Episode 185: Retire with Style Live Q&A

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Retirement income, 4% rule, safe withdrawal rate, inflation-adjusted spending, variable spending strategy, guardrails, sequence of returns risk, Roth conversions, Medicare surcharges, Social Security taxation, bond ladder, time segmentation, income protection, risk wrap, financial planning.

SPEAKERS
Briana Corbin, Wade Pfau, Alex Murguia

Briana Corbin 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

Briana Corbin 00:39
from YouTube and slightly under the weather. It's Wade and Alex, answering your retirement questions with just enough clarity to avoid a compliance review Maggie IRMAA and a little bit of chaos awaits.

Wade Pfau 00:50
So welcome everyone to the retire with style YouTube Live session. Thank you so much for joining us. We're here to answer questions that you have about all things related to retirement income. Alex, you did wake up this morning running a high fever, and I think you may be hallucinating more than chat. GPT, so for today, we will focus on questions that are more in my wheelhouse, which should be anything related to retirement income. I do know, Alex, you just completed a session on alternative investments or a series of podcasts, so any questions that come in about that, we will save it and we'll use for future episodes. But like near term future we'll record something once Alex is feeling better, and that'll also be used as the podcast episode. So the more Alex centric questions, we'll save for a following episode, and this will be more of a Wade centric podcast, as I am in decent health at this point in time, not running a high fever, I was able to get out of bed and all that so and there we go. There we go, yeah. So we did. We had some really good questions that some of them are quite long. Alex is going to have to use those reading skills here. But, uh, we had some great questions that came in advance, and we're happy to also answer your questions as they're coming in live here as part of this session as well.

Alex Murguia 02:05
All right, you want me to have far away here on the first one, let's go for it. All right. Here we go. This question is, we are familiar with the 4% rule as a guide for successful 30 year withdrawal

strategy? Is there a similar guide for, say, a 75 year old wanting to reset a withdrawal base on current retirement assets, or even on ongoing guidance, using guardrail principles as we age and assets change?

Wade Pfau 02:35
All right, yeah, that's a great question. It gets at the heart of a lot of the things related to spending from investments in retirement, right? The 4% rule, as originally conceived, was designed for a 30 year long retirement, because it's only the withdrawal rate you use in the first year of retirement, then you adjust your spending in future years for inflation, but you don't really worry about the withdrawal rate that represents from what's left in the portfolio. If your portfolio is growing after the start of retirement, your current withdrawal rate might go down. If your portfolio is shrinking after the start of retirement, your current withdrawal rate may go up. But the 4% rule is an example of a constant inflation adjusted spending strategy where it's based on spending amounts and it's not based on withdrawal rates. So that being said, we do hear this questions along these lines, quite a bit about, well, the 4% rule is designed for 30 years. Suppose I'm, in this case, 75 years old. Do I need to be using a 4% withdrawal rate? Well, not necessarily. So let's dive into that a little bit. If you maybe one starting point for that is like, if you're following the basic logic of the 4% rule in terms of no investment fees, no taxes, what's the highest initial withdrawal rate you could use in retirement for a specified time horizon. Again, we mentioned the 4% rule was designed for 30 years, but just with the same historical data. Bill dengan used to create that 4% rule. Here's a few guidelines on simple rules of thumb, if you have a 10 year retirement, 8% was that historical, approximately, speaking, safe withdrawal rate over a 15 year retirement, 6% withdrawal rate over a 20 year retirement, 5% withdrawal rate. 30 years gave us 4% and if your time horizon is like just ongoing 4050, plus years, it looks like the term asymptote, the safe withdrawal rate, seems to converge around three and a half percent with that methodology. Bill Bingen used to create the 4% rule. So if you're 75 Well, 30 years would be age 105 if you think you don't have to plan for a 30 year retirement at that point, yeah, you could be talking about a higher withdrawal rate. You whether, if it's 20 years again, that would calibrate to a 5% initial withdrawal rate. And so that's the conversation. In terms of like Bill Bingen style, constant inflation adjusted spending. We do also have to reflect on any sort of flexibility to adjust spending, so using a variable spending strategy. And that's the question asked about guardrails. So we'll get into that a little bit that helps manage a sequence of returns risk. In a way, the 4% rule logic maximizes sequence of returns risk because it assumes you're using an aggressive investment portfolio, volatile investment portfolio, but you're never adjusting spending based on portfolio performance. If you're willing to cut spending a little bit after markets go markets go down, you can use a higher initial withdrawal rate. And so the exact opposite of the 4% rule would be a constant percentage strategy. That's where you spend a percentage of what's left from the portfolio each year. And that really helps to alleviate the sequence of returns risk, because if the market's down, your portfolio's down, your spending goes down, you're not selling as much at a loss, and you can potentially have a better opportunity to recover from that. So to analyze those kinds of rules, I talk about the pay rule as a way to consider different spending strategies calibrated to the same downside risk with the retirement researcher Academy, we do have a payroll calculator available that we're currently making significant updates and revisions to to make it better aligned with how I talk about the payroll in my retirement planning guidebook. I'll do a workshop on that in July where we'll go through all the different spending strategies. But ultimately, you've got when we talk about guardrails and the way it's going to work. In the payroll calculator, there's really three broad guardrail or variable spending strategy type approaches that you might consider, and the

