Episode 160 Retire with Style Live (not really) Q&A Part 4

Tue, Jan 07, 2025 3:37PM • 46:15

SUMMARY KEYWORDS
retirement planning, financial personality, HSA benefits, Roth IRA, REIT investments, tax traps, Social Security, Medicare premiums, asset allocation, sequence of returns, fragile decade, fixed income, retirement income, Warren Buffett, stock market

SPEAKERS
Briana Corbin, 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 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 over, but retirement planning is just getting started. We're back with Wade and Alex tackling more of your retirement questions to help you make 2025 your best financial year yet.

Alex Murguia 00:54
Hey everyone, welcome to retire with style. I'm Alex, and I'm with my co host and trusted, very trusted friend. Wade Fauci, wait, how are you doing? I'm

Wade Pfau 01:10
doing good. How are you Alex, good, good. Are we ready? Sounded like you were in slow motion, just in case anyone was speeding up the their podcast speeds, they probably you sounded normal for a moment. What

Alex Murguia 01:24
are you trying to say? Wade, what are you trying to say? Wait,

Wade Pfau 01:31
a shift to three times speed. All

Alex Murguia 01:33
right, all right. What is it gonna say here? Okay. Are we ready to dispense some a knowledge for the cues that are coming up.

Wade Pfau 01:42
Yeah, absolutely. So we last few episodes are from the live edition of our Q and A session, and we were not able to get through all the questions at that time, so we're going to pick up where we left off and continue with the questions that came in for try to stump Alex and Wade on retire with style, perfect,

Alex Murguia 02:02
perfect. And the first, the first question I'd like to begin, go on. Sorry, did I jump on the

Wade Pfau 02:09
one I'm supposed to ask you? Oh,

Alex Murguia 02:10
but I wanted to. I wanted to. We don't do script here. Wait. I wanted to ask you a question. Anything new? Wade, since we've had small talk, we haven't had a while.

Wade Pfau 02:25
We've gone off the grid. We've

Alex Murguia 02:27
gone off the grid. Anything nuevo entuita,

Wade Pfau 02:33
nothing in particular, nothing. There we go. Just

Alex Murguia 02:38
getting ready for the holiday spirit.

Wade Pfau 02:40
Yeah, that's right. By the time this episode airs, we'll be getting close to the holidays, yeah.

Alex Murguia 02:45
All right, all right. Well, thank you for that insight. Wade, I think everyone listening in now feels like they know you a lot more like an open book, my friend, you're like an open book.

Wade Pfau 02:57
You have something you're dying to share, and that's your hope. And I'd and how about you?

Alex Murguia 03:01
Oh, wow, thank you for asking Wayne. No, no, no, I'm just messing with you, man. And then, and trust me, no one wants to

Wade Pfau 03:11
know children is not feeling well and you're up here recording a podcast instead of helping them clean up after.

Alex Murguia 03:18
No, my parenting style is I two words define my parenting style, weight, natural selection,

Wade Pfau 03:29
revival of the fittest.

Alex Murguia 03:30
Yes. So, so, hey, it's in God's hands now. So let's see what we'll see what happens. Okay, I've done what I can All right, so let's get let's see how many of these we can knock out in this episode, it's full of nuggets and Wade, why don't you start unearthing them?

Wade Pfau 03:54
Yeah, well, there were two separate questions, but I think they fit together pretty well, because otherwise there may be a lot of overlap. So let me start with you. Alex is holding a REIT, a real estate investment trust, ETF or mutual fund. I guess I don't think the ETF is specifically important, but is holding a REIT in an HSA, a Roth IRA, either smart or stupid? Why or why not? And at the same time, just kind of extending beyond that question, would the way that you invest in an HSA be the same as a Roth IRA?

Alex Murguia 04:30
Okay, real quick. My first comment is, I love the question. The way we are at retirement researchers to the point and there's no half stepping here, smart or stupid. I like that. Lay it on the line and let me know. Just, just let me have it right. But before I get to that, that one, the specificity with the read, I'd like to begin just with a broader one, which. I think is actually a great question, would you invest an HSA the same as a Roth once? There's two parts of this question, Wade and I want you to chime in here, and that an HSA, the money goes in pre tax and comes out tax free. So that's a huge benefit, more so than the Roth, because you're getting you need to get tax first on the Roth, and then you put it in the Roth, and then that's tax free, forever, forever and ever kind of thing. So

