Episode 6 Secondary Retirement Income Styles Part 2

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. Well, one likes to accumulate wealth the other likes to distributed today. We'll see if they can meet halfway our hosts Wade and Alex.

Alex Murguia 00:51
Hello, everybody. And welcome to this edition of retire with style. Alex Murguia.

Wade Pfau 00:59
And I'm Wade Pfau.

Alex Murguia 01:01
And here we are.

Wade Pfau 01:04
I was just thinking I thought I heard a dog barking in the background.

Alex Murguia 01:08
The moment the moment we started this, my kids walk in from school.

Wade Pfau 01:12
Oh, that's wasn't dogs that was your children? I am apologize.

Alex Murguia 01:15
No, no, no, it was it was they were reacting to the door kind of opening up kind of thing. But so it goes the show must go on. Right. Wade.

Wade Pfau 01:26
That's right. We've got a lot to talk about today in terms of building up the core remaining secondary factors to explain retirement style sets. Yeah.

Alex Murguia 01:36

And real quick, we realize this is our sixth episode in. And we've been kind of doing a recap. So we'll stop now, in case folks have been listening to these consecutively. But if you want to know more about the initial factors that we discussed, just check out the previous episodes. And that'll bring you up to speed. Right Wade?

Wade Pfau 02:01
That's right. Yeah, I mean, and we appreciate everyone who's actually listening from week to week as the new episodes are released. But for those of you in the future who are binging through, we realize you may not want to hear a five to 10 minute recap at the start of each episode.

Alex Murguia 02:17
All right. And so now, the thing is, you know, you know, this is kind of, you know, I'm thinking when people binge to this, you know, when you have Okay, Netflix versus retire with style, Netflix versus retire with style, I can see why we would get those attention dollars when you're deciding. But all right, so Wade, what are two factors that we have leftover that we haven't discussed yet that serve as the secondary factors in terms of your retirement income style?

Wade Pfau 02:50
Right, right. So well, we have the two primary factors, probability based safety first and optionality commitment. And then in the previous episode, we discussed two secondary factors true versus technical liquidity and front loading versus back loading. And today, this leaves us with the second two of these secondary factors. So there are six factors and all two primary for secondary. The two secondary factors we'll discuss today are accumulation versus distribution, and perpetuity versus time based flooring.

Alex Murguia 03:23
Yeah, and you know, what got me Wade. And I think he felt the same way. We thought, when we started this, that we had a feeling probability safety for us was going to be one of the most distinct factors and, you know, the data showed that to be the case, I thought personally, accumulation distribution was going to be one of these key factors. I mean, quickly, accumulation is think of it as terms of a mindset, where, you know, even though when you read, you know, there's a accumulation portfolio retire, and then it's more about the accumulation. But put that aside, no matter no matter what the milestone says you should be, you know, people have these, you know, you're creatures of habit, right? If you've done something for 30 years, it's tough to all of a sudden switch that out. And so an accumulation based mindset is this idea where you know, you just think in terms of the account value, the account value, the account value, don't put, you don't provide too much contextual anchoring towards why you have an account to begin with, other than I want more and more is better than less in that kind of vibe. And you get this, we see this, you could be a 70 year old client person, you know, whatnot, and you still look at your portfolio with that eye towards growth, growth, growth, you know, those kinds of blinders. And well, that's the wrong way of saying it, but that that kind of perspective, because it just is what you are who you are kind of vibe and so there's this accumulation thing and you're willing to exchange variable income for more accumulate from a greater net worth with with regards to how it's reflected within your portfolio. It's sense some more, you know, and you know, to some extent, yeah, there's that question of riches more, you know, wealth is kind of enough, you know,

if you will, you know when to say when, but accumulation is this implication of wanting to just grow that portfolio. And that's the that's the essence of it, and you're willing to exchange it for a lump your income stream? Whereas distribution, sorry, yeah,

Wade Pfau 05:26
I mean, that nickname accumulation comes from the fact that pre retirement, that's really how most people think about investing, it's maximizing risk adjusted returns, growing that pot of assets trying to achieve a wealth accumulation target. And so accumulation versus now post retirement. Do you keep that accumulation mindset? Or does your mindset shift towards distribution, which is, I'm no longer going to be was worried about maximizing my risk adjusted returns for my investments, I'm much more focused on sustaining a predictable income from those investments. And if getting more predictable, less volatile, more certain income, requires sacrificing some of that potential growth. I'm okay with that. Because my mindset shifts, I'm, it's no longer simply about the growth, it's about having that sustainable lifestyle over my retirement. And if you have that distribution mindset, you're just you're shifting more towards thinking about predictable income, instead of simply thinking about growth for the portfolio.