guardrails are just putting some sort of control over the Okay, well, maybe starting back a moment. So constant inflation adjusted spending. The benefit is, you know how much you can spend every year. The disadvantages, it amplifies sequence risk, and you may run out of money, and then you can't spend anything. But otherwise, as long as you have money left, you can spend something constant percentage is at the other extreme, you'll never run out of money with a constant percentage strategy, but your spending might be quite volatile, because it's fluctuating with your portfolio performance. So guardrails or any kind of rule variable spending strategy is trying to strike some sort of balance between those two. You want to adjust spending to help manage sequence risk, but you don't want to adjust it too much. You want to have some sort of control over how much those spending fluctuations would be. So with the payroll calculator, just the way we envision looking at that, you can have constant amount strategies. These are cousins of the 4% rule, but they're going to put some sort of guardrails around how much the percentage of the remaining portfolio can fluctuate so or it could just be in certain situations, I don't take the inflation adjustment, but I'll spend a constant inflation adjusted amount every year, but say, subject to I won't ever spend more than 8% of what's left or and that would be, I'd reduce spending when my portfolio starts to decline. Or I might say, if my portfolio keeps growing, I want to spend more. I'll spend at least 3% of what's left in my portfolio. So if my portfolio grows significantly, I'll start spending more. That would be putting guardrails around a constant amount. Then you have constant percentage type strategies, but you can put dollar guardrails around that. So you could say, well, I'll spend 5% of what's left every year, but I'll never spend more than $100,000 in a year, or I'll never spend less than $50,000 in a year, whatever the case may be, you're putting guardrails around the constant percentage strategy, and our patent rule calculator will let you analyze those types of strategies. And then the third one would be the actuarial methods, and that's going to be related to constant percentages, but it's the percentage isn't constant. It increases with age as your subsequent time horizon gets shorter, kind of like what we talked about at the start of this question of the shorter time horizons, you can use a higher withdrawal rate, because the money doesn't need to last for as long at that point. Now, the RMD rates published by the IRS to require for required minimum distributions are a guideline around that. And at age 75 the RMD rate is 4.1% now, generally, that's viewed as pretty conservative, because with the RMD rules, you're really assuming investments don't earn any return, and you're also assuming it's a couple, and one spouse is 10 years younger than the other spouse, so you might increase above R and D rates to be a little bit more aggressive with your spending. In the most recent edition of the retirement planning guidebook, I talked about taking those R and D rates and multiplying them all by 1.65 as a case study where that. Calibrate some of the downside risk with other spending strategies, and with that, it would be a 75 year old would be looking at a 6.7% withdrawal rate. So to summarize all that, yeah, 4% rules identified for 30 years. If your time horizon is shorter, you could increase above that. And also, if you're willing to be flexible with your spending, so that you can help reduce some of that sequence of returns risk, you could use a higher distribution rate as well.

Alex Murguia 10:27
Nice way. Now we have a lot of listeners in already, so about 80 or so. Do you have any questions following up with this one? Simply because we have a list of questions that were asked before the episode to cover. But before we leave this topic, we'd love to be able to address any follow ons on this one. Just go in, type it in, and everything's fair game,

Wade Pfau 10:53

right? Yeah, yeah. This is right now. We're on the theme of, like, the whole state withdrawal rate question related to safe withdrawal rates. And I don't think any of the other questions that came in in advance are related to safe withdrawal rates. So indeed, that would be a good time if anyone's been thinking about this particular issue. All right, we can always return to it

Alex Murguia 11:17
as well. Yeah, and just you know, we're not looking directly at YouTube, because there's like a little delay, like a seven second delay, and it drives us batty. So the questions are being relayed to us by our by our team, but that that's fine. All right. Wait, here's one. Let me get to the next one. Uh, hang on. Love the podcast been listening since the beginning, although I'm a few behind right now. How about an episode on the opposite side of what you normally cover? Normally, astrology, normally the show covers strategies used to avoid this tax or that. What do you do when you have been on the fortunate side of life? Let's say you started with nothing but work hard in a well paying job, kept the nose to the grindstone and just kept investing. You didn't retire early, but kept working not fire. Instead, you didn't retire. That's good. Now there is no chance to do the Roth conversions. I think you might have continued to earn income at max tax rates until you were 70. Therefore, therefore the past few years of market gains, you have more money than you ever dreamed possible. There's no avoiding the 85% tax on Social Security. You will pay a lot for Medicare because of the Irma tax. Are there any strategies left to us? Just pay the tax and be happy about it, which is fine, by the way, despite this, you still worry about having enough. But also how when it is safe, to start giving money to heirs so you can see them enjoy it, or start gifting to charity. I know this has been covered anyway, just a thought.

Wade Pfau 13:06
Okay, yeah, so this is somebody who's significantly overfunded for retirement, and that's great. Absolutely, congratulations. Yeah, congratulations with the planning. So yeah, indeed, in this kind of scenario, you're going to be paying taxes on 85% of Social Security. There's really no way to avoid that unless everything you've saved has been in Iraq. But I don't think that's the particular situation here, at an extreme case. So you probably have been making your allowed contributions to tax deferred IRAs 401, Ks to Roth accounts. And in this kind of scenario, you probably had additional savings beyond that, so any surplus savings was going into taxable brokerage accounts. So at an extreme case, your Social Security benefit and just the interest and dividends being kicked off of your taxable accounts maybe cover all your expenses, so you're not actually having to sell any assets or take any distributions. So in that kind of situation, let's talk about a few ideas in terms of what you might think about. Now, if you do have a charitable intent, in this kind of scenario, you don't need to even think about Roth conversions. You can do the qualified charitable distributions to cover for RMDs once RMDs begin up to the limits, which I think this year, is $108,000 I don't know how extremely wealthy we're talking about. Our annual charitable contributions might exceed that amount, but as long as they're less than that amount, you know that you could feed from the IRA into covering RMDs to charity qualified charities, you wouldn't really need to worry about harvesting any gains, because you're never going to be in a situation where you're having to sell assets. You're living off the interest and dividends from the portfolio, as well as social security you're probably paying. One Well, 85% of your Social Security is being taxed, and then we're probably talking about levels of distributions from your investments, where you're in the 15% tax bracket on those gains. And you just go along like that. You're not really thinking about Roth conversions. You're not having to harvest any gains either, because you'll get that step up in basis for any beneficiaries, you don't need to really worry about anything. Now, with the gifting side of that, you do have that