Wade Pfau 05:33
yeah, the HSA has the triple whammy of tax deductible contributions, tax deferred growth and tax exempt distribute. Distributions are tax free as long as they're for qualified medical expenses. Yeah,

Alex Murguia 05:46
exactly. And so to some extent, and Wade, Wade and I have talked about it, and Wade, even in this he's in his early 40s, and he's keeping receipts already. He's convinced me to start, to start doing that, because I thought, Oh, I'm gonna get plenty sick when I'm older, so I'll have plenty of ammunition. But Wade, you know, makes a good point well,

Wade Pfau 06:06
and that's because if the beneficiary is not a spouse, then they have one year to distribute everything, just like an inherited IRA with a one year window, although you can apply receipts against that to reduce the taxable amount.

Alex Murguia 06:19
So, you know, Wade, you know, stop the chop. More

Wade Pfau 06:23

than $10,000 of taxes by collecting those receipts.

Alex Murguia 06:27
Okay, anything else, wait, anything. Get it out of your system. Anything else,

Wade Pfau 06:34
bitter about my receipt? Can you turn them in for

Alex Murguia 06:36
Starbucks credits and stuff like that, too, or no? All right, and then you can multiply those points and get platinum status at Marriott whenever you, by the way, is like a big elitist when it comes to miles and credits and platinum and all that stuff on bond boy and American Airlines. But that's another topic. We can do a whole episode on just like point credit points and stuff like

Wade Pfau 07:05
that. Yeah, yeah, this. Do a lot of business travel, so it pays to be strategic about that. Okay?

Alex Murguia 07:11
And yes, Brianna, you are gonna have to edit this Q and A if we repost on YouTube, because we're going all over the place. But that being the case, an HSA has has the advantage over a Roth simply because the pre tax component to it, you can, like, really put it in pre tax, and it gets the same tax deferred and post, you know, and and income and all that kind of stuff. A tax free after you take distributions, you know? So it's it has three added, you know, the Roth has two great points. The HSA has three. You want to take advantage of that. So from an order of operations, I'd probably fill that tank up first. Now, that being the case, the actual question is, the investments inside of it, would they be the same?

Wade Pfau 07:58
And you do need the high deductible health care plan to be eligible to contribute. Okay,

Alex Murguia 08:03
yes, yes, yes. Good point. I was assuming that was already a yes, but yes. Wait, you got loopholes, yes and you need to be alive. Totally clear, you need to be alive. So the actual holdings, yeah, theoretically, they would be similar in nature, like philosophically you would want that. Now the question is, and this is a great example, tips, is usually another good one that's brought up, but REITs, should REITs be in that now REITs 90% of the payouts in REITs, I mean, 90% of the income that reads get from their business has to be paid out to shareholders because they have like, kind of a pass through ish kind of component so they don't get taxed on the income. So they're going to be this very, very distribution heavy tax that talk to your CPA, etc, but usually marginal tax rate kind of thing. So you want to make sure that you have them in these types of accounts as much as possible. They're good to have regardless, but you would want them to be there. Why? Theoretically, let's say the payout is 10% and that that's why that makes up a majority of the returns. By the way, they just get reinvested. But, you know, it adds to your to your accumulation. So let's just go with the example. Let's say the REITs returned 10% that year. But because you're taxed at X amount and you're at the 22% rate, you know, subtract that from the 10% you only keep. Let's just make the math easy, 8% of that return, right? And so if it's in a tax deferred account, you keep the full 10% of that. You keep the 100% of the 10% return. And so you want to make sure that you're maximizing that as much as

possible. So in that vein, yes, if you find REITs an appropriate diversifier within your portfolio, which we believe. If so, then it would be appropriate within, more appropriate within these tax, tax free, tax deferred, and at this point, even pre tax accounts such as an HSA and an IRA now and a Roth IRA. Wait,

Wade Pfau 10:19
yeah, just the kind of the ideas REITs are not tax efficient. So ideally, with asset location, you don't want them in a taxable account. So that means Ira Roth IRA HSA generally, then we talk about if it has higher expected returns, that's more of a Roth IRA, equivalently HSA consideration and REITs do seem to have some of that, historically speaking, potential, that they're going to potentially earn more than bonds. So if you're thinking about bonds for your IRA, REITs for your HSA, Roth, Ira, that money also tends to be more for the long term. So the only real difference would be if you're now at the stage where you're spending from your HSA, you want to not necessarily have super volatile asset classes that you're drawing from. But other than that, yeah, I think REITs are entirely appropriate as a consideration. The other tax exempt account space get

