Episode 194: RWS Live! Rethinking Retirement: Inflation, Annuities, and Roth Conversions

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SUMMARY KEYWORDS
Retirement income, Roth conversions, annuities, inflation hedge, Social Security, break-even analysis, strategic asset allocation, fixed income, equity mutual funds, funded ratio, retirement income challenge, sequence risk, lifetime income, financial planning, investment strategy.

SPEAKERS
Wade Pfau, Alex Murguia, Briana Corbin

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 00:38
if you're wondering why there's no big intro today. It's because we're picking up right where we left off. This is part two of our YouTube Live Q and A, and Wade and Alex are diving straight back into your questions on Roth, conversions, annuities, inflation and more.

Alex Murguia 00:54
Okay, thought of using tips to protect from unexpected inflation versus equities, which also track inflation. They're not contractually but have more upside long term than tips. So it's effectively, do I hedge? I read this as do I hedge inflation with tips or with equities? And I think that's a tricky question for a few reasons, which, I think why you also had a grin, which is like, don't, you know, don't let the tail wag the dog here. You know, from that standpoint, because I think you're gonna the noisiness of the volatility will make the question irrelevant about keeping up with inflation. But Wade,

Wade Pfau 01:36
yeah, tips give you contractually protected hedges with inflation, as does, importantly, delaying your Social Security benefits, both are going to be CPI linked. There's not much else out there that is CPI linked. And then the idea of stocks as an inflation hedge is that over the long run, you would expect stocks to grow to keep pace with inflation, and then some, over the long term, to potentially grow at a much higher rate than inflation right now, though, tips are like a 2.4% real yield over a kind of a the entire yield curve. That's not a bad real rate of return. But historically, if

you're thinking stocks now, this is getting into some of the questions about the risk premium and so forth, historically, stocks have outperformed inflation by much more than two perfect 2.4%

Alex Murguia 02:23
but, but this is a tricky question. The way am I just reading it? Because the way I see it is, I want to hedge inflation. Do I get tips or equities? And for me, I'm like, But tips and equities are so different from each other, fundamentally on the risk spectrum, spectrum, that it's like, I think first you have to determine to more equities or more fixed income, and then you know, if you say, happen to say more fixed income, then okay, tips is appropriate, if you happen to think more equities, then fine, more equities as a general matter, right? I mean, I think my misreading that, huh, like you got to decide first you're applying for inflation, but the risks are so different that you need to get that right first.

Wade Pfau 03:11
Yeah, you do want to consider your overall strategic asset allocation first. But I guess then at the margin, maybe, if you have some flexibility about which direction to go here, maybe that's where the question comes into play, I think, will relate to your retirement income style in part. If you're more safety, safety first, you're going to feel more comfortable with tips as an inflation hedge and also, again, delaying Social Security. If you're more probability based, you're probably more comfortable letting it roll with stocks with the idea that they should be expected to not or they probably will not only outperform inflation, but also give you a reasonable rate of real growth beyond inflation, beyond what tips could provide as well. And so another way to think about that too, I guess maybe the way you're thinking about it, Alex, is if you are more safety first oriented. And this is so a related question to this one is, if I buy an income annuity, should I build some sort of cost of living adjustment into it to help protect against inflation? And this is where I generally would argue, no, without a cost of living adjustment, it's cheaper. You can put less into the annuity. It won't increase over time, but then this gives the opportunity for your stocks to potentially grow over the long term, to layer in additional purchases. So I do think about if you have a sufficient floor of protected income, then I feel more comfortable relying on stocks to provide the inflation protection. If you don't have a sufficient floor of reliable income, then it's a lot more dangerous to rely on stocks to provide the inflation protection.

Alex Murguia 04:48
There you go. Wade, you said that more like Wenli. I couldn't convey it like that. Yeah, you just go back to the beginning and Okay, all right, so we got Tom here. It seems. Break It seems the break even analysis for when to take Social Security is an irrelevant factor in terms of the potential success of your retirement plan. Why do so many people focus on breakeven?

