Episode 242: Why Playing It Safe in Retirement Can Actually Be Risky

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Retirement income, Social Security, trust fund depletion, financial planning, bond ladders, annuities, conservative portfolio, survivor benefits, time segmentation, income protection, risk wrap, liquidity, longevity aversion, investment strategy, retirement income styles.

SPEAKERS
Speaker 1, 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 retirewithstyle.com/style and sign up to take the industry's first financial personality tool for retirement planning. Somewhere between Social Security math and a joke about collecting benefits on Mars, Wade and Alex sneak in real answers on bond ladders, tips versus annuities, and how conservative to get with your portfolio in retirement. Let's get into it.

Alex Murguia 00:57
Hey everyone, welcome to Retire with Style. I'm Alex, and I'm here with Wade, and we're continuing our Q and A series that started with our YouTube live session. I don't know about a month ago at this point, Wade,

Wade Pfau 01:10
something like that or more. Yeah, more maybe, right? It's

Alex Murguia 01:13
just we have these, and we get so many questions we can't get them all. We can't get to them all during the YouTube live session, which is like what 90 minutes. So you know, in our quest to leave no stone unturned, we'll continue the the Q and A session. What do you think, Wade?

Wade Pfau 01:32
Sounds like a plan.

Alex Murguia 01:34
All right, Wade, long time listener, first time caller. No, Wade. What do you advocate people at or near Social Security for retirement to use? 100% of their benefit, or 78% to account for the trust fund depletion? So this is obviously when you're doing financial planning. What do they assume? How much of Social Security is coming in,

Wade Pfau 02:02
yeah. And this is a reference to the idea that in about 2034, the trust fund for Social Security is projected to deplete. At that time, it's projected that incoming payroll taxes will cover about 78% of presently legislated benefits. So, if no action is taken, and really Congress would have to take action to cut benefits. Probably this would not be the final reform, but you know one potential reform is doing across the board cut of benefits by 22% when the Social Security trust fund depletes, and then at least those benefits would be payable not permanently at that point, but at least for for a while, that would help get things back on track for Social Security. So that's probably not going to be the eventual reform. Ultimately, it's probably going to be some kind of package of tax increases and maybe slight benefit cuts to some extent in some cases. But nonetheless, right? If you're wanting to have a relatively conservative financial plan, I would be perfectly okay with you taking the benefit that you're presently legislated to receive and calculating what is 70 78% of that amount, and assuming that will be your social security benefit. I think that's a reasonably conservative assumption. I do know sometimes people like to assume they're not going to get any social security, and that's a very conservative assumption because you're missing out on a lot of income in your financial plan at that point. I think that would be taking it too far, but I can get behind if you want to assume 78% I think that's a reasonably conservative assumption to use. If you want to assume you'll get the full 100% I'm okay with that too. So it's not like there's going to just be one answer to this question, but I'd probably lean more to the side of assuming some sort of haircut on your benefits to account for the need for social security reform.

Alex Murguia 03:58
And just for quickly for people listening in, and this is like this could be a whole episode in of itself. So it really is more just just the fact, bullet answers, and we have plenty of work workshops around this topic on Retirement Researcher Academy. So feel free to check those out. But one of the I don't want folks listening to the to account for the trust fund depletion, thinking that that's the end of Social Security, as Social Security was actually intended for a pay-as-you-go system, and the trust fund was really set up for the baby boomers specifically, right? To deal with the

Wade Pfau 04:33
the baby boomers and the declining fertility, and so

Alex Murguia 04:36
it it was known that it was going to run out. Trust fund depletion is not necessarily Social Security failing, not not in the slightest. I I think that's like an easy. When people say the trust fund is going out, I think in the news, I think people just think that's shorthand for there's going to be no no more Social Security. That being the case, what are some things just so so people aren't like. Oh my goodness! What could the government do that are easy wins and easy? I put in parentheses, not in quotations, that are some easy wins to kind of like maintain at least a respectable social security amount, as opposed to just giving it a 22% haircut. Yeah,

Wade Pfau 05:16
instead of giving it that 22% haircut, you could do a slight increase in the payroll tax rate. You could raise the cap on the the maximum taxable earnings, raise that so additional earnings are taxed, or maybe leave the cap where it is, but introduce a new that's been proposed in the past. That say, then once your income gets to 400 or $450,000, anything above that would be tax

again with the payroll tax. That's another possibility. You can raise the retirement age. It's another way to cut benefits, so to speak. You could reduce the cost of living adjustments to social security benefits. There's different reforms along those lines that you kind of put together, mix and match, put together a package, and get Social Security back on track. The Social Security Administration likes to project funding over the next 75 year horizon, and that's where we're getting to the. Well, that would get us to about 2020 with 2100 at this point, but right now we're looking at 2034, where there's not going to be sufficient funding for presently legislated benefits. But yeah, some combination of reforms along those lines can get you back to that 75 year actuarial balance that the Social Security Administration would like to have.