Alex Murguia 06:34
And a way to think about this Wade is I think you're seeing this and 401k plans now where you're having until the really good advisors does, but you see your statements, but you see your statements, not just from an account value standpoint, but you see it from the point of view of how much income will this provide, you know, assuming it's a total return approach, etc, etc. There's that there's that sense of rejiggering towards more of an income orientation when you're looking at your portfolio. And that goes hand in hand. And I don't know about you and I going back to high started, I thought this would be a greater factor, if you will, then what ended up being like, when we looked at the results, what are your thoughts here?

Wade Pfau 07:14
Yeah, I mean, to some extent, it does seem like, right, I would have been predicted this to be one of the core secondary factors, because it seems to speak so closely to the retirement problem, but also the different ways that people think about the retirement problem. Do they maintain that same investment mindset? Or do they shift and have a different type of goal and therefore potentially, want to think about whether a different type of strategy would work better towards achieving this goal, they haven't retirement.

Alex Murguia 07:46
The way and I ended up thinking about this, and it's always everything's evolving, right? So maybe in three years, I think differently. But right now, the way I'm thinking about this is, this is in isolation of everything else in a vacuum. It's a very telling factor. Right? But what I'm thinking that's happening in terms of when we look at the results is a lot of what's being explained with this accumulation distribution mindset is kind of being covered by the compilation, probably the safety first and optionality commitment orientation, like the story of accumulation distribution, is told, you know, that a lot is being told within the those two main factors that we brought on, especially when you look at outcomes and things like that, Wade.

Wade Pfau 08:34
Yeah, once you include those primary factors in the mix, there's not that much left for accumulation and distribution to explain, that's truly something of its own, because accumulation is more focusing on market growth and wanting to keep options open distribution is committing to a strategy and wanting contractual protections, wanting predictable income over an unknown length of life. And so if that's the case, it's, it becomes really a secondary factor, just because, again, once once you account for what can be explained by these other factors, it's kind of covered already. It doesn't add that much more to the analysis.

Alex Murguia 09:16
Yeah, so that's, that's where we stand. But that's it. But in and of itself, it is a it is a style. So you look at it, how we look at it. Now, when we're, let's say, providing this retirement income style and analysis profile to folks is, we looked at to see if there are consistencies with what you would expect and if there aren't, then you can bring up you can bring that up for further discussion. It's really how we're looking at it to see how I can reconcile potentially disparate beliefs. The other factor that we picked up on that well, that we picked up on in the literature and he thought, you know, let's see if this is this is really something here. And this is how you want to deal with essential expenses. And you know, We ended up calling it perpetuity versus time base, Wade.

Wade Pfau 10:06
Yeah. And so whereas I would have expected that accumulation versus distribution to be very important, like that's one is where if you're gonna say, How important are these secondary factors? this one I would have guessed is not going to be that big a deal. And it shows up as a secondary factor. But it is simply, if you think about building a floor of retirement income, and the floor is the idea of, if I do want to cover my essential spending with some sort of protected income, I want to build a floor of income. Do I think about that floor is something that I want to have earmarked over my lifetime? Or do I really think about it is rolling out on a on a time by time basis, like a time based, so I want the floor to cover the next three or four years, for example. And then a couple of years later, I might revisit and build out a few more rungs on that floor. But I think a bit more time based, not lifetime, versus I do think about it more lifetime. And as you've mentioned on past episodes, in terms of coming up with some sort of intellectual foundation for this, your love of the Michael Zuckerberg, retirement portfolios, and that sort of concept of different types of flooring, I think is a big part of what he's talking about in terms of a

Alex Murguia 11:23
Wade thank. Thank God you took I thought you were gonna ask me a question. And I was like, Oh my goodness. Some reference I was like, oh my god,

Wade Pfau 11:33
the four different ways he describes flooring. I think I think that's probably where this concept came from is just he was talking about the layout this flooring brick by brick or piece by piece or rung by rung, or do you want something that's more perpetual in nature?