Wade Pfau 05:18
So that's where maybe I need to spend more time on the Tiktok or YouTube universe. Like from my vantage point, pretty much breakeven analysis is a dying breed that no one really pays much attention to. But I suppose if I spend enough time online, Tom's probably right that. So what breakeven analysis tells you is when you try to decide, should I delay Social Security or not? Well, if I delay Social Security, I miss out on some benefits, but then I get more benefits for the rest of my life. What's the break even age where I'd be better off by delaying Social Security? And depending on the specific parameters, it's usually somewhere between ages 80 and 84 that if I live beyond, say, Let's just put it in the middle. If I live beyond 82 I would benefit from delaying Social Security. That's how folks like to think about break even analysis. But my

concern about that is then it almost frames it as this gamble of, well, what if I don't live to 82 I'm going to get cheated out of Social Security, and that's my concern. Is Break Even Analysis causes people to focus too much on the risk of dying before you break even, whereas in reality, what Social Security is doing is it provides that inflation adjusted lifetime income, and if you're the high earner in a couple for the joint lifetime of that couple, that is a survivor benefit, potentially as well. And also the break even ages for Social Security are before life expectancy. So even if the break even age was 82 if I'm already in my 60s, my life expectancy might be 87 so I have more than a 50% chance of living beyond the age where I would break even so even with break even analysis, I think you can make a case for delaying Social Security. But really the way I prefer people were thinking about it is not the break even analysis, but the fact that, well, what if I do live to 90 or beyond, then I really would benefit from having a higher protected income, so inflation adjusted income for the rest of my life. So that's why I don't think people should focus on breakeven analysis. Now, why? I guess, okay, the question was, though, why do people focus on the breakeven analysis investing?

Alex Murguia 07:33
I would only bring it up in case you had some sort of terminal issue that could affect your you know, your ability to live that long. But other than that absence of that, who cares?

Wade Pfau 07:46
But I think it's if, maybe if people are just thinking about investing, and it's the whole thing retirement income

Alex Murguia 07:52
is environmental, then that kind of, that kind of angle, like, Oh, give me the money, and I'll get a higher rate of return than the implied bump every year, that kind of thing.

Wade Pfau 08:04
Well, that, yeah, that's just people are thinking about, like, what's the best way to invest? And therefore, then let's take Social Security earlier too. Yeah, I don't buy that. And then, oh, and by the way, while you're thinking about investing, you have to live into your 80s to break even, so why even bother? Why don't you just take it early? It's probably a combination of those influences all working together to push the

Alex Murguia 08:29
you know what? I have seen, some newsletter, some investment newsletter, sort of pitch on my scroll like effectively, the argument is, why aren't you taking security, Social Security, early, because you can get more than what the government will bump you by delaying it. And you can get more if you follow these seven stocks that are, you know, blah, blah, blah, blah, blah. I have seen that quite a bit, and it would make sense that they would want to tempt you with the sort of, you know, if you can't do more than this, you know, you're an idiot, effectively, is what they're conveying.

Wade Pfau 09:05
Yeah, and it's back to the whole, I guess, the William Bernstein question from before. You're saying, Well, historically, the stock markets average 10 to 12% a year. So assuming you get that in the future, you should take Social Security as soon as possible so you can leverage your

investments. But the reality is that's a pretty aggressive assumption for those eight years where this matters, I have been the most vulnerable to market volatility.

Alex Murguia 09:31
You don't see financial plans coming out of advisors offices that have 100% equity portfolio with an expected return of 11% you just, you just don't. I mean, if you do, just walk out of there, yeah, like the

Wade Pfau 09:50
whole issue, the the more optimistic an advisor presents the plan, it seems. Well, they must be a better advisor. So why don't I go with them? But yes, you get assumptions that aren't for. Particularly realistic?

Alex Murguia 10:01
Yes, all right. All right. So let's do here.

