbin

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 resaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning.

Briana Corbin 00:41
The holidays may be full of surprises, but your retirement plan shouldn't be in the next part of our listener Q and A series way to knowledge, you're back to answer more of your burning questions just in time for the new year. Okay,

Wade Pfau 00:54
we do have a new question coming in from the live chat so I can read that one. I'm 56 in retiring December 1. Well, congratulations, my pension will more than cover my expenses. Okay, so we've got reliable income covering our basics. Great

Alex Murguia 01:13
ratio, essential funded ratio of 100%

Wade Pfau 01:16
perfect. And then we have our investments. I have a $1.1 million in growth mutual funds, would using the constant percentage withdrawal be a reasonable withdrawal strategy? Yes. So we can answer this more in terms of variable spending strategies, yes, yes. You could say a constant percentage withdrawal strategy is, quote, unquote reasonable. It's not necessarily the best one. It's at an extreme. So there's two extreme strategies for spending from investments. You have the 4% rule style, constant inflation adjusted amount. Every year I take out the same amount plus inflation. I don't care if that what percentage of my remaining assets that is, I just keeping keep the same amount we're now talking about, the opposite of that, which is, I don't care how much I'm going to be able to spend, I'm just going to take a constant percentage of what's left every year, which can probably be a higher percentage, because there's no sequence risk. With

this strategy, I'll take out 6% of the account balance each year and spend that for my discretionary spending. So yes, because this is discretionary spending, you could do that. You could even put quotes that. It's a reasonable strategy, but it's just maybe unnecessarily volatile. If the markets are up 20% it means next year you're going to spend 20% more for more for discretionary because you got your basics covered already. And this year, if the market is down 20% it means next year your discretionary expenses drop 20% you probably can smooth things a little bit. You don't have to make it that extreme. And that's where all the other variable spending strategies try to strike some sort of compromise between let's fluctuate spending with market performance to help manage sequence risk, but let's not take it too far, because it is nice to have a predictable, somewhat level, known income stream coming out of that portfolio. So there are other variable spending strategies out there that try to strike a compromise between constant percentage and constant amount, I would suggest looking at whether there may be something else out there that that appeals to you more, because yes, the constant with constant percentage is a reasonable strategy, but it's it's an extreme strategy, and it's going to lead to a lot of volatility in your spending, in a manner that, at the end of the day probably isn't necessary.

Alex Murguia 03:44
Yeah, I concur 100% with Wade. I would even say I think of Wade's book on spending. It's that yellow one that you see in the back.

Wade Pfau 03:58
That's an older book. I know I do summarize all that theoretically.

Alex Murguia 04:02
I mean maybe the numbers, you know, the update or whatever, but theoretically it's the same, right? It's not going to change five years from now. 10 years from now, I would say that's probably one of the least favorite strategies that are out there. I think it's easy, because you just say, Oh, I'm just going to take a certain percent every year. And actually, I think people think in their heads that they apply 4% and they take 4% of the value every time, and they think that's the 4% rule when it's not, you know, you went mute there.

Wade Pfau 04:33
Yeah, that's they're describing the concept which,

Alex Murguia 04:36
but I bet you like, we like did one of these mail on the streets, and just ask people. Well, they won't even know what the hell we're talking about. But you know, I mean that you know that know about withdrawals or whatever, to some extent, I think that's what a lot of people think it is, although it's not the case. So I would say, Terry, there are better things out there. And as a retirement researcher and listener to our podcast, so. Did a huge arc on this, probably 567, episodes on all the different retirement withdrawal strategy I suggest you dive into those. And I think at the end of that, you'll realize that just a fixed percent isn't the way to go.