Alex Murguia 11:14
a comment because you, you brought up a good point. And this is the other. This is kind of an assumption that I'm just, you know, I'm just taking for granted. But let me not take it for granted. I'm always assuming you have a diversified portfolio. And the question doesn't mean only REITs in an IRA, or only likes or something like that. And you know, let's say they have $100,000 portfolio. Excuse me, $100,000 portfolio, 90,000 of it is in an IRA. I don't expect a 90% allocation to REITs. I expect a fully diversified portfolio, and whatever the read allocation would have been within that portfolio is in that particular account.

Wade Pfau 11:53
Yeah, asset allocation comes first, and then, to the extent you have the capacity, the asset location is the secondary consideration.

Alex Murguia 12:05
And there it is. Anything to add? Wade,

Wade Pfau 12:08
no, I think we, we've figured out so it's potentially smart rather than stupid. Because

Alex Murguia 12:19
everyone Yes, you get an S, you get an S,

Wade Pfau 12:23
you get a smart, rated smart by retirement. No, no,

Alex Murguia 12:27
but that's a good question. I mean, yeah, I get it smart, stupid. There are no, there are no stupid questions, only stupid people that ask questions, right? Or smart people that, no. I mean, like, at the end of the day, that's how we do it here. So that's fine. No, I think it's a good question. It's smart. It's smart to do. So, all right, next question, I'll I'll hit this up for Wade. I have greatly enjoyed episodes for tax planning in retirement, regarding the three track, sorry, regarding the

three tax traps in retirement, many of us appear to be individual. Example The Irma. What? But what if you are married filing jointly? How does that work? So what they're getting at is, and I'm sorry when I read it, I'm kind of reading it slow so I missed the proper cadence. Effectively in our episodes, we did it on tax planning and retirement, many of the things we talked about, we happen to point out individual cases and we didn't. I mean, I don't know. Maybe we did and we didn't, we didn't point out. Oh, but married filing jointly, this would be the issue. Wade, take it away.

Wade Pfau 13:34
Uh huh, yeah, I, I'm gonna take umbrage with the question, or at least maybe we didn't explain it, right? But no, it's individual and married filing jointly. Same considerations, the three tax traps, I think, refers to we talked about the Social Security tax torpedo, where, as you draw an income if that uniquely causes more of your Social Security to be taxed, it increases your effective marginal tax rate, Medicare Irma, the one mentioned, where as your income exceeds certain thresholds that can uniquely create big jumps in your Medicare premiums for Part B and Part B and then the third tax trap, I'm assuming would be a reference to the preferential income stacking issue, whereas I draw ordinary income, if that starts to push my long term gains or qualified dividends from 0% rate into the 15% rate, that increases the effective marginal tax rate and all three of those, there's no distinction between single filing and married filing jointly. They apply equally to both. So I'm if we somehow didn't explain that, well, let's just clarify. It's really the same impact for both single filers and married filing jointly. The thresholds where things happen will differ, because in the lower income ranges, the usually the married filing jointly thresholds are double the single filer thresholds. Although that's not fully the case with Social Security, but otherwise it does apply equally in both scenarios, and I'm not entirely sure, like, what motivated the question in terms of with Medicare, it's per person. So if you're married filing jointly, if only one of you is on Medicare, you only have the premium jump for one person. But if both of you are in Medicare, you have the premium jump for both people with Social Security, maybe only one person's claimed but if you're filing jointly, the filing jointly thresholds would apply to that one person's benefit. So it's it impacts couples in the same manner as it impacts single people. There's not any, like, unique difference between the two cases. Yeah, I think,

Alex Murguia 15:50
yeah, the threshold when they're combined, the thresholds are just, it's the same rules apply. It's just the thresholds are higher. Kind of thing for a majority of the things. I would say this Wade. I'm sure you did a fantastic job, a stalwart job. I wouldn't I wouldn't beat yourself up for it. Hold your head up high. You're good. Don't worry about it. Whenever you're feeling bad about yourself, just read some of the reviews of the podcast that have my name on it, and I think you'll start feeling much better. So don't worry about it. Okay, buddy, you're good. You're good, no, but I do emphasize empathize with this person, simply because when you're learning this stuff, the reality is it gets really confusing. Individual join, and then you get all these beneficiary designations. And so I can see people just being like, you know, they're trying to get the orientation and calibration, right? So, yeah, it's fine, and

Wade Pfau 16:44
these questions help because it does help us. Then maybe there's some new

Alex Murguia 16:50

you're not allowed to backtrack at all. You stick, you stick with what you say, Don't now rewind and say, Oh, but that's a great question. No, no, no, no, wait, no, your piece.