Alex Murguia 11:54

Yeah, and you could see now you can begin to hear echoes right of different of different styles. Now, again, I'll preface this by saying these came out as distinct factors. So they are perpetuity time base isn't another way of saying optionality commitment orientation. It's not another way of saying, safety first probability base, it just isn't. They came out as different distinct factors. But that's not to say that there is nothing new bring being brought by these factors that the others aren't kind of accounting for when it comes to retirement income styles. But you nonetheless, you can still begin to hear echoes right. perpetuity time based, you know, if you're high in optionality, you're thinking about bucketing? What is bucketing? If not like a variety of time based strategies. If you're thinking about commitment orientation, you're thinking about a floor in perpetuity for essential income. What is what is an immediate annuity, you're effectively buying a pension for the rest of your retirement? What is that if it's not perpetuity? So you're seeing these, these sort of different ways at getting at, you know, retirement income styles, if you will. And it's important, I mean, we'd like them as the sort of confirmatory is maybe too strong a word. But, you know, the sort of, it's great for discovery, because then you could, you could just measure the sense of consistency between, you know, between someone's answers. And you know, it's just a rich, fertile ground for for follow up questions when there are some inconsistencies.

Bob French 13:34
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Wade Pfau 14:00
Yeah, so let's go back to asking a question about each of these. And again, it's not that there's just one question to define a style but to give a sense of what's involved here. And so with that perpetual time based flooring, I'll give you these two statements Alex and let me know where you fall on the spectrum between them and middle is not an acceptable answer. So first,

Alex Murguia 14:24
Wade's going to ask me to show my work. I know what I'm trying years during my middle school days,

Wade Pfau 14:33
I have a son who does not like showing his work. Statement one, I prefer to align reliable income sources with my essential expenses on an as needed basis. And then the second statement, I prefer to purchase a layer of lifetime reliable income to cover my essential expenses.

Alex Murguia 14:58
I am drumroll please. I am more on the ladder though the last answer the last question you asked. I'm probably one through six. One being the first statement six being the second statement. Um, I'm a solid five on this one Wade. Part of it is I'm a, just don't want the aggravation. I don't want the aggravation to revisit things over and over, especially if it if it solves a lifetime issue like essential, essential expenses. I mean, that's where I'm at. Where are you on this one?

Wade Pfau 15:35
Yeah, I think I'm pretty similar to you on this one in terms of I lean to that lifetime, perpetual income floor side, but not extremely. So at least not like it was with I'm an extreme back loader, but I'm not necessarily an extreme perpetual income. Goal.

Alex Murguia 15:54
And now, and you could see the first one right that I prefer to align reliable income sources with my essential expenses on a non needy, but on an on needed on an automated basis. So yeah. Okay, well, nevermind, let me I won't be doing any Amazon books or anything like that. But yeah, that's a clear, it's just not that I don't subscribe to that. I can see others doing it. But that doesn't appeal to me. Now, that's one question. If you were to ask another one. I mean, let me hit you up with another one of these. I prefer to segment my retirement income strategies by time horizons, for example, shorter horizons and longer term horizons. That's one question. The other one is, I prefer to segment my retirement strategies by Expense Types. For example, for example, essential and discretionary expenses.

Wade Pfau 16:51
So I do think more in terms of the second statement, but again, not extremely. So like, I can see the appeal the first statement, but out of that scale of one through six, again, with three and a half being in the middle, I'd probably be a four, which is more of a goal segmented. Thinking about like this sort of building out a floor for essential as being distinct from discretionary.