Wade Pfau 05:18
Now, Terry's adding so I have an aversion to investing. I was

Alex Murguia 05:21
gonna get into that part since you got the first one, but you can, you can inspire Wait, wait and

Wade Pfau 05:25
willing to accept the volatility and withdrawal amounts. Maybe one other suggestion is just another cousin of constant percentage is like an RMD based strategy, where you consider your remaining longevity, and as you get older, you spend an increasing percentage of what's left now that will lead to maybe you want to front load your spending. So using a higher percentage with constant percentage will tend to let you start with more spending early on. Spending may decline as you go along. A more RMD based strategy might lead to a lower spending early on, with increases over time. So if you'd rather front load your spending, I guess that would speak more to constant percentage, but yeah, just make sure you're aware of all the different options out there. And as long as you pick something you're comfortable with and you're comfortable with the volatility of spending, there's nothing wrong. People

Alex Murguia 06:16
want to know what you think. Don't be nice guy. Don't be Mr. Nice Guy right at the

Wade Pfau 06:21
end of the day, he's got, he's got a floor of lifetime income, and he's got comfortable with variable spending for the discretionary piece. That's the academically efficient rule is quite close to what you're saying. It's actually build a floor protected income to cover your basics and then use some sort of r, d based percentage rule for the discretionary constant. Percentage is a simpler version of that, that now you have to decide what percentage to use. The lower the percentage, the more you'll see spending increase over time, the higher the percentage you'll

Alex Murguia 06:56
see over time. A little known fact, way, if you keep on taking a percent, you'll never you'll never run out of money.

Wade Pfau 07:02
Yeah, you never run out. It will get lower.

Alex Murguia 07:06
1% of a penny is always, you know, a couple things with this question that I don't know. I get caught up in the wording, right? So I have 1.1 million in growth mutual funds. If it's just growth mutual funds, I think that's not a diversified strategy. I don't necessarily feel there's a premium, a market premium investing in growth mutual funds. And like growth mutual funds, income mutual like these kind of names that have the old school names to mutual funds. These are not sources of expected returns just because something calls itself growth funds, or even technology funds. So I would look into the allocation and make sure that the allocation is right, because just saying growth mutual funds, that's not necessarily an asset class that I would put all the chips on. Then the next one is I have an aversion to investing in bond funds, and have never done so I get that, I would say, when it comes to withdrawal strategies, how do we differentiate between bonds and bond funds? Okay, within a portfolio construction, when you're accumulating, the bond funds serve as a ballast to the variability of the equities, and so bonds fund. Bond Funds are very effective there, because a bond fund, and I'm assuming an index bond fund of some sort, right? A government index bond fund. Within that structure, there's hundreds of securities that are within the fund. If you're doing that yourself, you're just buying a handful of them. So you're going to put yourself at greater risk unless you have a family office and you have $100 million to

invest with, right? So you're going to be putting yourself at risk to duration and this and that, and you're managing all of those together, because as soon as you own more than, let's say, one bond, you effectively have a bond fund, right? A bond fund gets a bad rap relative to bonds, because you're pricing it every day. You don't pry. If you own bonds, you don't really care what what you don't know. I'm assuming you're not looking at the price volatility on a daily basis. But if you had to sell it, trust me, it'd be volatile. If you had to sell it every day, it'd be volatile. It's just, you're saying, I'm gonna have the dividends, and then I'm gonna wait till it matures, and it's always gonna be a part. Yeah, I get it, assuming it's AAA rated government at risk free rate, that kind of stuff. So that, being the case, you have an aversion to investing in bond funds. I would try to disabuse you of that, simply because, within the portfolio, construction standpoint, bond funds are actually quite efficient to provide that ballast. And if you're taking withdrawals from a portfolio in a total return vein, regardless if you're using this constant percentage strategy, or, you know, the 4% or 5% or, you know, whatever, that kind of thing, constant amount adjusted for inflation strategy, etc, then you're going to want most likely to have bond funds in there. Simply. To lower the standard deviation of your portfolio, which will then allow you to better take distributions over the long term. Now, if you're doing a ladder strategy, if you're doing something from the standpoint of purely retirement income, and you want to match the income from the bonds to your needs and so forth, then yes, that's a different kettle of fish, and I do feel bonds are more effective in that strategy. So for me, bond funds are it's actually they're quite good within the whole portfolio construction standpoint, to lower the volatility, Bond Fund, Bond, individual bonds, do a slightly more effective job of really getting fine tuned at in terms of the income that you specifically need, and you're holding risk free bonds. And you know, you know when you're going to need the cash flows, it's hard to beat that. Wait,

Wade Pfau 10:51
yeah, I don't know. You're lecturing him to hold bonds. He's got the pension, so he's got, no, I'm

Alex Murguia 10:57
just trying to I'm not trying to lecture. I'm trying to say, Why? Why Why wouldn't poopoo bond funds? You know? Why would you bring up bond funds to begin with? And so the alternative is always individual bonds. And so I'm trying to point out there there's a right place for them for the right situation, such as, there's the right place for individual bonds for the right situation.

