Episode 196: RWS Live! With Bill Bengen

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Retirement income, safe withdrawal rate, 4% rule, inflation risk, TIPS (Treasury Inflation Protected Securities), asset allocation, rebalancing, tax efficiency, sequence of return risk, small cap stocks, emerging markets, gold investment, retirement planning, financial personality, portfolio management.

SPEAKERS
Bill Bengen, Alex Murguia, Briana Corbin, Wade Pfau

Briana Corbin 00:00
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Briana Corbin 00:38
You know, it's a special day when even Bill Bingen shows up in a tracksuit ready to talk retirement math. This is part one of our yousube live with the man behind the 4% rule, where he joins Wade and Alex for an open Q and A that takes some sharp turns and a few fashion detours.

Wade Pfau 00:55
We're live. Okay, great. Thank you everyone for joining us here on YouTube Live. This is the retire with style podcast special edition with myself and Alex and Bill Bingen, who was on the podcast this week, and who's joining us now to answer your questions live with a live Q and A bill. Thank you so much for joining us.

Bill Bengen 01:15
Wade, thank you for the invitation. It's fun being here.

Wade Pfau 01:18
Oh, and it's our pleasure to have you. And I see the picture of your book behind you there, and I have my own copy as well a richer retirement, supercharging the 4% rule to spend more and say, enjoy more in retirement. And we're going to focus on questions that do relate to the topic of the book, which is really about the whole safe withdrawal rate. Type of question. We did get some questions in advance, and a couple of those were on different types of topics, like building a time segmentation strategy with bond letters, that sort of thing. We'll hold off on those types of questions today, we'll really want to focus in on questions related to total return style, safe withdrawal, rate spending from a retirement portfolio. In that regard, we do have seven questions that came in advance, and we will monitor the live chat to get to your questions. It's a

great opportunity to ask Bill anything on your mind, again, related to the safe withdrawal rate question and Bill, let's go ahead and get started here with the first question. Based on our discussion in the podcast, someone wrote, If Bill sees inflation as a primary risk in retirement, would it be wise to allocate some of those intermediate term government bonds into TIPS instead treasury inflation protected

Bill Bengen 02:29
securities? And the answer is yes, I think it definitely makes sense. It probably makes sense to have them almost all the time as a permanent allocation in your portfolio, but particularly now, with inflation being kind of dicey. I think they look particularly attractive.

Alex Murguia 02:44
Bill you had said, just because I didn't fully it's good to have them all the time as a as a way

Bill Bengen 02:50
permanent allocation. Oh, permanent. Okay, gotcha. Oh yeah, that's right. I don't include it in my book because I haven't been able to develop a background, a story for the acid class going back 100 years, but in time, I think I'll be able to work into that.

Wade Pfau 03:09
Yeah, yeah. Tips have only been around since 1997 and trying to estimate hypothetical tips before that is requires some guesswork. Yeah, I would think that's probably the issue. Great. So it's and that I think you also addressed in your book and also on the podcast, that you look at these seven asset classes. But that may not be the whole story. So you know, if someone's thinking about tips,

Bill Bengen 03:31
yeah, I would think most people would have a lot more than seven asset class in a portfolio, including reach and gold and commodities, maybe alternative investments, emerging market stocks and so forth. All worth your attention. Improved diversification. Great.

Wade Pfau 03:48
Thank you. So question number two that came in advance, is the 4% rule still a constant? I've seen it taken as low as 3% due to increasing life expectancies, or does it vary depending on market conditions, et cetera.