Alex Murguia 17:17
I'm definitely 4.35. I think I'm a five again, a pretty consistent in that one. And if you notice the nuance and how we asked that, we said segment retirement income, but one was by time short and longer term horizons show a shorter term bond, you know, let's say a bucketing strategy. And then longer term, you know, you leave it for the markets. But the other question was, instead of splitting it by time, these temporal allocations, you're splitting it by essential floor, and discretionary, where you can invest for more upside. I definitely view the world in the in the last component. So that would put me in a little bit of the perpetual camp.

Wade Pfau 18:03
Yeah, that essential perpetual floor. Yeah, I mean, this question, it almost is we talk later about strategies, it's kind of a time segmentation versus income protection the way that second question is worded.

Alex Murguia 18:17
Yeah, so here we have so that again, that's that's where I'm at? How did how did folks if you're wondering how folks did in general, in that prepare to, man, what's wrong with me today? In the perpetuity time base? It was more enough for 3.46? So it's very close to the middle, let's say one is, one is time based. Sixes perpetuity folks seem to land right in the 4.6. Right, sorry, 3.4 range. So right, you know, right, right in the middle, or right close to it, which is interesting. I wouldn't have thought that I would have thought just intuitively, folks would have been more time based, but they seem to be more split. What What's your take on that Wade? Not that you need to take

Wade Pfau 19:06
I don't know if I've necessarily even had thought much about how people think about their flooring. Is it's right in the middle. So that means there's a good division in the population between how they think about this.

Alex Murguia 19:20
I would have thought, you know, I don't know, I'm just thinking out loud here. But I would have thought just because you see it more with news, you know, you see a lot of articles about investing. And you I think you see a lot more bucketing kind of strategies for retirement income than the you know, lock it down, you know, and get a flow of essential expenses.

Wade Pfau 19:40
Yeah, and the consumer media.

Alex Murguia 19:41
Yeah, that's that's why I thought maybe that would have influenced folks, but you're seeing that none. I really, I mean, people have the way of doing it. Now accumulation distribution, kind of jumped the gun on the on getting into the averages. Haha. Let's look at an accumulation. Yeah, so let's look at accumulate distribution here. Wade, let me read this one. We're switching strategy we're going perpetuity time based accumulation distribution. And yeah, we get explained it. But what does it look like if you know, someone asked you a question, and you have to make a decision here. So wait, here you go. My investment strategy is primarily about portfolio growth. Or my investment strategy is primarily about ensuring a sustainable income stream.

Wade Pfau 20:30
Now, something to keep in mind, as we've noted in past episodes, these are what we originally had 900 questions, we narrowed it down. These are questions that did not make the final cut. And I kind of see a problem with this question. Because I'm, I'm not retired yet. And a lot of people who are looking at their style are not retired yet. So I certainly, today answering this question. My investment strategy is primarily about portfolio growth. So I would have to be a one on this. But I wouldn't answer that the same way. I think if I was really at the cusp of retirement,

Alex Murguia 21:05
that's a good point. Okay, so let's, let's imagine, let's imagine a world where it's 64, Wade, and you're on that precipice, you're on that precipice, the fragile decade is upon you,

Wade Pfau 21:23
then I would very much be probably a five or six, which is really having reoriented how I approach investing to focus more on a sustainable income stream. But that's

Alex Murguia 21:35
the point that everyone reorients some folks like I think, it I think we minimize sometimes that we're creatures of habit, if you've, if you've behaved if you view your portfolio a certain way, for 30 years, it's hard to just flip that switch. You know, I truly think that. So, you know, just just keep that in mind for for

you folks that are entering retirement, it's one of the some of the biggest mistakes we see with folks coming in is that, if they don't make that switch, it's easy to lose context of why you're investing, you're looking at your quarterly returns, and you're like, what's going on here, my portfolio is less than it was six months ago, or whatnot. And the reality is, it hasn't really affected at all the income, that you're that, you know, that that you can, that the portfolio can provide, assuming it's a total return, that, you know, you may have other things in it, etc, etc, then if you have this distribution focus, it shouldn't really matter. You know, and I get it, it's, you know, but you know, people could be just saying that to kind of avoid the hard conversations about, I don't know, portfolio construction or whatnot. But no, the reality is, is that switching to this distribution mindset, really provides a good context for why you're investing within the retirement. milieu. And that's just a better way of looking at things, not a better way of looking at things, but it's just sometimes a more effective way of looking at it for certain types of retirement income strategies. If you're somebody that, you know, you're fine with the variable income, you know, formal withdrawal rate, then knock yourself out, you know, remain in that accumulation mindset, but just self awareness is a very important quality to have you looking at your quarterly returns to maintain that discipline. So, Wade...