Wade Pfau 17:02
Just explain things better in the future, because we know where something we just maybe assumed or didn't think about. It helps to know how that could be interpreted differently, and so now we can improve our explanations about it. So you

Alex Murguia 17:16
went from taking umbrage to what now,

Wade Pfau 17:19
I was not offended by the question, I was just that there's no difference single. It applies the same, single and married family jointly. So it's not an issue just for single people, by any means.

Bob French 17:29
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 e book on retirement income planning. Okay, okay,

Wade Pfau 18:02
all right, next question,

Alex Murguia 18:03
next question. You're next All right,

Wade Pfau 18:06
we're gonna ask you whether you're smarter than Warren Buffett. So Warren Buffett, that's

Alex Murguia 18:12
a quick answer.

Wade Pfau 18:15
So Alex Warren Buffett has said to invest 90% of your assets in the S and p5, 110% in cash and bonds. Would you say that this is a good general guideline for anyone to follow?

Alex Murguia 18:31
Yeah, I would answer this in a couple ways. The first one, I don't think this person's meaning it this way, but sometimes when people begin a sentence with Warren Buffett says, you know, it's kind of like they're trying to set up like this person, you're not more credible than this person. And if this person says this, then you should be doing that. And if you're not, you're an idiot, you know, kind of thing.

Wade Pfau 18:57
Say it again. Sounds like you're taking umbrage with the question,

Alex Murguia 19:01
no, I said, I don't think this person is doing that, although I don't know, technically, it's hard to read tenor in these things, but that's but when you're in meetings with people, or you're just talking with somebody, they kind of love to pull that one out, right? Warren Buffett said, blah, blah, blah, blah, blah, you know I mean, and I could care less, to some extent, what he says or not, not, not because of Warren Buffett. But ultimately, I'm not so sure he's in the weeds with regards to retirement income planning, financial planning, Wealth Management, that's different than an investor.

Wade Pfau 19:41
And the other thing, too, I don't know the exact context. I thought he said that's how he invests for like, his wife, if he were to Yeah,

Alex Murguia 19:49
he's dramatically open. His wife has, like, I don't know, $20 billion I mean, yeah,

Wade Pfau 19:54
she's not at risk her portfolio in retirement, you know?

Alex Murguia 19:58
I mean, come on. Uh, so I would just begin it like that, like I Who cares what Warren Buffett says honestly, when this is not about, Warren Buffett says, when you look at a balance sheet, this is XYZ, or Warren Buffett said, when analyzing a company, XYZ, other than that, I don't really care. It's like Michael Jordan says this about retirement and complaining, I don't care. You know, that's kind of my initial response when that begins, why? Because I'm a human being, and you kind of see that, and you're like, Yeah, whatever, right? That being the case, he's not an he's not an advisor in the sense of helping people. So he's looking at it from the standpoint of investment only, right? And when it comes to investment only, I would say there's a lot of truth to this, from the standpoint of so he's just basically saying, Put 90% in the s, p, 10% in cash bonds. And cash bonds could be very different, because you can have bonds that are as risky as stocks. You know when you go into the corporate junk world, but I don't, you know. I don't know exactly what how that's meant. So let's just take the 90% in the S p5 110% just cash safety money, right? So 90% in the S p5 100 call it a day. Now, if you look at the overall stock market when it comes to investing and out performance, you're significantly better off in an S, p5 100 than picking a couple of stocks, because you're going to outperform the index. If you outperform the index, look at the arc that we did on what not to do from an investing standpoint, I would say you're going to have trouble pointing out to me or to anyone, how that's beyond chance outcome, beyond how that's beyond the chance outcomes, because you consistently see under performance. If, after 10 years you book you you benchmark yourself against the S, p5, 100, I'm gonna say at least 85% of active managers will have underperformed, right? And the 15% that outperformed, if you put them in the if you look at them the next 10 years or whatever, they go back to the mean, right? And so when it comes to an investment, when it comes to investment advice, yeah, absolutely, put it in the s, p5, 100. But could we do better than that from an investment standpoint, absolutely. And what I mean by that is, I think individuals, I'm doing this from memory way to correct me. But if you look at individual stocks, investing in individual stock versus the S, p5 100, and you want to see how much of the market you're capturing, individual stock will probably explain, like an R square of 20 to 30 like it'll explain 20 to 30% of the variance of all stock market movements. That means that sometimes