Wade Pfau 11:16
Yeah, individual bonds can provide a fixed income. In this scenario. There's a pension that provides a sufficient amount of fixed income, so I like to think of that as part of the bond allocation, which so I don't have a problem with his point about investing aggressively because you have sufficient reliable income to cover your basics.

Alex Murguia 11:39
I don't have a problem with that either way. Come say so, say, yeah, good, yeah, no. I'm trying to point out, sometimes I think people have trouble between bond funds and bonds, and they quickly discard bond funds. And so I'm just trying to point out, you know, there is a place for them that's actually quite effective for our other listening audience members. Fair

Wade Pfau 12:03
enough. Fair enough. All right.

Alex Murguia 12:08
What else do we have? Yeah,

Wade Pfau 12:10
if you want to go back to our other list, there we're at that, yeah, 85 to 90% question, okay,

Alex Murguia 12:20
okay, 85 to 90% of my assets are in a tax deferred account. I have about 400,000 in a taxable account. The conventional rule for withdrawal is taxable accounts tax deferred and then tax exempt if I need to withdraw 150,000 a year. I'm thinking to max out my 12% marginal tax rate in parentheses, married filing jointly from tax deferred, then the remainder from taxable, to keep my taxes mainly in a lower tax bracket. I'm not following the conventional rule of taxable. First, is my strategy flawed? Are

Bob French 13:02
you getting close to or are you in retirement? Well, investing during retirement is a little bit different than during your working years. Your investments are there to help you pay for retirement, and now is when they need to earn their keep to make sure you're on the right track. Download retirement researchers, eight tips to becoming a retirement income investor by heading over to retirement. Researcher.com/eight tips again, get retirement researchers, eight tips becoming a retirement income investor by going to retirement. Researcher.com/eight tips. That's the number eight tips.

Wade Pfau 13:41
Okay, so the first thing I would say is we actually completed the most recent arc of podcast episodes on this idea of tax efficient distributions. Please have a listen to that, because the specifically, your logic is not flat. I don't know if you're you've achieved the right answer, but your logics not flawed here. Yes, the conventional wisdom is spend taxable, then tax deferred, then tax exempt. But we talk a lot about the inefficiencies of that and that the true strategy that's the most efficient is going to be some sort of mix of spending taxable and tax deferred early on, until the taxable account depletes, and then spend a blend of tax deferred and tax exempt accounts after that to control your tax bracket. So it sounds like that's what you're doing. Now, you mentioned taking enough out of the tax deferred account to fill up the 12% bracket, and that would be after your 400k Well, it's going to be kicking off some taxable income, maybe not all that much. So you might have some capacity there, but it sounds like you may have in the ballpark of three and a half or $4 million in your tax deferred account, if you're only filling up 12% right now, you want to think ahead about once RMDs begin. And what's that going to look like? Is that going to push you into significantly higher tax bracket? It might speak to potentially filling up the 22% bracket right now, or at least working your way into that so but, but no, you're thinking about it the right way, because you're talking about doing a blend of taxable and tax deferred accounts. I don't know if filling up the 12% bracket with tax deferred distributions is the the right answer for you, but at least, yeah, that's how you want to be thinking about it. It's you. The conventional wisdom is flawed. You've understood that intuitively, and yes, you're working in the right direction there to to have that blend of taxable and tax deferred. And with the taxable it may just be the income being kicked off of the portfolio. You'll spend that first, and then you'll fill up the 12 year. In this case, you're filling up the 12% bracket. And then if you still needed more, have to work through all the math of if you still needed more, then maybe you're selling some shares from the taxable account as well. You might even consider Roth conversions. I

don't know if you have a Roth IRA at this point, but that would allow you to get more out of your tax deferred account than you necessarily want to spend this year because of a tax efficient approach that you're taking.