Wade Pfau 10:09
It looks like we're currently caught up on the new live questions. So maybe,

Alex Murguia 10:14
what time is it you want to make sure? Okay, we've got, all right, I'll go to this one. I am 72 and my wife is 63 we are both retired. Our annual expenses are $175,000 we receive 66,000 of Social Security each year, and have an annual private pension of 24,000 that is a joint survivor plan with no inflation adjustment. We have 3.5 million invested in a rollover IRAs, 2 million in a bond mutual fund, and one and a half million invested in equity mutual funds. Congratulations. I am considering investing a portion of my rollover IRA bond funds in a single pay immediate annuity for myself that has a 75% survivor provision for my wife, the annuity would not have an inflation rider due to my younger wife's age 63 he is 72 as a reminder, I am concerned about the impact of inflation on Her survivor payments, assuming my wife lives to be 93 would you recommend retaining my existing investment in bond funds or using a portion of these bond funds to buy a single pay immediate annuity with my wife as a survivor with no inflation rider,

Wade Pfau 11:41
and then noting that the total returns, but maybe it just got cut off for you. The the author is total return. Oh,

Alex Murguia 11:51
yeah, I didn't in the cell. I didn't see it. No, I am primarily a total return investor, but also leading towards income protection. Your thoughts. Husker Don, I assume Nebraska. Cornhusker,

Wade Pfau 12:06
yeah, thanks for the question. Husker Don, so you're told to return your wife's more income protection. And so it's great. You're thinking about, what should I put an annuity in place for her? It's certainly a consideration. I wonder you're talking about, like, joint with 75% survival, you'd probably get a lot more income, or you'd be able to get the same income for a lot fewer dollars, if you just made it single life for her, that might be a consideration. Like, if you're not really interested in the annuity yourself, just have it be a single life annuity for her? Yeah, I think we were kind of hinting at some of these issues about whether I can't get the inflation protection on

the annuity. But yeah, if you're thinking about drawing from some of the bond funds to purchase an annuity, a fixed annuity that would last her lifetime, maybe then, well, either maybe you don't need to do this quite yet, or you could layer in an additional purchase in the future for her to build up that annuity base so that she does have sufficient reliable income that will last a lifetime, in addition to the inflation adjusted Social Security that she'll be getting, as well as that pension that doesn't have the inflation adjustment, but yeah, anytime you're thinking about drawing from bond funds to purchase protected lifetime income that can create a more efficient plan, I wouldn't get too caught up on not having the inflation protection for the annuity. But at the same time, you could still wait a little bit. She's 63 that's not a necessarily big rush to purchase the annuity now and again, to the extent that within your family situation, there's no issues about maybe just making it single life for her instead of joint life, it would make sure she had the income, more income for a given amount of premium for her entire lifetime.

Alex Murguia 13:59
I'm in agreement with specifically, you've got time here. You can delay it, you can put the you can set it so that the wheels are in play if ever an event happens. But the reality is, I don't think you may need to make that decision right now based on, based on my reading of the question, and you kind of reflected that at the start of your answer as well way. Yeah, okay. And

Wade Pfau 14:27
okay, remember that so he is 10 years older than her, so that, and also past the age where hopefully you were delaying Social Security. Because, again, that's the best inflation adjusted and lifetime income, protected annuity out there, and she did, potentially beginning that for a lot of years, being nine years younger.

Alex Murguia 14:54
Let me see here. Uh, we'll do it. Here's another question. I. Hi, Wade and Alex, I am 67 I am a 67 year old married person, I guess, for almost 40 years to my 71 year old husband, I am in charge of managing our finances. And have a question that has been nagging me for a long time. I have continually read conflicting advice from various sources about whether it is advisable to pay the taxes for Roth conversions from the IRA itself if you don't have the funds to pay for it outside the IRA. Wait, you know what the T in front of the I is in the IRA? Is that just a typo?

Wade Pfau 15:42
I think that's a typo. Okay,

Alex Murguia 15:44
could you please weigh in? I'd very much appreciate hearing your expert opinion, and imagine there are other listeners who are Hang on, who are as confused as I am about this topic.

Briana Corbin 15:59
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.

Wade Pfau 16:39
Okay, so we're talking about doing a Roth conversion. Gonna do the Roth conversion, and then I have to pay a tax bill in the Roth conversion. Is it okay to pay the tax bill through a distribution from the IRA? Yes. So ideally, you wouldn't have to do that if you had taxable funds available. The best option would be to pay the taxes from outside the IRA. But I know I've seen the quotes that like Dave Ramsey's on record saying, if you had to pay taxes from the IRA, you should never do a Roth conversion. I have no idea why he thinks that, and it doesn't I can't understand the logic behind it. I Well, I'm so, let's kind of back up

Alex Murguia 17:24
workflow of why? No, I'm serious. So it's not just the oh my god, he's a punching bag. Just, you know, lay it out.