Alex Murguia 06:33
There it is. What did they do on tattoo?

Wade Pfau 06:37
The Star Wars one or the

Alex Murguia 06:40
yeah yeah good one? I was just thinking the future when you said in 2100. I mean, man, we're going to be like interstellar by then, right? Getting your

Wade Pfau 06:51
benefits on Mars.

Alex Murguia 06:52
Yeah, exactly. A lot of cheese, I hear. A lot of green cheese available. All right. Next question. I am sorry.

Wade Pfau 07:03
I said love boat, but that's Fantasy Island, right? For tattoo.

Alex Murguia 07:08
I am retired from the military. I am paying into the military survivor benefit plan for my wife to use. Does this amount affect the Social Security survivor benefit for my wife.

Wade Pfau 07:23
Yeah, and this is where we don't have the incredibly detailed specifics that there might be some kind of weird thing going on. But in general, no, this would not impact the social security benefit survivor benefit for your wife. Military earnings have been covered by social security, so even in the past, when there were the windfall elimination provisions and government pension offset rules that would limit Social Security if you had a pension from work from outside of the Social Security that was not covered by Social Security, but the windfall elimination provision and government pension offsets are now gone. You don't have to worry about that. But I don't think military pensions ever would have been impacted by the windfall elimination provision or government pension offsets anyway, because you still have the payroll tax on your earnings. So this is really kind of a supplemental way to save towards retirement with the the military survivor benefit plan as best as I can tell under normal everyday circumstances, this would have no impact on survivor benefits for Social Security.

Alex Murguia 08:30
for For those that are listening in, and just some of the terms may be new for no other reason. I think it may be helpful. What is the Social Security survivor benefit? What is that? Well, like, like I die, my wife gets 100% What about her social security? You know that kind of thing.

Wade Pfau 08:50
Yeah, the survivor benefit is what your surviving spouse will receive based on your earnings record. So you're eligible for your own benefits based on your own earnings record, and if you also you're also eligible potentially for spousal and survivor benefits from either a living spouse or an ex-spouse or a deceased spouse or deceased ex-spouse, and if that would allow for a larger amount, you get that top-up so that you get the largest overall benefit that you're eligible for, and so that's where oftentimes, if the high-earning spouse has passed away, the survivor benefit through their earnings record could be higher than your own worker benefit, and you would get that additional amount as part of your social security check.

Alex Murguia 09:40
Okay, is that something you apply for, or does Social Security figure it out? Those of you thinking at home,

Wade Pfau 09:46
you apply. You can apply separately for survivor benefits. There's for spousal benefits, you're deemed as applying for your own spousal benefit when you apply for your worker benefit, but with survivor benefit. There's two separate decisions, and so there's strategies around this. If if you're eligible for if your own worker's benefit could potentially be higher, you might take the survivor benefit early and then wait until 70 to start your own worker benefit. So there's different strategies you can use to maximize benefits with the survivor benefits because they are separate claiming decisions.

Alex Murguia 10:23
Okay. Change gears a little bit. Shouldn't essential expenses be fully funded with reliable income?

Wade Pfau 10:32
Okay. So yeah, this relates to a question that was in the previous episode of the income protection. Says you want to build reliable income sources to meet your essential expenses. So, if you have more of that income protection, safety first commitment orientation with the retirement income styles, you'd probably answer yes to that question. You do want your essential expenses to be covered fully with reliable income. But if your total returns, you have more that probability-based orientation, optionality orientation. You don't feel that it's necessary to have contractually protected, reliable income sources to cover your basics. You're comfortable drawing that from a diversified investment portfolio, either because you have the flexibility to adjust your spending based on how the markets are doing, or because you're just fundamentally comfortable relying on the idea of markets, market growth as it's going to grow as needed to make sure you can meet your essential expenses in retirement. So the answer to this question really depends on your retirement income style. Again, if your income protection, you would say yes, your essential expenses should be fully funded with reliable income. If you have more of a total returns orientation, your answer would be no. It's not necessary to build up reliable income streams to cover basics. I'm comfortable drawing that from my diversified