Alex Murguia 16:20
And so wait just and I know we did in the last podcast, but I if someone's listening in and they're thinking, Wait a second, but capital gains rate is lower than income tax, why not taxable

Wade Pfau 16:33
for like, why are we generally leaning towards spending the taxable account first? Yeah, because it's kicking off taxable income, unavoidable taxable income every year with interest, qualified dividends, regular dividends, yes, it's the night. It's a good place to have your tax efficient asset classes like a stock index fund, because long term capital gains will be taxed at a lower rate, and qualified dividends are taxed at a lower rate, but still generally because of the forced taxation every year, it works out better to spend those assets earlier on rather than later on, but not fully following the conventional wisdom of because the conventional wisdom, if you have a big IRA, and that's most of your assets, You're going to have a lot of years where you're just being forced to spend, where every dollar you take out is taxes ordinary income, and that can be quite tax inefficient. That's why spreading it out more over time can be beneficial. Okay, okay, so we'll go with a I'll ask you a question, Alex, and if you're here live, we'll probably just do a couple more questions and then wrap up for today. If anyone does have questions in the live audience, do feel free to get those included, and we can switch over to those. But in the meantime, Alex, thank you for your podcasts. In the recent episode about tax harvesting. You discuss that you cannot go into the same security that you sell for 30 days. Can you elaborate on how different a mutual fund investment needs to be to compare to what is sold? For example, if you sell an S and p5 100 index fund, can you then invest in a total stock market fund despite a subset of including of it, including the S, p5, 100. So this is about the wash sale rule. And you can't sell and then repurchase a, I believe the wording is substantially identical security for 30 days. And can you talk about Alex what? What does it mean to be a substantially identical security?

Alex Murguia 18:41
Sure. Well, that's a good question, and it comes up all the time, and you're right, the IRS just leaves it as substantially identical. But they don't go through the trouble of saying Apple equals a couple, or the S p5 100 from Barclays is the same as the S p5 100 from Vanguard. So you can't switch out of one and buy the other. They don't, they don't, kind of say, Don't do this, do that. But for our firm, it's at McLean asset management, because, you know, we actively do this. I would say that we do not, if from a mutual firm perspective, and let's keep the S p5 100. We do not like we wouldn't sell the s the the Barclays version of the ETF, S, p5 100, and buy the fidelity version. The next minute, we consider that to be substantially identical. And if you look at the mutual fund mandates, you know, they'll pretty much say this is tracking this index. This is going to track this index. And if the other one says this is going to track this index, then for us, that's a no fly zone. All right. Now we're not CPAs. We're not, you know, government employees or anything like that. So obviously this is, this is, this is our interpretation of it, and that's the extent that I would, I would leave it at that from a substantial, identical state. That point. So we don't like flip the flip those for each other. Now what we do do is okay for us, the S, p5, 100 represents large cap US market, right? There are other funds out there that capture a similar premium, right? And those being those that track the Russell 1000. The Russell 1000 is the

Russell 3000 is a proxy for the 3000 that you know, the 3000 stocks that represent the aggregate US stock market, right? The Russell 1000 are the largest of those 3000 and the Russell 2000 are the smallest of the Russell 3000 and so if you wanted to, I want to take advantage of the recent downturn, and I want to be able to sell the S p5 100, which I just happened to have bought, and I want to capture that loss and buy and still have exposure to that asset class. Immediately, we would sell the S p5 100 and buy the Russell 1000, if you will. And I'm using that as an example. No, I'm not for the Russell versus the, you know, the what have you right? But I would do that. You know, you can do the total stock market index even, and that will give you similar representation of the S, p5, 100 versus, let's say, the small cap indices. So we do that. So the best I could say is switching from a total from an S, p5, 100 fund. You do have options available that you can do from a tax loss less harvesting, tax loss harvesting perspective, and you still have exposure to that large cap asset class, such as the Russell 1000, a total stock market index, etc. And in our view, we deem that to be a doable thing, you know, as opposed to switching out and, you know, Fidelity's S p5 100, for Vanguard's S p5 100. What was the rest of that question? So I can make sure I capture it. And at this