Wade Pfau 17:33
Yes. So 100% of what you have in a Roth IRA is yours. With money that you put in an IRA, only a portion of it is yours, because a portion of it effectively goes to the government and you're trying to control well, when do I take money out of the IRA, including through Roth conversions, so that the portion that goes to the government is as small as possible? Now, with that logic, and also going back to when you made the contribution in the first place, like if I put $1,000 into an IRA. I don't own $1,000 if I'm thinking that money will have to come out at a 20% tax rate. $800 is mine. $200 is the government. If I put $1,000 into the Roth IRA, all $1,000 is mine. So in a way, the Roth IRA allows me to make a bigger contribution. And I my only guess is that's the kind of logic coming from the folks saying never pay taxes out of the IRA because your money that you already got into a tax advantaged account you are giving up because you're distributed to pay taxes. Now, to be clear, if you're under 59 and a half, you would have to pay a 10% penalty on money you took out of the IRA to pay the tax bill, but if you're over 59 and a half, that's no longer an issue. But then I think that's just taking it too far, like almost by that logic, if you think you should never pay taxes out of the IRA, it's almost like you should have never made a contribution into an IRA in the first place. You should have always only just been putting money into the Roth IRA, if that's the argument behind it. Yes, I'm taking money out of the tax advantaged account. But at the end of the day, if I'm able to do that at a reasonably low tax rate, and that's the whole reason for doing the Roth conversion, it's okay. Yeah, it'd be better if I could pay the tax bill out of the taxable account, but if I don't have taxable assets, I can't do that. I run simulations looking at this question. I run the simulation, they pay taxes out of a taxable account, or they pay taxes out of the IRA. Usually paying out of a taxable account comes out slightly ahead in terms of it is better to do that, but it's such a small difference, and it's not. It's it's fine, go ahead and pay taxes out of the

Alex Murguia 19:43
is there a taxable Is there a taxable? Excuse me, is there a taxable bracket that may be causing some confusion where, oh, but if you're paying taxes at this bracket to pay taxes on the IRA, forget it. You know, because my income tax is too high this year. So maybe. Do some craziness like that, or no? Well, that all tax brackets, it doesn't matter. Yeah, it's from the perspective of, if you're already in the top tax bracket, probably don't need to be doing Roth conversions at that

level, although there could still be reasons you might believe taxes will be higher in the future of your tax bracket. You're breakeven. You're not breakeven, but your kind of

Wade Pfau 20:19
analysis, well, you always have to look at the effect of marginal tax rate, considering the impact on Social Security, the impact on Medicare premiums. Now, with all these new phase out deductions, so if you're 65 and older, there's the extra $6,000 per person, but that will phase out. Roth conversions will eat into that phase out. All that you have to consider all these things together, but then at the end of the day it I'd say it's it's not optimal, but if it's the only choice available, it's fine to pay taxes out of the IRA to do a Roth conversion. And I don't understand why, because there's no explanation about why. It's just, oh, don't ever do it. And that's the end of the conversation. So I haven't fully parsed out why people think you shouldn't pay taxes out of the IRA to do it to fund a Roth conversion.

Alex Murguia 21:07
Now you know how I feel when you talk to me in meetings. All right, don't ever do it. Alex, we're not doing that. All right. Ta, okay. Next question, hi, I love you guys, especially Alex, not wait, no, you're the click and clack of retirement planning. Yeah.

Wade Pfau 21:35
Two fold question, you know that you know the reference, right? Cartel, look at this

Alex Murguia 21:38
guy. You know the reference. You know, that's the obvious. I'm not going to tell you now, are you wondering, do I really know that reference or not? Yeah, the car guys, whatever happened? Click and Clack, right?

Wade Pfau 21:50
Yeah, from Boston, from Boston.