Bill Bengen 04:03
Okay, it's really important to recognize at the outset that the 4% rule was never intended as an immutable rule, something that'll ever change. It's not like E equals MC squared or Newton's laws of motions, which we expect will be around forever. The withdrawal rate, in fact, has been higher in the past, the safe withdrawal rate, it was determined currently by the 1968 retiree 4.7% is that number. But if you look at if I was to do my research back in the 60s, I would have come with a higher number, because we hadn't got in for that terrible period of the 60s and 70s. Yet, as far as low end 3% I don't see anything in a historical record that I have that would have required a withdrawal rate that low, even as recently as you know, 2008 or something. Well, that terrible bear market. And unless inflation takes off. Off to the upside. I don't think we need to be concerned about going that low. Okay?

Wade Pfau 05:07
And maybe the corollary to that question, if someone was thinking about a 40 year baseline retirement instead of 30 years, I think giving up that idea of life expectancies, what kind of impact do you see with extending the life expectancy that way?

Bill Bengen 05:20
Yeah, absolutely. If you're planning horizon expands, you have to take your withdrawal rate down with it.

Wade Pfau 05:28
But not, not to a significant degree, I think, when we're talking about that type of link, yeah, no,

Bill Bengen 05:33
it says it's very comforting that, just the way the mathematics work out, that as you get to very, very long life expectancies or planning horizons, it stops dropping. It becomes it hits a floor. It doesn't get much lower the withdrawal rate. So if you want to live 200 years, here's more power to you.

Wade Pfau 05:55
Okay, great, great. Next question that came in in advance, and we'll monitor the live chat as well. Research on withdrawal rates seems to favor that the accounts are being being utilized are qualified. I don't get it if I'm trying to withdraw 40,000 before taxes, isn't it the same whether or not I'm withdrawing from a qualified or a non qualified account, $40,000 before taxes is the same $40,000 regardless of account type. So why the disclaimer?

Bill Bengen 06:24
Yeah, that question is making reference to some comments, possibly by someone else, which I'm not familiar with in my work. I agree with a questioner that taking money out of a 401, K, no matter what his status, probably doesn't make any difference.

Wade Pfau 06:43
Yeah, maybe another comment to add to that as well is just with the taxable account, the question's right, if you take $40,000 out at that point, it doesn't matter what type of account you're taking it out of, but getting to that point with a taxable account, you do have the ongoing taxation on the returns, the interest and qualified dividends, and so that eats away at the growth of the account over time. So that would be why the disclaimer is important.

Bill Bengen 07:10
I agree. I think they're probably the equalizer there is that the tax of account pays taxes as it goes for income, dividends cap depreciation, but the IRA account does not so if you look at net net after taxes, including taxes on withdrawals from IRAs, probably the total net amount left over is about the same from both types of accounts.

Alex Murguia 07:35
Okay, Wade, I discussed when something you said sparked a question for me, and we're starting to get questions live, so we'll go over it. But let me ask my question right now, because I'm curious what your thoughts are. Bill, in terms of you spoke about, if you amplify the, you know, the the asset classes within your portfolio, obviously you can get more upside, you know.

Well, how would you what would your response be to somebody that says, hey, look, I've got three stocks. Small cap, three stocks. Large Cap, three, you know, more of a stock picking approach that's very concentrated in a few stocks. Saying, Hey, I'm going to take 4% of this, and this should be a good thing. But what would be your comment on something like that?

Bill Bengen 08:24
Well, following a riskier investment strategy, which is completely contrary to the index passive approach that you know I use my book, so it's really hard to assess depends upon whether they're the new Warren Buffett or exactly or pretender. If they're the new Warren Buffett, they can probably take out 26% do this fine, but for most people, picking individual stocks is difficult, not that it can't be done, but it's challenging and it's also risky.

Alex Murguia 08:55
Okay, so, yeah, I was just curious the person who's sitting on, let's say, 567, stocks thinking, Oh, I'm going to take 4% from here, and I should be golden based on this book that I just read.

Bill Bengen 09:06
Well, yeah, I just think that's a risky approach, particularly if you got the mag seven socks.

Alex Murguia 09:13
I just wanted, I just wanted to hear it from your mouth, not not mine. You know, from that perspective, Wade, you want to go into some questions. We got Johnny D with one.