investment portfolio. And what would a time segmentation person say? Well, and time segmentation does want reliable income to cover their basics, but they wouldn't necessarily need to have that set up on a lifetime basis from the beginning. They don't need their whole lifetime reliable income floor in place. They're comfortable building it out rung by rung. They may want the next five to 10 years of expenses covered with reliable income, but they're comfortable for beyond that point, revisiting those decisions in the future, building that reliable income floor out further in the future. It doesn't have to all be fully constructed at the start of retirement.

Alex Murguia 12:33
Somebody that's high on that's on the probability side, but also on the commitment orientation, being you know via say longevity aversion sort of influence, they would land under risk wrap. How would they address these expenses? Well,

Wade Pfau 12:51
so risk wrap and time segmentation are more behavioral strategies where you're looking for not necessarily the purely optimal solutions, but something that resonates more behaviorally, and so with risk scrap, it's still about floors of reliable lifetime income. But rather than looking at simple income annuities to do that, you might resonate better with deferred annuities with guaranteed lifetime withdrawal benefits to build that reliable income floor, and that gives you that underlying technical liquidity of the the annuity value and the upside growth potential of the underlying annuity asset, as well as the optionality around, I could turn off that living benefit if I desire to do so at some point and stop that guaranteed lifetime income.

Speaker 1 13:38
Okay.

Alex Murguia 13:40
Okay. Your next question: If our primary investments are in the market, should that change to more fixed vehicles when in retirement?

Wade Pfau 13:52
Okay. So you're primarily investing. I guess really, it's just should you get more conservative with your investments. Kind of retire that stock to bond allocation as you retire. The answer, you know, generally speaking, to that is yes, and it's the whole human capital argument. Moshe Maleski has that book: "Are You a Stock or a Bond? and it's really about your your salary, your your paycheck. For not everyone, some people may have more commission oriented type incomes and things, but for most people, your work income is more like a fixed income asset than a stock, and and so that's the whole justification for when you're young, you have your future lifetime earnings ahead of you. That's more bond like in nature. The financial portfolio can be more aggressive, and then as you get to your retirement date, you don't have that human capital anymore. You have less bonds stored up as your future earnings, so then you want to have a less aggressive asset allocation in your financial portfolio. So that's the whole theoretical motivation behind target date funds and so forth. And in that regard, yeah. I mean that-that's the whole idea behind. Yes, as you get to retirement, you may want to have a less aggressive asset allocation than you had pre-retirement.

Alex Murguia 15:12

Yeah, I think that's right. I what about the counter argument that? Yeah, but when you retire, you know, let's say you retire in your mid in your mid 60s, you've got another 25 years potentially to you know still have your wits about you and continue to live. And if you sort of robotically all of a sudden go to a conservative portfolio and you're 5050, you're leaving a lot of returns on the table because my horizon is you know, 20 plus years,

Wade Pfau 15:43
right? Then it's getting into well, well, always said before was like you're less aggressive post retirement than pre retirement. But how far do you go with that? Yeah, you can definitely overdo it, and and so that's some of the concerns. Like with Bill Bengen's research about spending in retirement, he said retirees should never go less than 50% stocks. If you get to too low a stock allocation, that goes back to our earlier question about what's the meaning of risk. Yeah, if if your stock allocation is too low, you might have more risk of because you're you're pretty much locking in that you're going to run out of money if you end up living long enough in retirement, so indeed, it's not necessarily the case that you want to just be all fixed income or anything like that. It's just on a relative basis. Should you be shifting over closer towards having more fixed income vehicles post retirement? Yes, but but yeah, you definitely don't want to overdo it in that regard.

Briana Corbin 16:43
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Alex Murguia 17:07
Okay, Kevin Warsh recently suggested that he's going to be less transparent with journalists in terms of where rates may be heading. What are your thoughts about that transparency, or lack thereof?

Wade Pfau 17:24
Now we're getting into joke questions coming on current events.

Alex Murguia 17:30
Come on, man! All right, all right, all right. Let me see here.