when you buy a stock, it could be a great stock, but the market tanks by 30% that year, your stock is most likely going to be down as well, because it's just a stock you know, in the market, as opposed to its prospects as a business, it's going to be subject to the same macro environment as as the others, right? And if the market drops by 30% you can assume something happened, right? So you're not getting diversification. And hence, this very this variance can kill you on the downside. Hence, the 90% of the S P, you know, hence an allocation to the S p5, 100 is better than individual stocks because you're missing out on expected returns, systemic expected returns. Now that being the case, the S p5 100, which is the index of large companies within the overall stock market, will explain a lot of the variants of the overall stock market, but probably still something closer to like, let's just say, in the 70s, you know, the R square on that God, a single factor model will explain maybe 70%

Wade Pfau 23:49
right? Are you going off from the angle of S P versus, like, a globally diversified portfolio? Because I was just thinking it's more. Forget the S p5 100 part, just 90% stock allocation. Is that appropriate?

Alex Murguia 24:03
No, I was going in the choice. No, that

Wade Pfau 24:06
completely differently, but All right, well, then you

Alex Murguia 24:09
could finish it off, how you do it, and they get, you know, it's two for one, right? Yeah. And so now I'm looking at the S, p5, 100, and you could do better than that, because that's a single factor model that explains partly 70, in the mid 70% of all stock market returns. And so you layer in a value, there's different premiums that you get compensated for investing in systematically capturing within the stock market, right? The S, P is large cap, right? So there's value, there's momentum, there's size, there's things you can also expose your portfolio to to capture more of the returns that are available. And then you go to internationally. This was asked last time, why internationally? Internationally, the expected returns are going to be the same as domestically, but they increase the opportunity set of the different stocks that you can capture. So. It just helps you, because there's such a concentration even the S, p5 100, there's such a concentration within the top 10 stocks. And it happens all the time. It's not just happening right now, that by having other large caps that also help explain variance within overall stock market returns, it's actually a good thing, not a bad thing, because as much as it can help you on the upside, being concentrated, it can really hurt you on the downside. And when it's just luck, either way, you want to kind of just protect yourself. And so to me, a good general guideline is allocate to the different areas of the market in which you have systematic expected returns, right? Not just the S p5 100, although the S p5 100 is superior to just picking a stock and letting it run, you know, or picking five stocks and letting them run. So to that extent, Warren Buffett is correct. But when you get to diversifying a portfolio, especially when you're trying to determine retirement income strategy and the like, I think it falls short of the mark, right? The fact that that person brings up Warren Buffett. Who cares? Now, Wade's point about 90% equity, 10% cash bonds. I'm not. I'm not. I wasn't here to judge that. I just assumed Warren Buffett would that's just a random number that was just arbitrarily thrown up 9010 I think that's an aggressive one, but I think there's a question that we're asking later on that maybe helps answer that a little bit. But

Wade, what's your take on the second part of the well, the second interpretation, which is one you had, yeah,

Wade Pfau 26:30
I'm not a warren buffett historian, but so I don't know the full context, but I thought I've seen at some point he was talking about how he allocates like for his spouse, and that's kind of she's if you gave her a funded ratio, she's probably dramatically over funded. In fact, the 10% in cash is probably 10 times more than she'll ever spend in her lifetime to begin with. And so that allocation can make perfect sense, because once you've got your lifestyle protected and covered, then you can be more aggressive with the discretionary wealth above that. And so he's really, for the most part, investing that for the next generation, or, I think in his case, more for like charitable type, like this is a permanent foundation to support charities over the long term. So 90% stocks for that can make perfect sense going beyond that, though, of course, you have to consider your risk tolerance, and you have to consider your retirement style and how well funded you are with respect to having reliable income in place. If you have a floor of protected, reliable income that covers your basics, and you have the risk tolerance to handle it, the math is in favor over the long term of getting greater long term growth, especially with a flexible spending strategy for the discretionary expenses off a higher stock allocation. So yeah, you can't argue with just on a mathematical basis, that sort of allocation being fine if you're comfortable sticking to it, and you can sleep at night with it, and you've got your basics covered. If those things don't apply to you, though, then that's definitely a lot more aggressive than we usually hear for retirees, and maybe too aggressive for many people. So you gotta Well, but wait now I'm gonna ask the general guideline. Maybe not.