Alex Murguia 21:54
I can't imagine they're doing. One of the brothers passed

Wade Pfau 21:56
away, so I don't record anymore, tragically, damn

Alex Murguia 22:01
it. Wait. If anything happens to me, I want you to continue. I want you to continue this legacy. All right, not stop. Wait. Go on without me. I'm sure everyone actually would prefer that. All right. I love you guys. You're the Click Clack, uh, retirement planning. Laugh Out Loud, lol, two fold. Question from Alabama. I've done a little listening for an answer. Sorry if you've already covered it, which you probably have. I'm 65 still working a tiny bit, therefore making some income. Husband is 70, and waited to take his social security at 70, friends say I should file against his when I reach my fra, 67, over 10. Will that reduce what I would have gotten at 70? Or does it go up when I hit 70? Mine will ultimately be higher than his. So I'm waiting also those social security estimates you get x at 65 comma x plus 8% at 66 etc. If I'm no longer making the income I once did in parens by a long shot, well I still get the age 70 estimate. Or is that

assuming I'm still making hyphen, paying taxes on my former income between 65 and 70. Thanks in advance.

Wade Pfau 23:28
Okay, yeah. So actually, there's a couple of questions on here. We got to make sure we hit them

Alex Murguia 23:32
all. Are you attack or click? Number

Wade Pfau 23:36
one, I'll be I'll be clack or point number one to make. So the author is the high earner in the couple. They're younger, but they're the high earner. So they're the ones that really want to be thinking about waiting till 70. The the husband who waited till 70 as the low earner in the household could have potentially claimed earlier, but she as the high earner in the household, has a much stronger case for waiting till 70. Now that being said, friends told her about filing at full retirement age to get a spousal benefit, I guess, and then getting her own benefit at 70. So your friends, that was something you could do in the old days, but it got phased out with a law change in 2015 so you know, you can no longer do what your your friends are talking about. If you file a full retirement age, you are deemed as filing for your own benefit first, and as a high earner, there wouldn't be any spousal benefit. Top Off, on top of that, in the old days, you could do what your friends say and file a restricted application for your spousal benefit. You can't do that today.

Alex Murguia 24:48
10 years ago, they kind of stopped right, more than five, less than 10. In that range

Wade Pfau 24:52
was the Yeah, the Budget Act of 2015, 10 years. 10 year anniversary. I. Um, so, right? So we got that one no, because as the high earner, you have a stronger case for waiting till 70, and you can't do any of the old tricks that used to get talked about in books written prior to 2015 right?

Alex Murguia 25:13
And you say tricks in such a nasty way?

Wade Pfau 25:17
No, that was Social Security claiming was such a big topic until the Bipartisan Budget Act of 2015 that took all the fun away. But, yeah, you used to be able to do these. It's a trick. You file a restricted application to just get it was a common, common your own benefit grow until 70. You can't do that anymore. So this would be a case where you're thinking more about waiting till 70. The other part of the question about like I'm no longer making the income I once did. Well, I still get the age 70 estimate. I guess we're talking about you must be looking at your Social Security statement as part of this conversation. The Social Security statement will tell you what they're assuming for your future earnings. I do assume you earn something every year until you reach the age where they show the benefit at that age, and it's usually linked to your last year salary, or what they have recorded as your last year salary. So if you look at your Social Security statement, the bots on there retirement benefits right on the first page, on the bottom of that, it

says these personalized estimates are based on your earnings to date, and assume you'll continue to earn and then they'll show $1 value per year per year, until you start your benefits. So yes, there's going to be some assumption if you earned less last year, as it sounds like you're maybe phasing down and not earning less at this point, it may have already incorporated a lower number, but yeah, check double check what that number is. That number is. Now, if that number became zero, your age 70 benefit would be a bit less, but maybe not all that much less. It kind of depends on, do you already have 35 years of earnings, or are there some zeros in the 35 years that extra work would still be taking up. If you already have 35 years of earnings, you may not even be replacing New Years. So it may be the same benefit. If you have fewer than 35 years of earnings, your age 70 benefit might be a bit less if you do decide to retire. We have calculators that can help look at that kind of thing, but I'm in most cases, it's not going to be that much different. You might have a $40 lower benefit or something if you decided to retire today at age 65 but yeah, double check. What are they assuming for your earnings for subsequent years? If you it's too much math to get into right on the podcast, but if you took your current year benefit and multiplied it by that, using that kind of 8% idea, by the right fraction between now and when you turn 70, to transform your current year benefit into the age 70 benefit, you'll probably see that number would be a little bit less, and that would be a more realistic guess at what your Age 70 benefit would be if you stopped working.