Wade Pfau 17:36
No one asked that, by the way. Yeah, yeah. No one asked

Alex Murguia 17:39
that. No one asked that. Okay, does building a 30-year tips bond ladder to fund living expenses fall under time segmentation or income protection? I actually like this question.

Wade Pfau 17:52
Yeah, it's and it's really a philosophical question. And during our retirement income challenge, it seemed like this was a pretty popular question. Sometimes the same person asks the same question multiple times, and that makes it seem more popular. But I think it was different people asking it, so yeah. So is a 30-year tips ladder time segmentation or income protection? You

know, it's somewhere. It's kind of a hybrid of the two. Like time segmentation, usually you're not building a front end bond ladder that's 30 years long. It might be anywhere from like three to 10 years, maybe 15 years at the extreme. As you go towards 30 years, it's not giving you that lifetime income. But you know, maybe 30 years is is not a high probability you live out longer than those 30 years. So it starts to bleed into income protection. If you're going to force me to just pick one or the other, I guess I'd have to label it as time segmentation, just because for me, income protection really does imply commitment to reliable lifetime income, and a 30-year tip ladder is not truly a commitment to a reliable lifetime income.

Alex Murguia 19:05
Okay.

Wade Pfau 19:05
How about you? Do you differ in that? No, I I think there's no answer. Time

Alex Murguia 19:09
segmentation because there is some sort of finite cutoff on it. I'm sorry. What?

Wade Pfau 19:14
I mean, there there's no answer because these are all just debated terms to begin with. And time segmentation, I always say, like, if you ask 1000 different financial advisors what time segment takes you on a

Alex Murguia 19:25
bond ladder,

Wade Pfau 19:26
yeah, you get 1000 different answers.

Alex Murguia 19:28
Yeah, yeah, I'm thinking, I'm just thinking about a bond ladder myself. So, in that sense, you know, the other piece is, you know, we talk about what I like about the question is like when we're looking at the Risa matrix, at the very top, you have that optionality, right? Where you're constantly reviewing it, and then the more you lock in on things, you move lower and lower and lower because you're you're kind of introducing more commitment to whatever decision making process that is. And I'm using commitment and length of time, kind of. Similar because that's the amount of time you locked in, and we've always mentioned the the further out you go in the ladder, you're kind of moving downward, you know, on the on the reso matrix towards commitment orientation. Usually, the other piece that's interesting, and you had mentioned this the other time, which you know tips, you know, are are actually quite attractive right now. But when you look at what a sustainable withdrawal rate is historically and things along those lines, I mean, tips right now are looking pretty good. You know, comparable to that sort of withdrawal rate, right?

Wade Pfau 20:38
Yeah, right now with a 30-year tip slider, you're getting an average real yield of about 2.9% which corresponds to a 4.9% safe withdrawal rate over 30 years. Now, why does that

Alex Murguia 20:49
correspond to a just a a 4.9% withdrawal rate?

Wade Pfau 20:55
I'm sorry.

Alex Murguia 20:56
Why does that that bring the math on that for so people understand?

Wade Pfau 21:00
Well, if you build a tips maturing each year for the next 30 years with say $100,000, the the most income you could get on an ongoing inflation adjusted basis out of that would be about $4,900. That 4.9% of your initial amount could be sustained Over a 30-year horizon,

Alex Murguia 21:23
that's a lot. You're not going to see some. You're not going to see a study saying, "Oh, the sustainable draw rate from a diversified portfolio is 4.9%. Yeah, certainly, like that's pretty high,

Wade Pfau 21:35
right? And if you go with a diversified portfolio, it is possible you end up with less than 4.9% but right right now you can get 4.9% by constructing a 30 year tip ladder. So that's yeah, it's that's about as high as it's really ever been. Tips yields in the early days when they were introduced were higher, but there were a lot of missing maturities at that point. You really couldn't construct, and right now there are still there's a gap between 2034 and 2039 where there's no maturing tips, so there's a little bit of an approximation in this.

Alex Murguia 22:06
Well, the other thing I would say is, you know, I you would have nothing in the tips ladder at the end of 30 years, whereas the portfolio maybe you have more, but if you've been spending less along the way, that that would be the expectation anyway. So you would have more.

Wade Pfau 22:23
Uh huh. Yeah, you could then build a tip slider that pays out like 4% of your total assets, which would mean you leave behind, or you buy a big 30-year tips to give you that liquidity at the end of the 30-year tip slider.