Wade Pfau 21:56
point it's like, like, the total market index, 80% of that would be the S p5 100. So could you sell your S p5 100 and buy the total market index? Even though 80%

Alex Murguia 22:08
are tracking the S p5 it's within it. But, you know, the S P is in it. But to me, I would deem that not to be identical, not substantially identical, yeah, because it's, it's the entirety of the US stock market, not just one asset class. Now, because it's market cap weighted to your point that you just said, yeah, those stocks that are also happen to be in the s, p5, 100 will have a disproportionate effect on the returns of the Russell 3000 or the Russell 1000, if you will. Heck, you can even say seven stocks right now, right? I don't know what the actual number five stocks make up 30% of the S, p5, 100. I'm making up a number I don't know off the top my head, what, like Apple, Nvidia, et cetera, et cetera, represent. But the point is, I think, from a practical standpoint, I think that is within the fly zone area, as opposed to the S p5 100, and just switching it out for another S p5 100.

Wade Pfau 23:11
Good stuff. Yes, excellent. Do you want to do another one? Or

Alex Murguia 23:18
it's up to you. Sure. Let's kick out one more. Let me see

Wade Pfau 23:21
here. I already know you're going to start reading it that next one is the one I covered, because the RMD with annuities question.

Alex Murguia 23:28
All right, so you want to give me the REIT one, or you want to do the money, but I think we may have the non qualified annuities for after tax money. Which one of those you want to

Wade Pfau 23:41
Yeah, you could go with that one,

Alex Murguia 23:45
the one I'm going to ask you, yeah, okay, one you're saying, Are there non qualified annuities for after tax money? If so, are there ones where the money's paid out remain untaxed? Okay? And let me do that again. Sorry, just one more time. That's not that long. The question, I know, right? I was like, I read it like, if it was expecting, like, the Gettysburg Address, and then I'm like, Oh, wait, it's already over. Are there non qualified annuities for after tax money? If so, are there ones where the money's paid out remain untaxed?

Wade Pfau 24:26
Yeah, and this is an easier one to answer, too. I'm assuming, after tax money, usually that's another name for a Roth IRA Roth account. So I am assuming this question and then, but then, these are qualified annuities inside of qualified retirement accounts. So I'm going to ask the question a different way, because I think that's what was intended. Are there qualified annuities for Roth accounts? If so, are there ones where the money paid out remains untaxed? And the answer is yes, you can get an annuity in a Roth account, and then the qualified. As long as it's qualified distributions which you've had the account for at least five years. You're 59, and a half or older, or meet some other condition that money would come out untaxed.

Alex Murguia 25:13
That's it. That's the shortest answer,

Wade Pfau 25:17
short and sweet. All

Alex Murguia 25:19
right, and there we have it all right, everyone. Thank you for this live session. We're looking forward to it. We have tons of questions that we've had. If you have questions, even if you're listening to a recording of this, put them in the comments, because what we're going to be doing is we're going to try to get to all the questions that that we get, that we get, even though the writings that we had emailed to us in anticipation of this session, so feel free to put it in there, and we'll collect them, organize them, curate them, and provide our best answers for them. All right? And it goes without saying everything here, obviously, keep an advisor before making a final decision. All we're doing is just trying to give you educated answers to general questions. We don't know your specific situation, so just keep all of that in mind when you're listening to our answers.

Wade Pfau 26:09
Yes, thank you compliance officer, and thank you everyone for joining us, and we'll catch you next time, next time on retire with style.

Alex Murguia 26:15
All right, everyone, thank you so much. Bye.

Briana Corbin 26:18
This might wrap up today's episode. But don't worry, there's more to come. Be sure to join us next week as Wade and Alex answer even more of your burning retirement questions, you won't want to miss it. Oh and Happy New Year.

Bob French 26:32
Wade and Alex are both principals of 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 the risk, including Risk of Loss past performance does not guarantee future results. You