Alex Murguia 28:15
Now I'm gonna ask you a question, and it wasn't asked, but I think it dovetails with this one, and I think we can also address the last question we're going to do today, since we're kind of on this topic a little bit, it makes sense just to continue it. But okay, you had said, you know, the math makes sense, but I want people to understand the following, why not put 100% equity in a portfolio for retirement? If you know that it has a 30 year time horizon, and if you look at any 10 year rolling historical return, stock markets have a it's up there. Let's, let me just say 90% chance of outperforming on a rolling return basis the risk free rate. So why not just put it in that if that's, if that's my horizon in retirement? Because if I retire at 60 I'm got, let's just say 20 years, right? I retire at 65 you know, I got 20 years on this portfolio at 85 if not more so why don't I just put it in 100% equities?

Wade Pfau 29:24
Well, you've got the sequence of returns risk issue that when you're spending from the portfolio, you're more vulnerable to short, temporary type downturns that don't recover quick enough. But even beyond that, going back to Bill bingen's original study on the 4% rule he called for retirees should have 75% stocks in retirement, never less than 50% stocks. You see that come up in many subsequent studies that even in spite of sequence of returns, risk, higher stock allocations usually give you a much better average performance without. Much worse outcomes in terms of the downside potential risk if things go really poorly in retirement, the 4% rule didn't apply to 100% stocks because there were a few historical cases where you could have gotten into trouble, not that much more trouble. It still did better than like, 20% stocks, yeah, but I Oh, sorry. Finish your Oh, but, I mean, but that being said, This assumes you're comfortable with a very aggressive stock allocation, and that you will stick with it and not panic and sell off your stocks

after a downturn, which can then really dig a hole for you, because if markets go down and come back up, but you panicked and sold after they went down, you missed a subsequent recovery, and you're you've really disarmed.

Alex Murguia 30:43
What did the creator of the 4% rule do about 18 months ago, or something weird like that, when? Oh

Wade Pfau 30:51
yeah, there. Was jittery. It was during the spring of 2020, I Oh,

Alex Murguia 30:57
that late. Okay, four years ago. I thought it was like two years ago. What happened a few years back to the creator of the 4% rule, Bing, then when, yeah,

Wade Pfau 31:08
he was interviewed in one of the financial advisor publications, I think advisor, or financial planning or something. And he did, I don't remember the exact details, so I don't want to guess, but he did dramatically lower his stock allocation, despite all of his research showing you should not do that. And I don't remember the specifics off the top of my head about what exactly happened there. I think there was an article in

Alex Murguia 31:33
The New York Times that mentioned, I think so. And everyone was like, what like? The big takeaway was, Oh, my God. You know what he said? Like, what the hell is he doing that? Being the case, the other part that I think goes unnoticed all the time is it doesn't really affect the success rates all that much. If you're like, at a 40% allocation to equities versus 70% allocation to equities in terms of sustainable withdrawal rates, you may know that better off the top of your head, but directionally, it's not a, it's not a move the needle kind of number. It's like, you know what, you're going to be fine in a 4060, portfolio versus a 6040, portfolio. So why do you need that aggravation? Unless the goal is legacy, maximize legacy as much as humanly possible. But I don't, we don't really see that that much. Usually, when we're talking to clients, there are cases right, where somebody has a significant amount of money and becomes about being impactful for the next generation. But let's just say, for the folks between, you know, zero to 5 million, even, a lot of the conversations are about, hey, I want to make sure I can maintain this standard of living and whatever is left over, fine, but that's gravy. Hence, what is this race to die with the most amount of money for? But I don't understand. And so

Wade Pfau 32:57
there is a range from about 30 to 80% stocks where it doesn't really impact what the safe withdrawal rate is in terms of a spending rate, but the higher the stock allocation on average, the the better the the outcomes in terms of remaining wealth balance at the end of that retirement horizon. Okay,