Alex Murguia 22:35
Yeah, yeah, yeah.

Wade Pfau 22:37
But yeah, for me, it's more still more time segmentation because the the longer the tips, the more interest rate risk there is. That if interest rates go up, you could have a big capital loss, but you could you're not fully committed to the tip ladder. You could always sell off rungs, and that's where you do maintain some degree of optionality, even though there is that interest rate risk. But that's another reason why I would rank it more as a time. It's an extreme time segmentation, but

Alex Murguia 23:06

yeah,

Wade Pfau 23:07
it's more time segmentation than income protection. But I could just as well see somebody arguing the other way that really it's more income. I mean, everyone

Alex Murguia 23:16
gets the joke interactionly where where this is going, so it's fine. It's not like the Risa police are not gonna,

Wade Pfau 23:23
yeah,

Alex Murguia 23:23
capture us.

Wade Pfau 23:24
There's no Risa police. It's like

Alex Murguia 23:28
it kind of rhymes a little bit. Not doesn't rhyme, but it kind of just rolls off the tongue. Maybe we should start

Wade Pfau 23:34
that organization to

Alex Murguia 23:35
yeah

Wade Pfau 23:36
go after people's strategies.

Alex Murguia 23:38
Here we go. Oh, time segmentation. What do you think about using separate target date tips ETFs for each rung of a bond ladder, shares, if you will? We get this. It's an interesting question as well.

Wade Pfau 23:53
Yeah, and it comes up a lot. So it's should it should I buy an individual tip? Like if I want money in five years, inflation adjusted, should I buy an individual five-year tips, or should I just buy one of these ETFs that would function like a five-year tips in the same sort of manner? And it's just really the with the ETF, you're going to have an expense ratio on it, and are you willing to pay that for the convenience of not having to actually construct your own bond ladder might be worth it in some cases, and also the expense ratio might not be the true full cost of the ETF because if you're going as an individual constructing your own ladder, you're dealing with retail pricing on the tips, so you may not get as good of pricing as the institutional investor who's putting together that ETF. So the that what that simply means is if there's like a 0.2 percent expense ratio on the ETF version, well, really you're not paying that much more because you would not get that good

a pricing if you constructed your own ladder. So that's really the trade-off. Do you want the convenience of the ETF version, or are you comfortable building your own ladder and then saving on the the cost of that opportunity?

Alex Murguia 25:13
Okay. Bond ladder versus bond ETF. Is it worth the hassle to maintain bond ladder,

Wade Pfau 25:23
yeah, and really, I that's a related question. I just, I guess, well, but

Alex Murguia 25:27
but well, now I'm looking at bond ETF, not necessarily as like the sort of bullet.

Wade Pfau 25:33
Oh,

Alex Murguia 25:34
it's a big target. I, I, I kind of read that initially as just like an aggregate bond fund ETF.

Wade Pfau 25:39
Okay, yeah, to make this question different from the previous one, yeah. Instead of a like defined date maturity ETF, it's it's our traditional bond fund constant. Yeah. Exactly. Constantly duration Q and A. Yeah. So the the fund approach has interest rate risk. You don't have those maturing rungs that are going to provide the spending you need for that year. If you have to sell shares after interest rates have gone up, you might experience a capital loss. So that's the downside of the fund, but it's a lot easier. So whether or not it's worth the hassle to build the bond ladder and get that interest rate risk out of the picture really just depends on on your perspective and willingness and efficacy when it comes to building bond ladders.

Alex Murguia 26:30
No, I agree. If it can be done, I I kind of tend to think it's worth it just because you can really make it bespoke. Time segmentation. How do you suggest replenishing the bond ladder going forward? I think that that the work you did on critical path is is interesting, and maybe throw a shout out to retirement researcher on that

Wade Pfau 26:53
one. Yeah. So the the question here is like, okay, I I want 10 years of bonds, a laddered approach. So I've got 10 years. A year passes. I spend that first rung. Now I have nine years left. Do I want to refill that 10th year so that I have the full 10 years? The question is like, how do you go about deciding when to do that?

Alex Murguia 27:18
Okay. Before you get into it, just real quick, when you when we're talking about bond ladders, sometimes because this has come up with some of our readers or questions, sometimes people think you're just using the dividends for year one and using that for income. The reality is you're using the dividends and that matured bond for that particular year, using the entire proceeds,

Wade Pfau 27:40

right?