annual gift exclusion limit this year is $19,000 to each individual and from each person. So if you're a couple, that could be $38,000 in 2025 to each individual you'd like to give to is in part of the as part of the exclusion, so that that doesn't impact any sort of estate planning. Now, if estate taxes are going to be an issue for you, that's a whole nother conversation. We won't really get into specific strategies around different irrevocable trusts and things. But if the estate tax is not an issue and you're wanting to or it might possibly be an issue, but you're not going to go too deep into the trust planning for that, making those annual gifts, especially if you're able to do that without selling assets, could be definitely a consideration there. Beyond that, if you think you are going to be at a point sometime where you're going to have to sell assets to meet expenses? Or if charity is not really a consideration, you might consider Roth conversions up to at least the standard deduction or maybe in the 10, 12% brackets. But you do want to be careful about preferential income stacking. That's going to be the first constraint on any Roth conversions, and that's where, if I'm doing the Roth conversion, pay tax on that. But then that's also pushing some of my long term capital gains, or in this case, probably qualified dividends, from the 0% bracket into the 15% bracket. So in this kind of scenario, you may have so much annual preferential income that it is already getting up to the 15% bracket before you start taking ordinary income. In that case, you don't have any preferential income stacking problem. You can go ahead and do Roth conversions, paying taxes at those lower brackets, and then at that point, what you're looking out for is the IRMAA surcharges you might want to keep under a certain Irma threshold. Now you will face at some point the net investment income tax but that's a marginal rate of 3.8% that preferential income stacking might impact. Or at some point your gains going from 15 into the 20% brackets. That would be an extra marginal 5% that you might ultimately want to manage, but you could have some flexibility there and beyond that as well. So well, yeah, I think that's most of the ideas I had in advance. Oh, one consideration is your resa style, so that, because I think it was a nuance in the question, are you worried about when you can give to charity without jeopardizing your ability to meet your own retirement expenses? And a lot of people do worry about that. And you might be in a situation where you're not needing to sell any shares, you're able to live off the income generated from the portfolio, but you're still worried about running out of money. So if your resa style suggests you have this concern. You're worried about outliving your assets, you have that longevity concern, if you are more safety first oriented or commitment oriented, you might look at ensuring that your lifestyle is fully covered through reliable income sources, and then that really does give you the flexibility that beyond that, it's all discretionary wealth that is ultimately probably going to be earmarked more for beneficiaries, so that can give you more confidence that you can go ahead and start sharing that wealth while alive, so you can enjoy seeing the benefits of that rather than leaving it all hold up and waiting until death and then leaving behind a very large legacy At the end. Since you

Alex Murguia 19:01
said Reese's style, what I encourage, and maybe Amber Can, can do this, she's on our team, is maybe put a link to retire with style where it's which is the website for our podcast, where folks, if they wanted to take a Reese and see what that's all about, they can do so and so we've got three good questions here coming up from the live session Wade, I will run through them. This is from Steve. I have two more years to be eligible for Medicare. Does it make sense to spend money out of a Roth account older than five years after dB, after depleting cash so as to reduce M A, G, I, to maximize ACA subsidies. You may also want to talk about those acronyms, just to make sure everyone is on the same page.

Briana Corbin 19:49

Let's take a moment to let the audience know that this show is sponsored by retirement researcher. You can learn more about retirement researcher@retirementresearcher.com and subscribe to our newsletter where you'll. Receive weekly actionable information for your retirement planning benefit. Retirement researcher is an online community devoted to helping you create the retirement income plan geared towards your goals.

Wade Pfau 20:11
Yeah, yes. So we've got someone two years before Medicare eligibility, and for most people, that would imply they're 63 years old become becoming eligible for Medicare at 65 and they're using the Affordable Care Act for health insurance until Medicare eligibility starts. So in those two years, you actually get the double whammy of the impacts of taxable income, your modified adjusted gross income used to calculate either your Affordable Care Act subsidies or your your Medicare premiums, the income you have at ages 63 and 64 could both reduce your Affordable Care Act subsidies as well as lead to Irma surcharges, because that income you look at that income two years later to determine your Medicare premiums for the year. So yeah. I mean, we got to look at a case by case basis, and so this is only general kind of conversation. But indeed, it does make sense to consider whether it's worthwhile to potentially tap into the Roth to meet expenses at ages 73 and 74 assuming you can take those qualified distributions to help manage Medicare surcharges two years later, as well as to manage how much Affordable Care Act subsidies you're eligible for this year, the Affordable Care Act subsidy implied the loss of subsidies if you frame that as a tax. I mean, it's not a tax, but it's if I earn another dollar of income, I get less subsidies. It works in the same manner as a tax and the effective marginal tax rate on that up until you get to the 400% level threshold of the poverty line, which could be somewhere depending on where you live and how many people in your household up and somewhere in the ballpark of $80,000 below that point, the implied marginal tax, it jumps around quite a bit so but it's fluctuating between about 6% and 18 and a half percent. But for a lot of those income levels, it's closer to that 18 and a half percent side. And then once you get past 400% of the poverty line, you get a long tail where the effective marginal tax rate is eight and a half percent, and that gets added on all your other tax brackets and tax rates. So you don't necessarily want to be voluntarily generating taxable income when you're eligible for Affordable Care Act subsidies, and also now, by the time Irma becomes an issue. You're probably in that long tail of eight and a half percent on the Affordable Care Act, and you're watching out for those Medicare surcharges two years later, yeah, again, I can't say with certainty that you should spend from your Roth in those years, but I certainly think the case is there to investigate whether that's a worthwhile consideration to help manage your modified adjusted gross income in those years where you're impacting both affordable care accept cities and Medicare surcharges from for two years later.

Alex Murguia 23:17
All right, and Steve, you have follow up questions. Just drop it in. We're here. We'll move on to the next one. This is from George and his question or statement is, I am 75 years old. What is my time horizon or withdrawal rate?