Alex Murguia 28:03
Okay, there it is. There anyway, we're at the hour. But there's one quick question, since he's live, why don't we do this? And we have a lot of questions I have added, but if, if you have questions, we'll get to them. Maybe not right now, this will answer one more question, but list questions here, we will get to all of them. We'll do it Wade and I will get together. It will be recorded, but we'll publish them on the podcast. So if you have any questions, please list them out. We'll go through them and get back to you folks. We you know, we like to develop a nice inventory of them, and we'll kick off with this one. But before doing so Wade, you talked about the funded ratio. You were kind of hinting here at tax maps and things like that. You may want to talk about a little bit about an upcoming retirement income challenge that we have, and how that fits into a retirement researcher and how some of these questions could be answered there as our you know, maybe we try a little promo here before I get

Wade Pfau 28:58
to question. So we usually try to do retirement income challenges every three to four months, and we get around 400 folks, it's a free week long event where you take a resa, use our funded ratio tool and have a financial plan by the end of the week, we have had a pause because we decided to go back to basics and completely revamp and restructure our funded ratio tool. So we've got a new and improved funded ratio tool coming for our next retirement income challenge. It's still in the final stages of being tested, but assuming everything goes well, when we're planning to have our next retirement income challenge the week of October 26 so it's still two months off in the future, but keep that in the back of your mind, and we'll definitely talk about talk about it more as we get closer to the date. Yeah, hope you join us for the retirement income challenge, and it's a great opportunity to get a basic financial plan with a week long exercise.

Alex Murguia 29:52
Here we go. All right now, question is, I found the reverse equity glide path method that. Mentioned during a previous meeting. Really appealing is that something you see used in

practice frequently. What are the factors to consider? All right, why don't I just kick it off quickly, since there's a practical piece to this question, ultimately, the rising equity glide path, the reverse equity glide path. I assume that means rising. You said, reverse like retirement, rising. Okay, all right, effectively, you, you do see this in practice, and it's something that was informally being done. Wade and Kitsis did a nice little paper on it, and it caught as well. And it, if it makes total sense. If somebody's starting, let's say somebody is probability based. Yeah, they're probability based. Optionality driven, retirement income preference, and they want to draw from their portfolio, but they also realize they're entering into the fragile decade, and let's say their risk tolerance, risk capacity, what have you, has them at like, what would be a 6040, portfolio, right? You be because of this. They they still want that quasi quote, unquote buffer, but they're, they're probability based, optionality driven. They're not necessarily income protection or time segmentation that you could maybe work within a window. And so what you can do effectively is artificially lower, not low. What you're not artificially you're lowering the stock to equity allocation, let's say, as opposed to 6040 you do 4060, and then you you have sort of a preordained agreement that every six months, every some sort of temporal distance, we are going to up it by five percentage points, two percentage points, whatever, until you're back to what you would be from a risk capacity and risk tolerance standpoint in a normal state. And that that reduced equity allocation should help temper the volatility for those first few years, as you're entering that fragile decade that, and you do see that in practice, it's not done very formally, like every three points, we're going to go up every three points every six months. You know that kind of thing. It's done during meetings how you feel, but there's that intention to move it up over time. And you do see that, wait,

Wade Pfau 32:22
yeah, yeah. And so kind of the genesis of this was, I think it happens a lot in in real life, but inadvertently. So just assume you're like 5050, stocks and bonds in your investments, but then you do have a social security, maybe you have a pension, maybe you have some sort of front end bond ladder that you're gonna gonna spend down and not replace,

Alex Murguia 32:43
and real quick Wade. And this is true, inadvertently, people keep cash on the side as well, which is kind of a quasi fixed income allocation. There's many clients that we have that we're managing XYZ, and we know that they have 3% 5% of invest in cash in their own bank account. So there's also that kind of sense of things.