Alex Murguia 27:40
So it's not just like getting dividends and living off the dividends. Or actually, when the bond matures, you're using that money to also spend, you know, spend through your expenses. Just wanted to make a point.

Wade Pfau 27:52
Right, you have to construct bond ladders backwards from the end because you need like the full face value plus that last coupon for the final year, but then that gives you coupons every year. If I'm building that 30-year tips ladder, I start with the 30-year tips, and now I've got coupons from that for the next 30 years. Then I go to year 29, layer in how much more I need with the 30-year coupons coming in. So by the time you get to year one, you've got 29 years of coupons coming in first. If interest rates got very high, that might be more than you actually need for year one. But I think in most cases, it's still pretty typical to think you might have to buy a little bit of year one tips as well, so that the maturing face value makes up the difference after those 29 years worth of coupons. So, so yeah, you have bonds maturing each year, as well as coupons coming in as well.

Alex Murguia 28:47
Okay, so now, how would you suggest replenishing the bond ladder going forward?

Wade Pfau 28:51
Yeah, and so there's a lot of different potential approaches that can be used, and I never published a research article on this point, but behind the scenes, I compared 16 different methods. All the different like, if the market was up last year, replenish. If the market was down last year, don't replenish. The complicated critical paths that you mentioned, where you figure out how much wealth would I need each year for the rest of my life to make the plan work. Well, if I have more than that, replenish. If I have less than that, don't replenish. And then the rule that I found seems to work just as well as anything else. And I think we might have even answered this question on a recent episode because I think the rule that works just as well is you record the nominal value of your investments at the start of retirement and use that number as a threshold in any given year. If if your investments have grown to be worth more than they were at the start of retirement, replenish. If your investments are worth less than they were at the start of retirement in nominal terms, hold off on replenishing. Give your portfolio a chance to recover, and that picks up a lot of the characteristics of the glide path. It's the glide path is you. Wealth can eventually kind of work its way down to zero, just because your time horizon is getting shorter and shorter. But you don't get that full effect with my basic rule. But you get most of the way there. It seems to really work just as well as anything more complicated, and that's what what I usually like in my books now. Those are the rules I use because this is this kind of rule is used for many things. When to replenish a bond ladder for time segmentation? There's variable spending strategies about should I take the inflation adjustment for spending or avoid it? Well, it's take the inflation adjustment if my investments are worth more than at the start, skip it if they're not worth more. Do I have a buffer asset? Well, draw from the buffer asset, and when my investments are worth less than at the start, don't draw from the draw from the investments when they're worth more than at the start. That same sort of rule I use for a lot of different purposes, and it's really just that simple. Record the value of your investments at the start of

retirement, and use that as the threshold. If your portfolio is growing, spend from the portfolio or replenish whatever whatever the thing you're doing is. If it's worth less, hold off on replenishing.

Alex Murguia 31:09
Okay, and we've got got a run of time segmentation questions, and we got two more here. For for people on the left side of the resub profile that would mean that your top left time segmentation, bottom left income protection. Can you discuss the trade-offs between using a tips ladder versus lifetime annuity? I, I think introducing secondary factors go a long way towards helping discriminate between these.

Wade Pfau 31:42
Okay, well, yeah. Let me just give a quick basic idea, and then maybe you can elaborate more. The sure the benefit of the tip ladder is you're locking in that inflation protection. the The disadvantage of the tip ladder is like if we're talking about the 30 year tip ladder, like before, you don't have anything left after 30 years. So in year 31, you're out of luck at that point. With the lifetime annuities, you don't have the inflation protection built into the annuity, but it will last on a lifetime basis for you. No matter how long you live, you'll continue to receive those payments. And then the tip ladder: if you died early, you'd get the leftover to your estate with the lifetime annuity. If it was life only, you get the most mortality credits out of it. But if it's no cash refund and/or if it's a deferred annuity with a living benefit, it would work like the tips ladder, where any remaining funds would go to your estate. And with the life annuity, you also get those mortality credits. You're you're not just spending interest on the underlying fixed income assets. You're also pooling that risk across a large cohort of individuals, so that a higher standard of living can be supported for the lifetime of all the individuals in that risk pool. Since those who end up not living as long don't need as much, don't receive as much back. Some of what they would have gotten goes to those who end up living the longest, and raises a standard of living for everyone in the risk pool relative to a bond ladder approach.