Alex Murguia 33:17
the other the other thing is, yeah, I know. But when, when income is the outcome, at least as a theme, you know, pick your battles a little bit. The The other thing, because I think this is similar, because it was talking about allocations in retirement, why not 100% etc? There's also a human

capital piece that you don't have anymore. You're not working, so you're a little more susceptible to liquidity events and things like that. Hence, I don't necessarily buy the argument of, why not 100% in stocks? I think that's that's an Excel answer, and it's not grounded in like real life events. Is the best answer I can give you with regards to that also, it goes unnoticed, but the magnitude of drops once you're retired as a percent of your net worth is greater, and what I mean by that is, when you're in your 30s, a 20% drop in your building assets doesn't hit you as hard as when you're in your 60, in your 60s, and You have this 20% drop in terms of nominal wealth. So you want to make sure you're always like on guard for stuff like that, even though you're gonna because if you're in year two, markets go down 30% I don't know how much solace you're gonna find into the ah, but don't worry, there's a 30 year horizon. I'm gonna be fine. I think you turn you put your begnan hat, hat on, you get a little nervous, and you start making decisions, because you're going to say to yourself this time, it's different, that kind of thing. It's

Wade Pfau 34:47
like, if you're probability based, you're more likely to be able to weather those downturns. But if you got put into a probability based strategy that wasn't right for you, you might not weather those downturns as well. Yeah,

Alex Murguia 35:00
and we've seen that plenty, all right. I mean, there's, there's, look, we're coming off of an election. We have clients, we have clients that are conservative, we have clients that are liberals. And you can imagine, as with any election, the losing folks get a little nervous with regards to who's coming into office and the like. And so this is not a political statement, but it's, it's, but everyone, I think, can right now, relate to it. If the person is in office and it's not someone that you voted for, you may be thinking, My goodness, what do I do with my investments now? Because the next four years is going to be different, right? And I'm bringing this up to point out all the things that are going to happen over the next 30 years, right? That you're gonna have some serious consternation about, and you're going to be like, my goodness, I have to do something with my portfolio. So as as disciplined as you think you are, you're probably not when it comes to maintaining this 100 this very, very aggressive portfolio in retirement. That being said, Wade, I'm going to ask you the the next question, which is, when would one start allocating money towards more fixed income, cash like investments, 10 years out from retirement, five years out never. And I think, I think first determine your style, right, and then go from there. But I'll let you take it away, man, I

Wade Pfau 36:26
was supposed to be the question I asked you, but now that you really, oh,

Alex Murguia 36:30
yeah, okay, wait, let me ask myself this question. Well, tag teaming this answer, and I started truthfully. I let me do this again, because we're going to record this and set this up separately on YouTube. You want to ask me the same question, and I'll ask

Wade Pfau 36:47
you so Alex, when would one? When would you or one

Alex Murguia 36:51

take it from the top and listeners on the podcast, I appreciate your patience. We just need a clean edit, and we don't edit the podcast. Fire away. Wait, okay,

Wade Pfau 37:00
Alex, when would one start allocating money towards more fixed income or cash like investments, 10 years out from retirement, five years never?

Alex Murguia 37:12
Some of the above, none of the above, or all of the above? Odd. Well, right off the bat, I would imagine there's this is this question is asking, as you getting close to retirement, when do you start shifting? When you start down, shifting from an allocation, if at all? Our view is that effectively, as the five years before retirement and the five years after retirement, we referenced them as the fragile decade. Wait, I believe is the one that coined that term, and that people

Wade Pfau 37:49
think that. I don't think it's true, but it's not you. People have said that about me, but I don't think I did that. I you know

Alex Murguia 37:56
why? Wait, it was me. It was me, the fragile decade, right? Let's just say the fragile decade and that. And what that means is that you have to be fortunate as you retire to be in a good economic cycle. And what I mean by that is the market returns you experienced five years before and five years after you retire, are going to have a disproportionate effect on the income that you're able to take specifically if you're in a total return strategy, right? And so from that manner, if you, I'm going to assume now you are a total return investor asking me this question, that assumption is is a good one, because not a good one in that, in the sense that it's good you should be it's it's good one, in the sense that first we need to determine what strategy you are in, the answer would be very different from somebody who's time segmentation, somebody who's risk wrap, and somebody who's income protection. That's important for us, because by default, I think we've done the industry a disservice. We as an advisors, presenting like the total return as your main strategy. And then there's everything else, and total return is just one of four. So assuming that you fall into the total return bucket, I think you should ready your portfolio for retirement income, let's say, two years before you retire, as you're as you're onboarding into this fragile decade, right? And you could do many things. You can go straight to fixed income and how much it's relative to the financial plan, relative to how much there's two things. Risk is two things, a preference, and sometimes it's, it's a, it's a, it's a necessary thing if you want to accomplish certain goals, right? Sometimes you may need to capture returns for something 20 years out. And there's no thing. There's nothing that's really going to get you then, unless it's a market driven return that you're invested in over 20 years. So you can count on time, diversification, etc. Absent of that, though, kind of. Your things out. And so assuming, though, that that's the case, you want to begin to start prepping your portfolio beforehand from a capacity and need standpoint. Now there's that you have to reconcile that with your personal risk tolerance, not resale profile, retirement income style. Retirement Income style comes first. But once you've determined that, and let's assume you're in a total return, then you can work on the allocation. And so that's a balance between your risk tolerance, you know, your preference of how much risk you can take, sleep at night, that kind of thing, versus how much do you need from a resource standpoint, because you may need to take on more risk than necessary, or you can take on less that will you'll find some baseline allocation from there. And then, as you retire,