Wade Pfau 23:34
I guess this first question we had so 75 there's not any one answer to this. You might like, if you want to quantify things a little bit, there's a really helpful website, longevity illustrator.org, you could go there and see the distribution of your life expectancy. I mean, if we just ask, like, if you're in decent health, 75 year old man in decent health. You're probably looking at a life

expectancy in your late 80s at that point. So that could be another 15 years or so. But then we always talk about you don't just plan to your life expectancy. You have to plan to something beyond that. But we also don't know if he's married, right? We don't know that either we're so just for the one individual, seven at 75 if you were planning, well, what if I live to 95 of course, you can do that arithmetic. That would be a 20 year time horizon. If you want to plan beyond 95 you'd add on top of that and so. But Okay, now let's simplify and say we're looking at about a 20 year time horizon. What's the withdrawal rate on that? Well, that bill bengan style analysis would suggest, with a 20 year time horizon, somewhere in the ballpark of 5% for inflation adjusted spending, but you could go higher than that if you're using a variable spending strategy, and that's where I suggested even. Uh, with the RMD method that I talk about in the retirement planning guidebook, looking at around 6.7% for that age. So we can't give you the exact number, but Yeah, somewhere in the ballpark of five to 7% is probably reasonable.

Alex Murguia 25:13
I would, I would ask a follow up to this Wade, and I'll let you actually, like, flush it out more just because of my throat. But effectively, this also assumes that George is thinking about this, and he's a total return person. And I, you know, I just want to give people a level set that there's many ways to get right their retirement income, and it goes into like the RESA and your style. And so I, first off, there's no magic number. I think folks always want this magic number quick and dirty, because that's the world we live in. But, and that's all right, there is none. But there's also many ways to get this right that has nothing to do, that has nothing to do with a withdrawal rate. You follow where I'm going with that way, right,

Wade Pfau 25:58
right? The whole conversation around what's the safe withdrawal rate that is inherently a total return framing of the question of retirement income that I'm primarily going to meet expenses through distributions from my investment portfolio. And I know want to know what's the highest sustainable amount I can spend without having to worry about running out of money. But there's volatility with a portfolio, so there's no true answer to that. And so it really becomes, well, how much am I willing to make significant cuts to that spending in the future? If the more I spend a day, the more I have to be ready to potentially make cuts in the future, where do I strike the balance there. Now, the way around all of that is, yeah, if you're really concerned about outliving your money, and so I was just, I was answering that in a total return frame of, okay, plan through 95 that's 20 more years. Let's plan to spend it down over a 20 year time horizon. The alternatives are no, if your income protection, if your time segmentation, if your risk wrap, well, especially if your income protection or risk wrap, looking at reliable income sources to meet lifetime expenses, make sure you've got your basics covered without having to worry about market volatility, and then you can more comfortably spend more aggressively from whatever is left in the investments, because it's for more discretionary goals. It's not to meet your essentials. And if your time segmentation, you build a bond ladder for the upcoming time horizon to make sure you've got expenses covered over the the upcoming

Alex Murguia 27:32
years. Yet, to me, a more nefarious thing that happens when it's when you with and George. Just know that. I know this may not even be where you're coming from or anything like that. I'm just using this as an opportunity, but a more nefarious mindset that happens with somebody who's 75 years old and is thinking, hey, what can I withdraw? Right? What can I withdraw here? No one is going to withdraw. So their portfolio is at zero, at 95 right? There's always going to be

some slack left in there. And to me, the biggest mistake that someone could do is okay, they're able to accomplish their goals, but they they really just went chintzy on what they could withdraw, and they die with this unintended, like, you know, unintended amount that that could have been allocated much better for their own enjoyment, for their families, enjoyment during retirement. And I think many opportunities are wasted simply because of that impoverished thinking of, oh, you know, I mean, I need to, I need to always have a cushion. I need to always have a cushion in case the market collapses and I need to withdraw money from and there's many ways to account for that that will let you sort of lock it down and really enjoy, you know, retirement significantly more. Wade, do you agree? Disagree? Yeah,

Wade Pfau 28:46
yeah. And the dominant paradigm in the consumer media is total returns for retirement. Because it's total returns is what you generally do pre retirement. And there's not always an appreciation about how things change plus retirement. And I don't think that does lead a lot of people to if they're forced into a total return approach, relying on investing and market growth to meet their retirement spending, and they're ultimately not comfortable with that. They worry about outliving their money and then they don't spend as much as they could, whereas being able to build a floor of reliable income might provide a much stronger foundation for them to spend more in retirement and enjoy more in retirement. It's that, that idea of a license to spend that you get if you're worried about outliving your money to have contractual protections backing that spending power in retirement. So it's not to say that total returns is right or wrong. It's just our research consistently shows about a third of the population is properly reflected with a total return approach, which means two thirds of the population might also want to consider other strategies, beyond just asking themselves, what's the safest draw rate from an investment portfolio? Yeah.

Alex Murguia 29:55
I mean, our work will be done when we don't get that question, we get a question like, What strategy makes the most sense? For me, et cetera, et cetera. Because to some extent you could up your withdrawal rate significantly if, for essential expenses, you have some sort of bond liner, yeah, I mean, and then discretionary, you treat it more for total return. You know, there's many ways to blend that will allow you to really maximize that spending. With there should be a calculation way, you know, the Sharpe ratio is return per unit of risk. There should be a withdrawal per unit of headache.

Wade Pfau 30:26
Yeah, I think you just got a new research topic.