Wade Pfau 09:24
Yeah, yeah. I didn't see that. I was in the wrong chat before. So I do see the live questions coming in. So the first one from John as small cap may not perform well in the future due to flight to venture capital, private equity and need of probability filter, or profitability? Sorry, need of profitability. Filter isn't the safe Max, up to 4.5% from adding small cap, overstating the future safe Max.

Bill Bengen 09:50
You know, it's a fair question. Small caps are clearly in a period of transition. And yes, equity, private equity. And venture capital is becoming more important, and they tend to drain off some of the best small companies before they get to the mutual fund world. However, I not willing to give up on those fall caps yet. They've had cycles before where they've greatly underperformed a large gap that they have over the last decade or so, and then come back and had dramatically good performance. So I think the jury is out on that I'm not changing my allocations yet. I suspect small caps are entitled to a nice run here.

Wade Pfau 10:34
Okay, great, and Tony asks bill your original 4% rule gave retirees a simple benchmark, but your newer research suggests we may safely draw closer to 5% if we're now in an era of higher inflation, volatility and longer retirements. How would you redesign the first year withdrawal rule to reflect both longevity risk and personal inflation rates without overwhelming the average retiree with complexity?

Bill Bengen 11:00

Sure the two most important factors in determining your number your withdrawal rate, are the inflation rate for the first 10 years of retirement, and also stock market valuation. The idea being that if the stock market is very expensive, we're probably not very far from a major stare. Major stock bear market. Major stock bear market early in retirement is always associated with low withdrawal rates, so that, taking those two into account, if I was retiring today, I'd probably be looking at somewhere around five and a half percent for three years from a tax deferred account, which is lot better than the 4.7% but then again, we're not faced with the dire economic circumstances that were present 5060, years ago.

Wade Pfau 11:43
Okay, great. And maybe a follow up question to that, while we're still on the topic of inflation, from a castles with current inflation, you discussed a five and a half percent, what you just said as a reasonable withdrawal rate for starting retirement. Now, if inflation pops up like it did during covid, how would you recommend adjusting

Bill Bengen 12:04
if inflation does appear to be a problem, I recommend reacting immediately, by cutting at least temporarily your expenses until the storm blows over. We had a storm like that three years ago where it got up to 9% but it blew over. So although it affected the portfolios. It was nothing, nowhere near as devastating as, you know, the decade of high inflation in the 1970s So, yeah, I think you need to react to inflation defensively, almost immediately, but be prepared, you know, to raise your withdrawals when a storm clears,

Alex Murguia 12:39
okay, and to react immediately. You're speak, you're speaking, not necessarily the allocation. You're speaking more of the distribution, amount,

Bill Bengen 12:46
absolutely yes, absolutely correct. What you're taking through the portfolio. Doesn't reduce stress on a portfolio. Okay, make less for time being, if you can do so.

Wade Pfau 12:57
Okay, I think this next question is on the same theme as well, and it's actually from somebody who has clearly read your book, and so may require a little bit of background to explain to the audience what the question means before answering it. But callowish is asking, how bad of a deviation does there have to be for the current withdrawal rate from the synthetic withdrawal rate to have to change course in the amount of your retirement withdrawals, and that is something covered extensively, what these mean in your book, but we didn't even broach that topic on the podcast. So if you could explain what's meant by current withdrawal rate and synthetic withdrawal rate, and then how do you think about when those differ from each other, when you actually make

Bill Bengen 13:37
Yeah, that's a great question. Current withdrawal rate is just simply your current year's dollar withdrawals divided by the starting value of the portfolio the of that year and the first year. It's what we call Safe Max the safe withdrawal rate. It's identical, because the first year is the first year after that. Hell are losing my train of thought here second, oh, with respect to inflation increasing this remind me the question.