Wade Pfau 23:24
How would you answer that question, Alex.

Alex Murguia 23:28
The first one

Wade Pfau 23:31
you focus on

Alex Murguia 23:34
You're absolutely right. And right now, I you know, my time horizon is such that I'm still in the growth phase. But I am mentally ready knowing that a transition will come upon me and that the second question where it's primarily about ensuring a sustainable retirement income stream will take precedence. You know, at certain point, you know, you've taken your shots, right. You are where you're at.

Wade Pfau 24:01
And it's in those five or 10 years before retirement, that's often called the transition phase to retirement. And it's kind of an issue of does anything change? Or do you keep doing the same thing as you transition into retirement?

Alex Murguia 24:14
Yeah. Here's another question that I think maybe helps with context. I will sacrifice retirement income stability for potentially larger next that nest egg or I will sacrifice a potentially large larger nest egg for retirement income stability.

Wade Pfau 24:34

So for me, I would lean more towards the second statement, so that would be like the square range of four or five or six. And I'd probably go with the four

Alex Murguia 24:45
Yeah, I you know, I think I would to from that vantage point, I agree with you if if I'm not quite a former five, but I'm definitely not a six and I'm definitely not a a three and a half got you Wade Definitely. Three, I think I would be, you know, four or five, I'd had to see how the spirit moves me. When I'm when I'm gonna, you know, fill in the question set. Now I'm folks do in general on this one I mean this is one the split down the middle, I'm sorry, no order on the page take it away you do this.

Wade Pfau 25:33
So this is another one where it didn't split right down the middle, it's for the accumulation distribution, the average score was 4.06, which is leaning on the distribution side. So there is a tendency in the population to lean towards shifting to an acute distribution mindset in retirement.

Alex Murguia 25:55
Now, what gets me and this is where maybe the argument of and maybe this is why you're seeing kinks in the, in the secondary factors and why they weren't primary, if you will. They're good, they're insightful, but maybe this is where behaviors and attitude change a little bit. Because, you know, if I had a dime for every time, somebody, you know, looked at their portfolio, and they're, let's say, 70 years old, and they're thinking about China, or they're thinking about, you know, monetary policy and how that's gonna have immediate impact on their portfolio, etc. I mean, the answer, if you're in this distribution phase is just look. And again, there's a caveat, because we're actually implying that these are total returns, since I'm talking about investment accounts. The answer is, who cares? If it's really gonna provide this, this sustainable withdraw? Now, it shouldn't matter. The context of this is within a portfolio distribution. And the reality is, if you're worried about that, you've kind of implicitly made the, you've accepted that this this this income will be variable, because you have a volatile investment that you're drawing income from. And I just think there's, I wouldn't have expected it to be this high, you know, to be this i, this. To me, this tells me that why why is there more contractual protections present in portfolios? Wade, what do you think, did that I bring it back home? Or did I go all over the place?

Wade Pfau 27:29
Yeah, I mean, that's Yeah, I think that's a good explanation why this is perhaps a secondary factor. And then another issue dimension is just these correlations between these factors, and are two primary factors are relatively high. And therefore, though they present as distinct factors, it's kind of back to the issue of, they don't do a whole lot extra, beyond the primary factors, because a lot of what they explain can be explained already by our primary factors. So for example, if you accumulation distribution, if you have a distribution mindset, that tends to correlate with having more of a safety, first outlook and more of a commitment orientation, for example. And also if you have a perpetual time based orientation. If you're because I don't know how you have these letters.