Alex Murguia 30:28
No, but Right, like that kind of thing. That way you just enjoy yourself. But here's a here's another good question. And again, keep keep them coming. I mean, it helps with momentum. You got one from Wade, from Wait, from Ray, and it's thank you for sharing your knowledge to us. He's referring to me, obviously. Way should we spend our 401 K down first. I'm 67 I have not taken Social Security yet. Thank you. So this is another one of these kind of generality, kind of questions that I think it depends. But go ahead,

Wade Pfau 31:02

yeah, we've got to definitely throw a strong it depends caveat on the start of the answer, but, and so the conventional like that is back up a moment there. The conventional spend down strategy for retirees is you spend on your taxable account first, then you spend on your your 401 K, your, your tax deferred 401 K, or IRA, if you rolled over to an IRA, and then once that's gone, then you spend from your Roth account. Now that being said, maybe there is no taxable account, and that would point to the 401 K, but also, at the very least, like directionally, yeah, I would say that you probably want to be thinking about spending your spending down from the 401 K in those years before Social Security started, because that can help better set you up once Social Security begins, up to 85% of your Social Security benefits are taxable, and if you're able to cover your expenses from your 401, K, before Social Security starts, you may not have to take as much out of your 401, K, oh, did I I'm just assuming he's going to delay to 77. Haven't taken Social Security yet, so yeah, you're probably delaying. So yeah, you're delaying to a 70 you're going to get more inflation adjusted spending from Social Security. At that point, it's okay to be spending on the 401, k in the meantime. And then once RMDs begin for you, whether at age 73 or 75 depending on your year of birth, RMDs might be less because you've been spending down. And so I everyone's situation is different. But unless you're extremely wealthy, you might be able to get that tax rate on Social Security that could be on less than 85% of your Social Security benefits. So yeah, definitely consider spending from those more tax intensive sources in the years prior to starting Social Security as a general answer, but with the caveat that everyone's situation is different, and there could be something we didn't address that might impact your decision.

Alex Murguia 33:09
Excellent. All right, we got another question from Brian, and again, keep them coming. We're here. We're going to try to get to as many of these as we can. And frankly, if we don't get to them. Now we will have dedicated episodes where we just run through them, so just put a question in, and we'll make sure you get taken care of. Now we have one from Brian for a couple that has no heirs and wants to leave their estate to charity. How much sense does it make to amass money in Roth accounts, besides the windows. Oh, sorry, besides the widow's penalty. Are there other good reasons?

Wade Pfau 33:50
So no heirs and want to leave their estate to charity? How much sense does it make to amass money in Roth accounts besides the widow's penalty? Are there any other good reasons? Well, the whole logic like, do I want to contribute to a Roth or to a tax deferred account? Is, when can I pay the lowest tax rate? If my tax rates are higher now, I contribute to an IRA, and then I can take out of the Roth at a lower tax rate. If my tax rates are lower now, then I want to contribute to the Roth, but for money that goes to charity, the tax rate is zero. Assuming it's a qualified charity, they don't have to pay taxes on it. So that would lead to you don't want to be paying taxes on the money and putting after tax savings into a Roth. If you're quite sure that ultimately is just going to go to a charity, even if the tax deduction is only the 10 or 15% range, that's still better than 0% in terms of my tax rate would be higher today I want to be contributing to an IRA. So the basic logic is, any money that you're pretty sure. Is going to go to charity. You don't really want to be paying taxes on in order to get it into the Roth, because you don't get any tax benefit from moving money from a Roth to a charity. You'd want to lean more towards getting tax deductions now, holding it in the IRA, and then being able to either do qualified charitable distributions, or just leaving the IRA to a charity where there's no embedded income tax liability. From the charity's perspective, they get to take that money out at a 0% rate. Now, if there's a

chance, you may need to also spend that money. I guess that's where the widow's penalty and other things come into play. But that's if you're not familiar with the idea of a qualified charitable distribution after age 70 and a half, and that's still the right rate age for qualified charitable distributions. It's not linked to the RMD age anymore. So after age 70 and a half, you can make contributions from an IRA to a charity of up to, I believe it's $108,000 this year. And year and not have that get included in your adjusted gross income, which helps manage it's much better than just making a straight up charitable gift, because it's not a below the line deduction. It's in a it doesn't go into your adjusted gross income. It helps with managing social security taxes, payroll, Medicare, tax premium, Medicare premium surcharges and so forth. So managing it more from the perspective of I think this money is going to go through to charity. Let me get tax benefits for myself, which means putting it more in the IRA side than the Roth side, but then thinking about qualified charitable distributions, if I end up needing to with the widow's penalty, my surviving spouse is going to be hit by tax bills and RMDs, then just make those gifts more in advance,

Alex Murguia 36:55
nice and Wade what are you thinking about it? Wow, we're no Mr. Beast. We have, like, about 100 folks that are on and questions keep on coming in, and I'll say, please send us questions. I mean, the opportunity to have Wade and directly answer questions for your retirement planning is a it's a pretty unique opportunity. So we'll continue with this one. This is from I don't have the name in front of me, but it's five years away from one spouse retiring in parens, the other will retire two years after that. In general, what are your thoughts on focusing on paying off the current mortgage, 88,000 versus contributing to a Roth IRA during that time period. We can't do both. Our original thought was that we wanted to get rid of the mortgage, since it would closely match the cost of our monthly Medicare premiums that will kick in in five years. Five years doesn't seem like a very big time horizon for growth or decline, I assume, in the market of Roth contributions. So we thought we'd attack the mortgage balance. Thoughts, PS, Wade needs to show us 10 push ups before. Oh, my God, why wasn't this the first question, Wade needs to show us 10 pushes before this YouTube session ends today, no less than five. Wait, let's do the push ups first, and then we'll work into the the the other, the other part of the

Wade Pfau 38:26
off camera. Let's see after the episode. But yeah, I mean, this is a important question. So there's always a lot of things that go into, like, should I pay off the mortgage or not? On the pure math side, one is simply, what's your mortgage rate? These days, some folks have mortgage rates that are significantly below what treasury bonds are paying, and so that really speaks to them.

Alex Murguia 38:58
Wait, can you? Can you? That's a good question that comes up every once in a while, the piece about paying off mortgage versus treasury bonds, and how there's a little kind of analysis with that.