Wade Pfau 14:12
Repeat the question way it said, the one about So you talk about the synthetic withdrawal rate Chartbook. That kind of give you a course of where you want to be around, but then the current withdrawal rate might deviate from that, and what kind of deviation would trigger you to make some change.

Bill Bengen 14:28
The synthetic withdrawal rate is an arbitrary hypothetical curve showing what the withdrawal current withdrawal rate should be each year during retirement, based upon a very simple average return and average CPI figure, and you can compare that against your actual current withdrawal rate, there will be deviations, almost certainly, because the synthetic curve does not experience bull markets, nor does experience bear markets. So that what you'll have to do. Do is make a decision. If it's due largely the deviation is due largely to a bear market that you're experiencing. I wouldn't do anything. I'd wait maybe four or five years, and you'll probably see, as happened in the past, that your plan will get much closer to the benchmark over time because of the stock market recovery. If it's due to inflation, though, it's once again in a matter where I think they have to act and be prepared to cut back severely if it looks like there's going to be persistently high inflation.

Briana Corbin 15:34
Hey, there. I know you're in the middle of an episode, but I wanted to pop in and remind you that we are coming up on a huge milestone episode, 200 of retire with style, and we want you to be a part of it, whether you've been listening since the very beginning or just recently, found the show. This is your chance to help us celebrate. You can send in a message, share your favorite moment, or ask Wade and Alex a question to be featured in the episode, just head on over to retirewithstyle.com or check the show notes below for a link to get involved. While you're there, be sure to enter our special giveaway. We'll be sending out some pretty sweet Limited Edition retire with style merch boxes to a few lucky listeners. And don't forget to follow us on social media. We'll be posting polls and questions where you can vote on what gets featured in the episode. Episode 200 is all about the retire with style community, and we'd love for you to be a part of it. Okay, that's it. I'll let you get back to your episode.

Wade Pfau 16:31
Yeah, and that, I think you have several case studies in the book about that, and I think that's really emphasizing maybe the point here of bear market deviations don't necessarily cause you concern, but it's the if inflation ends up higher, that's where you really talk about potentially greatest enemy. Yep. Okay, great, great. We do also have a question from Mr. Dennis, so if we review the plan on an annual basis, it would seem that the amount of the 4% withdrawal would vary widely depending on the market return. It that seems contrary to the idea of the safe withdrawal rate. And I think there maybe he's thinking of 4% as in what you call the fixed percentage strategy, rather than the inflation adjusted spending cola strategy. So be clear with all questions asking.

Bill Bengen 17:20
You know, if you start at a 4% level, let's say withdrawals, it will fluctuate considerably due to market conditions. Bear markets will drive it down. Bull markets will drive it up. That's normal to be expected. And the important thing is comparing it to your benchmark, what your expected

return is, and if it's within a distance of that or if you know there's a reason for it that's going to take care of itself over time, there's no need for any action.

Alex Murguia 17:51
I'm not 100% certain on that response to the question it could be I'm misinterpreting then and the way I'm reading the question, I think he's a little off, Wade right in terms of not you, but the question, I think the person asking the question is taking 4% of the portfolio every year, as opposed to 4% in year one. That sets the nominal amount, and then you adjust for inflation going forward, right? Wait, I think he's the question is cool, yeah, like

Wade Pfau 18:23
that general confusion. Sometimes people misinterpret what 4% means in the context.

Alex Murguia 18:31
You'd be surprised how often that happens, how often that happens. And that's why I want to, kind of, like say, with the person asking the question that if you're taking four, if you're taking a percentage of the portfolio every year, then fine, you know it, yeah, what this person is saying makes sense. But in the nomenclature of retirement income planning, when you say the 4% rule, you know, thanks to Bill, it's taken as for whatever percent the first year, year one, and you know, $100 you're taking $4 year one, and then every year thereafter, it's adjusted for inflation, that $4 and that's why you're getting at markets recover. But inflation kind of is more nefarious over the long term, and that's the biggest killer, because then that's why you're increasing, let's say, in high inflation environment, your distribution, yeah, did I clear things up, Wade there, or did I conduit it even more?