Alex Murguia 28:29

Yeah, it's actually put the acronym upside. Yeah, inverse, that you flip the Yeah, you have a perpetuity mindset, you're most likely going to be safety first. Yeah. perpetuity mindset, you're also going to be commitment oriented, there's going to be a strong orientation towards commitment. And so

Wade Pfau 28:50
what it's saying is like, if you are like to say it the other way, if your probability based in optionality oriented, there's a pretty good chance you'll have an accumulation mindset, and a time based flooring preference. And if you're safety first and commitment oriented, there's also a pretty good chance that you'll also have a distribution mindset and a perpetual floor based mindset. And so again, you're not getting that much additional information. How did these two secondary factors, but but they're distinct, and they're important, and they're worth talking about.

Alex Murguia 29:25
Yeah. And other gender, gender differences? Yeah, you just see what on a relative basis, you see, women tend to have a higher tilt towards a distribution mindset. I think, again, similar to what we found with others is that, you know, life expectancy may play a role in in that from a marital standpoint, which surprising to me, but it didn't, there wasn't any significant difference between the groups, and with perpetuity time based but didn't seem to be any differences between gender or marital status or anything like that. Which, you know, you never know, right? So that's that that's sort of a secondary. These are the secondary factors. Now, one that we tried that didn't show up was I don't know, we wanted to look into forecasting, non forecasting, if investment philosophy had anything to do with a retirement income style. Why not? You know, in the literature, there's a lot about, you know, just multiple asset class portfolios, capture, market returns, et cetera, et cetera. And we wanted to see if there was any sort of splintering with regards to any of these factors. And if you're, if you, if you're a follow forecasting approach, or if you're more of a non forecasting approach, and there wasn't much there in terms of retirement income styles around that.

Wade Pfau 30:48
And if that terminology is not clear, it's more, if you're a forecaster, it's, you kind of think you can time the market that you can predict when stocks are gonna go up or down, or that you can predict interest rates or that you can predict any one of the many economic variables out there that could help explain market behavior. And if you have a non forecasting approach, it's more of that random walk idea that you think the markets already priced in and all the available information. And it's not practical to try to outguess The next thing that the market is going to do. And so that tends to be backed more by the academic literature. And so maybe more of a sense of being a rational behavior versus all the books out there about charting and market timing and everything else that doesn't have a lot of academic credibility behind it. But But again, that we test that factor, but it did not present itself as being distinct. It doesn't help to explain retirement behaviors, our retirement styles,

Alex Murguia 31:52
Can't get them all. But know that so I, you know, that sort of wraps up our retirement income styles. And again, with this, this is where, you know, we looked at it and, you know, probably safety first and optimality commitment ended up sort of winning the Bake Off, if you will. But there's also interesting reasons why that was so which we've covered in these previous podcasts. So you know, and then what

we want to do now is really, we gave hints, we gave a little more hints, I sort of went off a little bit Wade, right? About how you can put these two factors together and create a matrix, the retirement income style awareness matrix, if you will, the recent matrix based on your isa profile and how we can effectively begin to use these two factors, put them together

Wade Pfau 32:45
to two primary factors.

Alex Murguia 32:47
Yeah, two primary factors episode. Why don't you do it Wade? I'm confusing myself, we're

Wade Pfau 32:53
just talking about these two factors that are so important, okay. probability based safety first and the optionality commitment just to make sure, yeah, we're following along.

Alex Murguia 33:04
How we take that and we create a matrix for the resort framework. All right. And so what we want to do now is really break that down, and show how this framework really leads to, you know, it can help you identify your style, but more so, which we didn't see at the beginning, but how this style translates to a starting point for a strategy and we're really going to start, you know, rolling up our sleeves on that one. All right. That concludes today's podcast. Thank you for listening. Yeah, two primary factors episode. One, are You doing away? confusing myself, we're, you want to take us home there?

Wade Pfau 33:37
Thanks, everyone. Look forward to catching you again on the next episode.

Alex Murguia 33:43
Bye now.

Bob French 33:46
Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tysons Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with risk including risk of loss. Past performance does not guarantee future results.