Wade Pfau 39:09
Well, yeah, I mean, if a mortgage is like a negative bond, instead of paying you interest, you're paying it interest. But if my mortgage rate, just say, is 3% but I could buy a bond that yields 4% rather than paying off the mortgage. I might as well put those funds into a bond paying 4% make the mortgage payment at 3% and have an extra 1% left over. That's kind of the logic there. That's on the pure math side, on the behavioral side, some people really don't like having a

mortgage, and so if, if you just will sleep better at night and feel more comfortable paying down the mortgage, that's probably more important than any of the math considerations. It can can also speak to your your retirement style, like if you want the peace of mind of not having a mortgage. Mortgage. That's probably the first consideration, if, if you're really more flexible about whether or not you have the mortgage, and you're just really asking mathematically, what's the best approach to take? Well, that's where, okay, going back to where we started, depends on the mortgage rate you have, but, but also, like if you're comfortable having the mortgage, unless the rate is too high, the odds are that you could probably earn a higher rate of return on investing than you could on the mortgage and the putting money into the Roth, that's one of those things where you never get a chance to redo it, like any year you don't make the Roth contribution, you're just going to have less money in the Roth. So it's not just about what would the investment return be in that next year, five year window that we're talking about, but really, what's the lifetime impact of having more money in a Roth and having that additional tax diversification and flexibility, and that gets more into the whole tax planning over the lifetime type conversation. So that being said, again, behaviorally, are you comfortable with a mortgage or not? If not, that definitely there's no problem with paying off a mortgage if you're fine having the mortgage. That probably does speak more if you are more total returns in this regard, potentially leaning more towards building up that Roth while you're able to and then you can always pay down that mortgage later. And if you get into a tax situation where you you need to be able to meet those fixed mortgage payments, but you don't want to generate taxable income to do that, those funds could always come back out of the Roth at that point to make those mortgage payments.

Briana Corbin 41:46
Are 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 your copy of retirement researchers, eight tips to becoming a retirement income investor by going to retirement researcher.com/eight tips. That's the number eight tips.

Alex Murguia 42:24
Okay, I hope that covers it. Yeah, yeah. And we got a nice burst of questions. So that's awesome. We got questions from Carl withdrawal strategy. Five years in cash bonds, other money in stock, end of year, mark it up. Refill cash bonds. Okay, so hang on, there's a little bit of a Tarzan component to this statement. All right. Withdrawal strategy is five years in cash and bonds, other money in stock that the end of year, market up, refill cash and bonds. Market, market down. You wait. Okay, so I see what this is, sort of a strategy. What do you think? I don't know, of many people discussing,

Wade Pfau 43:07
yeah, this is the classic time segmentation. Yeah, this is common. Oh god, it's one of the four retirement income styles. So if your retirement income style is time segmentation, you know doing something along these lines is definitely what you want to be thinking about,

Alex Murguia 43:21

if anything, the thing here that translates into some of the work you've done is when to decide to refill the bond ladder, and you know that critical path stuff that you've done? Yeah, so the I see vibes in that, in this question,

Wade Pfau 43:34
right? Let me the question scrolled off my screen here. Let me, oh, we have a lot of questions. Now,

Alex Murguia 43:40
okay, I'll read it again. Here's a withdrawal strategy. And Carl is just speaking in bullet points. So that's fine, five years in cash and a bond, other money in stock. So he's got, I assume, you know, he has expenses that he needs for five years in cash and bonds, other money's in stock. At the end of the year, he'll replenish the cash and bonds. If a market is up, if the market is down, he'll wait. What do you think?

Wade Pfau 44:07
Yeah, okay, so this is a classic time segmentation strategy with a five year fixed income bucket and with annual checking to see, should I like so I've got five years of bonds with cash and bonds. After one year, I've spent a rung of that ladder, and now I have four years left. Do I want to replenish it? Back out to five years or not? And then the basic idea is, if markets are doing well, or the wording here like if the markets Well, the markets are doing well, I replenish. If the markets are not doing well, I don't replenish. Yeah, that's classic time segmentation. You You could there's a lot of different ways you decide. You could decide whether to replenish the bond ladder, the critical path that Alex mentioned is the more classic that would be, the asset dedication approach. You could also do a more simplified if. The market was up last year, I'll replenish this year. If the market was down last year, I'll re I won't replenish this year. What I talked about in retirement planning guidebook was I looked at a bunch of different strategies, and a strategy that seems to work as well as anything, but it's quite simple. It would be a cousin of the critical path idea, but it's when I retire, I'm going to write down my investment balance, whatever it is, and then I don't have to inflation, adjust that number or anything. I just remember, okay, at retirement, I had $643,000 then in the future, when it comes time to decide whether, well, when I want to take a in this case, whether I want to replenish the ladder. If my portfolio balance is higher than when it started, I'll take some of that surplus and go ahead and replenish the ladder. If my remaining portfolio balance is below that initial starting amount, then I won't replenish the bond ladder. And that gives more opportunity for the portfolio to grow and recover, so that in the future you can and can then replenish the latter. If time segmentation is your style, that's a perfectly viable retirement income approach. It does rely on the idea that you're kind of generally comfortable markets will grow over time. So if I can just buy myself some time for the portfolio I want to do so, and I believe the portfolio will recover like I got a five year window, which may be four years at this point, but I'm expecting markets to recover at some point now. It does imply that as your portfolio is going down, you are starting to invest more aggressively overall, because you've got your growth portfolio and you have your bond ladder. So as the bond ladder piece gets closer to zero, years, you're all growth portfolio at that point. So behaviorally, that's a consideration to the extent that this strategy works, because it actually has you getting more aggressive when markets are not doing as well. And historically, if markets haven't been doing well, they tend to recover at some point. So that can work out for you and that, but you have to be comfortable, comfortable with that kind of psychology of I'm not going to allocate into bonds when markets are done. I'm going to stay the course with my growth

portfolio, with the hope that it will recover in time to replenish my bonds at a later point. But yeah, that's time segmentation. That's a viable retirement income approach if you take the RESA and especially if your style is time segmentation or close to the border to time segmentation, I don't see any problem with looking at that kind of an approach for building your retirement income strategy. Perfect.