Wade Pfau 19:30
Right? Well, I yeah, I think it's that's okay. We, if you are taking 4% of what's left each year, yeah, you have volatile spending, and so you don't, that's not really a safe withdrawal rate question. That's but Bill, maybe you compare the two strategies in the book. What do you find generally about the cola approach, where you increase spending each year for inflation, versus the fixed percentage approach, where you let spending fluctuate fully in response to market performance?

Bill Bengen 19:58
Yeah, and it's it. It doesn't generate as much income during retirement as the cola scheme, the fixed percentage scheme. However, it has the virtue of you never run out of money.

Alex Murguia 20:08
Yeah, I got venues and venues. Mrs.

Bill Bengen 20:12
Lincoln, that's one thing not to worry about. Yeah, you may take a 30% cut in expenses one year, but what the heck run out you

Wade Pfau 20:24
Yeah. So I think that answers the question, because that's just right, the fixed percentage strategy is not the what we're talking about, usually with safe withdrawal rates. Actually, the questions are flying in now, and I got to figure out where we were on the list here.

Alex Murguia 20:37
I will think I'm looking for the word synthetic on this. Okay, the next question is, it is from casas, again. Thank you for answering Maria, your question about inflation. As a follow up by, how much would you immediately cut the withdrawal rate if inflation pops up, like a few years ago?

Bill Bengen 20:57
That's a really an interesting question, and a tough question too. It depends upon how much inflation increases. If inflation goes to 4% it's a modest change. But if suddenly we were in seven or 8% inflation, then you're going to have to look cutting back very substantially, maybe 23% to get your withdrawals in line, you know, with what's what's coming.

Alex Murguia 21:19
But my, my, my quick answer to your responses. But isn't that why you looked at the historical record and just maintain it? Because it's, you know, this is what's worked historically. And so the idea is, it should work going forward. I would you, you know, why cut anything is just go with it, because that's what was studied to begin with, and it should work out at the end. I don't subscribe to that, or not subscribe to that. I'm just curious what your interpretation is to that. I would

Bill Bengen 21:48
agree if you use the 4.7 safe withdrawal rate, the universal SAFE Act I call, which is the worst case for all investors over the last 100 years. But if you're taking our higher rate, let's say five and a half percent, okay, it does not incorporate the prospect of a prolonged period of elevated inflation, so you need to make adjustments, Okay,

Wade Pfau 22:10
that's fair. Okay? And then this is a more in depth question, but Tony asks, so in a richer retirement you emphasize the importance of customizing withdrawal strategies based on individual circumstances, rather than relying solely on fixed rules. For someone like me retiring in 2025 with a mix of Roth assets, HSAs and taxable accounts, how would you suggest integrating tax efficiency and sequence of return risk into a dynamic withdrawal plan that still allows for confidence spending early in retirement,

Bill Bengen 22:42
that would be very complex question to answer, and I'm not going to really attempt to do it. I suggest that that individual facing that situation needs to consult with a professional financial advisor to get full analysis of the situation and get proper guidance.

Alex Murguia 23:02
And this, this is a question that for both you and Wade, and it's when you're doing your research, because you get, we get asked this a lot, you know, and it's an important one about ordering taxes, you know, ordering the sequence and the taxes. And when you folks are developing your research, it seems you don't even you know taxes are you just control for it by saying we're not looking for it because of the nuanced approach, because it's so nuanced per individual cases, right? Have you wait or, bro, do you folks think about it like that? Like, listen, it's it's too complicated. I'm not gonna concern myself with the taxes or the different accounts tax deferred or so forth, because it's just impossible to satisfy everyone.