Alex Murguia 33:15
So those are the trade offs. Yeah, I also view the trade offs a little bit in In liquidity and longevity, in terms of where are you on that balance, and I mean by that the fact that you're on the left hand side of the recent matrix means that you you really strive for that true liquidity, and so as long as you maintain harmony with that, that's that's that's a good thing, and true liquidity is when you you really have assets that are earmarked for something in case it comes up, as opposed to if your total return and you're taking from a portfolio a sustainable withdrawal rate, and all of a sudden you have an unexpected $60,000 expense, and you take it from your portfolio simply because it's quote unquote liquid. You can put in an order, and the next day, the cash is available for you. That's liquid on a technical basis, but it's not truly liquid because that money was already earmarked for your sustainable withdrawal rate. And so, right off the bat, the two things they have in common in terms of this leads to the trade-off is that they both believe in true liquidity, which is you have assets that are earmarked for an event, you know, the surprise, new roof, or or what have you, right? So they both like that, and those are both in the in that side of the the recent matrix, you know, and the the strategies on the left side of the resa matrix have to do with tip ladders and lifetime income, annuities. So, to me, the trade-off that you're making, regardless of the levers or characteristics that these things have, is longevity. You're making a trade-off on longevity, you know, relative to the ability to, you know, have a lot more. Optionality, and what I mean by that is, as you move down that that that that matrix, lifetime annuities become a lot more interesting to you simply because longevity aversion, which is the

fear of outliving your assets, really begins to overwhelm the decision-making process that that you're going through because that that seems to be one of the main investment risks that that you have, and so frankly, for those folks, it seems to be they would have a proclivity towards lifetime annuity. A trade-off is you're signing a contract, so there is you're committing to it. So if something better, quote unquote, better comes along later on, you may not be able to switch out of it. Now there's many writers and things like that that you can start moving around musical chairs with annuities. But the more chairs there are, you know, the the the the less it becomes a true lifetime annuity. You know, you're not maximizing the credits and the like. A tips ladder is on the other side. You know, depending on the maturity, if you have a lot of optionality, you don't have as you don't have that sort of longevity aversion because you wanted to always reassess things. You're fine not having your longevity issue like locked in for the rest of your life, and so the trade-off of a bond ladder reflects that that proclivity as well. That one being more optionality

Wade Pfau 36:30
makes sense. Why? That's how I kind of look at it. Yeah, yeah, and that's a good point too. Like the more worried you are about outliving your money, really, the less you can spend from investments. And in a bond ladder context, that means you're not really comfortable spending it completely down after the 30-year bond ladder. You want to only spend a portion of that and preserve a portion maturing in 30 years to fund the next segment of your lifetime. So the the more aware you are about outliving your money, the someone could say, "Well, annuities look. Someone could say, "Well, you could have investments on the side, and you have a 30-year bond ladder. I don't know. That seems like that's an extreme example, you know. Well, that's the way you would manage the longevity risk from outliving the bond ladder. You can't put it all into the bond ladder. You'd have to, yeah. And that means you're just spending less because you're preserving part of your investments for that post 30 year, yeah, you'd

Alex Murguia 37:23
you'd have to have so much money to be able to accommodate a 30 year bond letter to cover your complete expenses that you're fine going to zero. It just it's going to be hard to see that in in real life is kind of what I'm getting at.

Wade Pfau 37:37
Yeah, and just the more worried you are about outliving your money, the more attractive the annuity becomes because otherwise, with investments, you're you're spending less, so you can preserve more to feel comfortable. You won't ever outlive it all.

Alex Murguia 37:49
Okay, and we got one more question with the word beyond letter in it. In that family, do

Wade Pfau 37:55
you want to do it today or save it for the next? Oh yeah, yeah, yeah. We can save

Alex Murguia 37:58
it. Actually, yeah, it's it's a good transition for the next sets of questions that we have. Okay,

Wade Pfau 38:04
all right. Well, well, that's an episode then. Let's

Alex Murguia 38:07
call it a wrap. Thanks everyone for listening in. We'll catch you next week on Retire with Style, answering more questions.

Wade Pfau 38:15
Thanks everyone.

Briana Corbin 38:18
Wade and Alex are both principals of McLean Asset Management and Retirement Researcher, both are SEC registered investment advisors located in Tyson's 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.