Alex Murguia 47:41
And again, keep on sending questions. If we don't get them to that get through them in this hour. Well, we'll have sessions where we get them all. So just use the momentum to ask away. Here's another question. Wade. What key steps? This is from 502, mm, 444, what key steps might be considered in the three to five year run up to retirement at 65 not claiming Social Security till 70. The only thing I would, I would contribute to this, before you go on, from my voice standpoint, is, I think once you know your style, you're able to develop a checklist of things leading up to retirement that will make sure you're you know, you can transition smoothly, as opposed to running yourself into a corner that you then need to back out of.

Wade Pfau 48:36
But yeah, yeah. And so in this case, the individual would be between 60 and 62 planning to retire at 65 delaying Social Security to 70. What are the some of the things they can be thinking about at that point? We always say step one of retirement income planning is take your resa as the first step towards thinking about retirement, and that will help you identify, and that's a free resource available to everyone help you identify your retirement income style. And then you're just starting to think in terms of along those lines. If your total returns, you don't necessarily make many adjustments to the portfolio, other than possibly if just changing your asset allocation as it's linked to your age, but if your time segmentation, like with the previous question, in the three to five years before retirement, it might be a matter of reallocating instead of putting into bond funds. I start to build that bond ladder, and so then I get to retirement with an upfront bond ladder to cover the next few years of expenses. If I'm income protection or risk wrap, I might be thinking about having some sort of deferred annuity where I'm starting to allocate into that protected, reliable income, where and the income will turn on at 65 or at some point after that age beyond that, you want to be thinking about Medicare. At 65 what sort of decisions will you be making with Medicare? You want to make sure you've considered Long Term Care, planning, thinking about where you want to live, what do you want to do in retirement, making sure you have a plan for how to fill your time in retirement, the non financial considerations of retirement. What else? Well? Yeah, well, there's a, there's, there's a lot of things to be considering, but that would be some of the the important ones in those years before time. What kind of retirement strategy do I want? Are there steps I can be taking now to transition from my investment portfolio into a retirement portfolio that may incorporate some other tools that you don't usually think about pre retirement, such as an income ladder, income bond ladder, or annuities. You have thought about Social Security, but thinking about Medicare and health care, thinking about long term care, thinking about where you want to live, thinking about what you're going to do with your time in retirement, investing, not just financially, but in your relationships, to make sure you've got that foundation to get the most out of retirement and have social contacts and have a life outside of work, it can take work to prepare for a life outside of work, so making sure you're you're Thinking about those issues as well.

Alex Murguia 51:20

Okay, here's another one. What is the best way to determine if raw This is from Nancy. What is the best way to determine if doing Roth conversions before starting Social Security is worth the expense of stepping into Irma?

Wade Pfau 51:37
So Irma can be a threshold where people stop. There's not going to be any one right answer to this. But remember about Irma. So this is the Medicare increases in monthly surcharges. There's five different income thresholds in the US tax code, where if you have $1 more than that, you're going to be paying per person on Medicare in that household, the either a single person or a couple, with the first Irma threshold, it's an extra 1000, about $1,000 per year. And then a couple of the thresholds, there's a $1,500 bump, but it's just for the one year. So it the thing about Irma, it's if you get hit by Irma, people really hate Irma, but it's not the end of the world. If, like, for one year, you end up paying an extra $1,000 or $2,000 if there's a couple both qualified for Medicare. Now, of course, people hate doing that, but if you're thinking about long term tax planning, you're really looking for opportunities to pay taxes at the lowest possible rates of your lifetime. And so yeah, the $1,000 surcharge is something you want to monitor. It may not always be something you want to avoid. If you're at higher wealth levels where you may be managing, like the 32% type tax rate in retirement, it's quite possible that you could pass through the first or second Irma threshold as part of the tax planning, and that can still lead to more after tax spending power over your lifetime. So it's not necessarily the case you want to avoid Irma at all possible costs, but you want to be cognizant of Irma. And it's like, as I'm voluntarily, generally reliable or generating taxable income, perhaps two Roth conversions, I have to be monitoring. How does it this is kind of the order of steps. How does that impact my Social Security taxation? If I am have already cleaned if I haven't cleaned yet, that's not part of the picture. Is this pushing my long term gains or qualified dividends into a higher tax bracket, and then you start hitting Irma surcharges, and then you hit the net investment income tax and then you succeedingly, hit higher ordinary income tax brackets. And then eventually you'll hit the 20% bracket, which is really the 23.8% bracket on long term gains. And so you want to push along until you reach a threshold where you stop. And when I look at different Roth conversion strategies, sometimes people do push through an Irma threshold or two, but in many cases as well, the IRMAA threshold is where you put on the brakes. You don't voluntarily exceed an IRMAA threshold as part of the tax planning. So that's, I think, like in a general sense, about all I can say on that particular topic is, sometimes it's okay to pay an Irma surcharge as part of the tax planning process, but you definitely don't want to accidentally trigger an Irma surcharge unintentionally.

Alex Murguia 54:33
All right. Wade, here's one more. I'm an educator who will get no social security. I get us. I'll get a state pension with no color adjustments. I've been viewing my uh, 457, B and Roth RIA as the sole inflation risk cover for myself. Is this accurate?

Wade Pfau 54:56
Yeah, so if you're not eligible for Social Security and instead or for. A government pension that does not have any not not just a CPI adjustment, but an E coli adjustment, you've got a lot more vulnerability to inflation risk, so your investment assets ultimately need to be the source of inflation protection. Now it's not just the fact that I have these accounts, the 457, B, or the Roth IRA that that's my inflation protection. It's how I allocate assets within those accounts. And really the only asset we have outside of Social Security, in a general sense, is tips. So you might want

to consider an allocation, especially on your the bond side of your allocation tips to provide that inflation protection. That's the most surefire way of getting those inflation adjustments, if I mean the other the other way is you just a growth portfolio creates risk, but the hope is, over time, it will grow to keep up, at least with inflation, and hopefully grow beyond inflation. So you could be thinking of a growth investment portfolio as a long term hedge against inflation. And if you're more if you're comfortable doing that, that's fine, and then the more surefire way to get the inflation protection would be with tips. And if you don't have social security, that probably does push the conversation much more in the direction of considering an allocation to tips to make sure that you at least have some assets that are linked to the consumer price index in the US.