Bill Bengen 23:45
Well, can I answer in my book, I analyze taxable accounts and the fact on withdrawal rate of increasing your tax rates the higher the tax rate below your withdrawal rate, different correlation there, and that can be figured out mathematically without too much difficulty. Well, I don't know if that responds to the question, but

Alex Murguia 24:06
yeah, just how you view somebody consider taxes when they're looking at this type of research, since the research usually doesn't account for taxes.

Wade Pfau 24:15
Yeah, that's the just with a Roth account, there are no taxes. With the IRA, you pay taxes out of the percentage distribution rule that's we talked about earlier, with the taxable account. It's not the same story, because taxes are eating away at the growth of the account over time, and you need to account for that. Okay, yeah. Okay, great. Next question, and actually, this question comes up quite a bit, and it's related to the tax question too, in a way and rebalancing. So when calculating a safe withdrawal rate, are the percentages pulled evenly from a five fund portfolio that's with the five different stock asset classes in the baseline portfolio? So are you pulling evenly from each of the five stock funds? Reasons, I've always wondered, because obviously pulling from better performing, better performers, and leaving a poor performer alone, I guess might make would work better.

Bill Bengen 25:13
Yeah, from my perspective, I use a total return approach, so I don't make distinction between whether income is generated from the portfolio, from income, interest income, or dividend, capital appreciation, it's all dollars, and they all mount up at the end of the year. There's a distribution made from the funds, and then that can be used in part to cover your withdrawals, which, to a certain extent, should be covered by your cash fund. That cash fund goes first,

Alex Murguia 25:41
but, but they're also getting at if, let's say you have four funds, and one fund returned 100% for the year, yeah, the other three are flat. Okay, you know, do you? Does that factor into your decision making from a total return perspective across the four funds?

Bill Bengen 26:00
Because rebalancing, to a certain extent, will take advantage of that phenomenon and give you an opportunity to earn returns from classes that have not performed well are probably about ready to perform well. So I would make an adjustment based on that.

Wade Pfau 26:16
Yeah, for the listeners who do like to get into the weeds on that in your new book, you're using quarterly data, and then you rebound the baseline. You rebalance annually. So if you're not rebalancing every quarter, how do you approach? Are you drawing equally from each or do you, like with Alex said, drawing from the winner in that quarter with the 100%

Bill Bengen 26:36

gain? I'm not sure if there's a conflict there. I mean rebalancing annually is just a process that you go through. Regardless of what pattern you follow with respect to withdrawals, doesn't matter. To take monthly or quarterly or annual withdrawals.

Alex Murguia 26:51
Wait If the one that goes up by 100% when you rebalance, they're all going to have the same amount of money in them at the end

Wade Pfau 26:57
of the day after rebalancing, yeah, after rebalancing every quarter are the I get this the analysis being done quarterly or just annually, but starting from each quarter,

Bill Bengen 27:10
maybe, yeah, I've tested in the book. I test on a quarterly basis, you know, to see how that looks, comparing one quarter, rebalancing, two quarter, three, quarter, four quarter and not rebalancing at all. And it turns out that probably the best approach for retirees is to use the one year rebalancing. It doesn't deliver the highest withdrawal rate in all circumstances. But then again, you can't predict the circumstances and the withdrawal rates from that. So in the vast majority of circumstances, annual rebalancing seems to do, but Good job. Good enough.

Wade Pfau 27:44
And then when you do rebalance, it really didn't matter where you are drawing from, specifically, because after rebalancing, you end up at the same point. Okay. The next question, if microcaps not available, what asset classes might you consider to replace micro caps in that five stock fund portfolio you look at

Bill Bengen 28:09
tough to replace a high returning asset class like that earning about 11% plus over time you might consider opportunic investing like emerging markets, which are very cheap now are likely to have comparable returns. I think over the next five to 10 years, we want to consider gold too. I know it's done very well lately, last two years, but the way our governments are spending I think it's going to continue to do pretty well for a while.

Briana Corbin 28:39
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.