Wade Pfau 33:08
But then, like on the like the social security side, if you think of the value of my lifetime Social Security benefits as part of my bonds, that's getting spent down over time, and if I'm spending conservatively from my investments. I'm not necessarily spending the investments down over time. So what does that

Alex Murguia 33:25
mean? Wade, I want to make sure people understand what you just said, because you're mixing a little bit of income from Social Security as part of the bonds. Like somebody can be like, Why? Why is that part of the bonds? I think that's a very good point. I want folks to understand that, yeah,

Wade Pfau 33:39

in terms of, like, the funded ratio idea, we want to look at all your assets, and that includes the present value of future cash flows. So Social Security, it behaves a lot like a bond in that it's there's not stock market volatility attached to it. It's an inflation adjusted income for the rest of your life. And when you look at the lifetime value of that generally, you would classify that more as a bond like income source, rather than a stock like income source. But as you age, you you spend it down when you're 100 the present value of your remaining Social Security is going to be a lot less than when you're 60, and so you

Alex Murguia 34:18
have that asset pool of liabilities. I you know. Ergo, you know, fixed income is shrinking, as is, hence, the equity is going up rising glide

Wade Pfau 34:27
path, yeah. And then, if your portfolio stayed 5050, but if you tacked on plus a declining value from Social Security, really, your stock allocation on a entire household basis, will be rising over time. Now that's where it's kind of implicit rather than explicit. I think a lot of people end up doing that sort of thing just unintentionally, in terms of the actual managing the asset allocation from my portfolio. So it's going to be lower at retirement, but then I'm going to increase the stock allocation as I age that resin. I hear from a lot of people. It resonates with in terms of how many people actually are doing that? I don't know. I don't get the impression it's a super high percentage of the population, but there's definitely people who find that really it resonates well. It's a powerful way to manage sequence that returns risk in retirement. And if it resonates with you, more power to you. I wouldn't push the idea on on folks, just because just the psychology of increasing your stock allocation with age can be available. But it's a

Alex Murguia 35:30
credible strategy. It's a credible strategy. I think we just get confused. Is what someone thinks, Okay, you're naturally 6040, and you're you know, so we're going to start there, and when I'm 85 I'm going to end up with a 95 five portfolio. What witchcraft is that, you know that kind of stuff, that's when people kind of and by no means we the ceiling on these things are what your risk tolerance, risk capacity, equity allocation, would be, not higher.

Wade Pfau 35:57
And it's also just a way to manage this disconnect that exists where you know Bill bingens 4% rule the and all the the safe withdrawal rate research about spending from investments tells retirees to hold. And what Bill Bingen said in his original article was 75% stocks in retirement, and in no circumstances, less than 50% stocks in retirement. And then you go over and look at all the target date funds that folks are using in their 401 K plans. It's incredibly rare to find a target date fund that would be more than 50% stocks post retirement date. So another way to think about the rising equity glide path is, yeah, if you're in a target date fund, you probably are a lot less than 50% stocks at retirement. Now the target date fund is going to keep you on a low stock allocation throughout retirement. That's not necessarily optimal either, but kind of as a risk management tool, gradually working your way back up to the levels that Bill Bingen is talking about, I think can make a lot of sense as a way to manage sequence risk in a total returns framework.

Alex Murguia 36:59

All right. Wade, that's a wrap for today's live session. And we've got questions on the on the old Excel that people had sent in. And again, if you folks have questions, type them in the comments. We'll get to them all. I mean, this gives us great, great content for future podcast episodes, so we really appreciate it. A lot of

Wade Pfau 37:18
questions that came in in advance that we'll get to. And yeah, if you add more questions here, we'll see those and get them added to the list. And watch for upcoming episodes of retire with style, the podcast where we'll work our way through any questions that we didn't get to today. Take it easy, everyone. Thanks for listening. Looking sharp. Wade. You too, Alex. Catch you next time on retire with style. Bye. Wade.

Briana Corbin 37:43
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.