Alex Murguia 56:34
Okay, now what I would say to everyone who's listening here and and the like, and we're going to collect all these questions and we're going to go through them. In fact, they'll probably be, they'll this is what will be the content for our next few episodes. At this point, I think because we have a lot that were already sent to us, and we're getting some live, or we're nearing the hour, so I'm not sure we'll be able to get them all. But that being the case, we're going to do this and Wade and I will just sit down and record them and notify everyone when they're up. If you're somebody that's not subscribed to retire with style, please do so on Spotify, on whatever go to retirewithstyle.com. If Bri Amber, if you don't mind putting the link there, and just subscribe to the podcast that way. When we do the Q and A's over the next few weeks, you'll know when they're coming in. What I also recommend is everyone take the reset, because a lot of these questions we've been just going into, we've been going into the context of, well, what's your style first, and the like, and then you can determine the best opportunity set to go around doing that. So I strongly encourage everyone to take the RESA we've had the links there. It's free. It's a good way to kind of really contextualize what what angle you want to have for your retirement income planning session. Now, as we wrap up, I'll have Wade. Wade. There was one question about just risk wrap. And maybe you may want to talk about risk graph. It had just come in. You don't mind touching base on that, and while you touch base on that, since we have about, let's say, a minute or two left, please just sandbag us with questions. If you have questions right now, we're obviously not going to get to them right now in the next 10 seconds. But if you don't mind doing that, you know two things, it gives us a lot of more time for us to digest the questions. And again, you're not gonna have many opportunities to ask us directly, and we're gonna spend the next few I can imagine this being five episodes Wade just going to rolling through questions. So please put in questions, and we'll get to all of these as you know, as we roll with the podcast?

Wade Pfau 58:41
Yeah, on the retire with style podcast, I think the today, what we're recording right now, was scheduled for June 24 but then, yeah, we'll just have as many episodes as we need after that to make sure we've answered all the questions, because we've only gotten through one of the seven that came in advance, and then we've been working on questions that have come in live. And I know there's many questions we haven't gotten to yet, but we'll keep answering those questions. We'll make sure we address them all in the next series of podcast episodes, however many episodes it takes to make sure we answered all these questions. So absolutely thank you. And keep those coming in. And then, Alex, you said, just risk wrap something, just

Alex Murguia 59:20

allow people another two minutes to maybe put in questions. I figured risk wrap, you can probably cover in two minutes just what it what it is. There was somebody from from England, that was asking about it, not anyone. I think I don't know what somewhere Well, I will answer this. Well, Alex, when you retire, will you, will you be opening a pickleball training academy. Maybe here I got something that's pretty cool, maybe, maybe, but not before, not before we get out these bad boys. We created these pickleball patterns for retire with style. These are the samples we've been playing with them. Most likely we're going to order a ton of them in the upcoming days, and this would be for our readership, and so it's going to be awesome from that standpoint. So more to follow. And back, there's a quick question here. Is hiring a financial advisor? Worth it? We're going to have a workshop on that. Look, I'm gonna say yes, we have an advisor. Wade and I are managing principals of an advisory firm at the end of the day. Yeah, is it cost effective to have an advisor? Absolutely, but take me saying that with a grain of salt, obviously.

Wade Pfau 1:00:37
Yeah, we can cover that in more depth. But yeah, there's four retirement income styles, broadly viable approaches, the total returns, the traditional investing based approach, relying on market growth, giving you flexibility for your assets, spending from them, the time segmentation we talked about today with the I want fixed income to cover my upcoming expenses so I have short term spending buckets, long term growth buckets. And then income protection and risk wrap are both cousins of each other. They're they're kind of the flooring approach. Income Protection is a classic. I want a floor of protected lifetime income to cover my basics, and then I can invest on top of that for more discretionary goals. And then risk wrap is the newer hybrid. It's I want that floor of spending protections, but I also want more market exposure. I'm more comfortable with market exposure, and so that's where risk wrap approaches could be. You want guardrails around your market risk, whether that's the kind of structured return that some financial products provide, or whether that's the whole conversation around. Say, again, just to keep it simple, a variable annuity with lifetime income benefits. You can still invest for growth, but you have an income benefit that makes sure that even if that account value depletes, you have a protected lifetime income stream from that asset. It's just that income stream may be less than you get through a traditional, simple income annuity, but risk graph is providing that behavioral desire for market growth, but alongside protections and guardrails around that market exposure,

Alex Murguia 1:02:11
and there it is again, Last call. Type in any questions that you have. We won't get them in right now, but we will definitely be getting through all of them in the upcoming episodes. And if anything, if we get these questions now, it gives us time to formulate answers. Not that Wade is not giving us his absolute best right now, but you know how it goes right Wade,

Wade Pfau 1:02:34
it's always better to be able to think about these a little bit in advance, like the one about what should I do before retiring? I could probably make a little bit better list with a bit of time to think about it. Maybe we'll

Alex Murguia 1:02:46
re answer that in a different manner. All right, thank you everyone. This has been an absolute pleasure for us. Wade party thoughts,

Wade Pfau 1:02:56
yeah, thanks everyone. And again, we didn't get to many questions today, but we will. We're going to have a series of podcast episodes, and we won't stop that series until all the questions have been answered. So, and that won't begin right away, because we do have a few episodes we'd already recorded, but starting June 24 the however many episodes it takes after that, we'll be answering all the questions that came in. So thank you so much. Thank you everyone.

Briana Corbin 1:03:22
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