you you work the portfolio to a more greater and greater fixed income allocation. So by the time you retired, you're at you're at that sweet spot. Whatever that movement is dependent on an idiosyncratic variable, which is yourself. Now that being the case, there's one strategy that Wade's written about that gets talked about quite a lot. I see it as more of a time segmentation strategy, but it's the rising glide path in which you take a you front load the allocation to fixed income. Let's This is a pure mind thought example, but let's say your 8020 portfolio right now, and you're five years from retirement, and you're like, Okay, 8020 you know, it fits my risk profile, but you know what? I got to get ready for this fragile decade, and I'm a total return person, so I know probability based thinking. Well, I believe that it's going to work out over 20 plus years, but I got to do something for the first 10, and I don't want to buy anything that's structured, a structured investment contract. I don't want to do a bond ladder. I don't want to whatever, put it in Bitcoin or whatever, have you, right? And so what I want to do is start at a higher than normal bond allocation, and that's going to be my quote, unquote buffer from a portfolio standpoint. And I'm going to start at, let's say I think I'm going to end at 5050, when all is said and done. So I'm going to go 30, 3070 right now, 30% stock, 70% fixed income, which is artificially high. But by the time I retire, I shall be, I'll reduce that bond allocation every year certain percent. So by the time I'm retired, I'm at 5050, you know I mean, and then maybe five years into it, I can be 5545 and that will be my settling. And what that has allowed me to do it, it's reduced the variability of my portfolio, and so once it'll get it gives me the best chance to have the steadiest value while I'm taking distributions during the important, fragile decade. That's how I would be thinking about it. What that number is, I think you need to get that baseline with a financial plan and determine the context of what you're doing, and then back into the allocation that gets you there, and hopefully that reconciles with your risk tolerance. If it doesn't, then you have a little bit more work to do. Wade,

Wade Pfau 43:10
yeah, I guess I just maybe answer it a little more simply in terms of, I think five to 10 years before retiring, that's a good time to start thinking about the transition to your retirement income plan, which implies a shift from stocks to fixed income, broadly defined, that's where you look at your retirement income style. If your total returns, you'll just lower your stock allocation in that lead up to retirement to help manage that sequence of returns risk. And you could use that rising equity glide path post retirement, if your time segmentation, you start switching from bond funds to individual bonds to build that ladder so that you get to retirement with five to 10 years of fixed income maturing bonds for the next five to 10 years to cover those early years, if your income protection, start thinking about shifting some of those bonds into deferred income annuities or some sort of fixed annuity with a living benefit, probably, and if you're risk wrap, you might look more at shifting over into some sort of variable annuity with a living benefit and with a deferral period of five to 10 years before you turn on income. And there you go. That covers all four retirement styles, five to 10 years before retirement. Ideally, you start making that transition.

Alex Murguia 44:25
Voila, there it is.

44:29
All right, wait, I think we're

Alex Murguia 44:31

good on time. You want to call that one for today's session, and we'll fire up another round of questions for the next one. That

Wade Pfau 44:38
sounds good? Yeah, we still have more questions, so probably at least another episode, but yeah, let's go ahead and hit the stop button for today. So thanks. Thanks everyone for joining. Retire with style, and we'll catch you next time with more of your questions answered by Wade and Alex.

Alex Murguia 44:55
All right, everyone, take care.

Bob French 44:59
Wade and Alex. 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 risk, including Risk of Loss past performance does not guarantee future results. You