Todd: Welcome to the Financial Mentor podcast, episode number nine, with Wade Pfau, Professor of Retirement Income. In today’s episode you’ll discover advanced concepts on the all-important but seldom discussed income side of retirement planning.

Announcer: Welcome to the Financial Mentor podcast, where you get unconventional insights into wealth building that actually work. Discover data-driven strategies and learn from a wealth of experience so you can take your financial skills to the next level. With your host – Todd Tresidder.

Todd: Today I’m honored to have Wade Pfau on the show. Wade has a Ph.D. in economics from Princeton, holds a CFA or Chartered Financial Analyst designation, and he is professor of Retirement Income in the new PHD program on retirement planning at American College. Welcome, Wade.

Wade: Thank you, thanks for having me.

Todd: Thanks for coming back to the show. We had a great show in episode one, and I’m looking forward to a great show here as well. When it comes to retirement planning, there are two sides to the equation. There’s asset accumulation, or how much do I need to save for retirement, which I’ve written a book on, and I’ve noticed how that gets all of the attention. It’s like the quarterback for the football team or the pitcher in baseball. It’s the sex appeal of retirement planning. But there’s another side to it, which is income – what is a safe withdrawal rate or how do you manage the income you withdraw in retirement? From a practical standpoint, I consider that just as important, if not more important, than the asset accumulation side. So we’re going to explore that subject today.

I want to start the discussion with safe withdrawal rates, just to bring listeners up to speed for those who aren’t familiar with the subject. That’s also what brought us to where we are today. We started way back in the day with Peter Lynch being quoted at 7% withdrawal rates and then William Bengen did a study. Why don’t you bring us up to speed, Wade?

Wade: The first point you made is important – the accumulation phase is distinct from post-retirement and building a retirement income strategy. As the baby boomers are reaching retirement there are now vast changes in progress. Even my job title is Professor of Retirement Income, so I am focusing on the post-retirement period. The retirement income industry developed in the mid-2000s and they’re doing a lot of work in that area. There are new retirement designations on retirement income and it’s now a growing area. The way financial planners are thinking about it really began with William Bengen’s study which was, in many ways, an oversimplified study, not to criticize it, because he had a clear objective. You mentioned Peter Lynch talking about a 7% withdrawal rate. William Bengen thought ‘That doesn’t sound right. Let me develop some assumptions that can be tested,’ and so he assumed that people use a constant inflation adjusted spending strategy and he
looked at these long periods from history which *we talked about on the first show*. He looked at someone retiring in 1926 and over 30 years, through 1955, then someone retiring in the next year, 1927 through to 1956, and so on, and found what sort of strategy would be sustainable and he found that someone who retired in 1966 would have been the worst case scenario in US history. If they had a portfolio of 50% S&P 500 and 50% intermediate term government bonds they could have sustained a withdrawal rate of only 4.15% of their retirement day assets. That’s where the idea of the 4% rule came from and, again, that was just made to have a lot of basic, simple assumptions to illustrate that 7% is not a safe withdrawal rate. That wasn’t necessarily meant to be the end of the story but financial planning took off with that research and then, a couple of years later, the Trinity study came out which didn’t really add much beyond what William Bengen had already done except create a rather unfortunate simple addition which was the idea of success rates and failure rates, where they repeated Bengen’s analysis but looked at different kinds of strategies – like if you use a 5% withdrawal rate over 25 years with a portfolio of 75% stocks, what’s the success rate? What percentage of the historical simulations with that have worked out and what percent would have failed or run out before the end of the time period? And that’s really the way the financial planning profession created the issue of safe withdrawal rates. It’s a simplified way of thinking about retirement income.

**Todd:** One of the problems I have with the whole 4% rule, as it became popularized, is the whole idea of dynamic withdrawal rates versus static withdrawal rates. When I look at the 4% rule I see a static model. First of all, why don’t you define what the 4% rule is, so we can at least know what the static model is as a benchmark?

**Wade:** So the assumption behind the static model 4% rule means that at your retirement date you can withdraw 4% of your assets and in subsequent years you can ignore whatever happens with your portfolio, whether the market goes up or down, and continue to withdraw the same amount of income – not the same percent of your portfolio but the same amount of income – adjusted for inflation. So you have this constant, inflation-adjusted, spending stream that should last throughout your retirement. The question is – will that be sustainable? Or how low does the withdrawal rate have to get to make that sustainable? And the answer was 4% should make it sustainable over 30 years based on the worst case scenario in US history.

**Todd:** What people need to understand with that is that if you withdraw a static amount that starts at 4% and your portfolio fluctuates up and down and the amount you’re withdrawing is growing with inflation, whether your portfolio is growing or not, there are historical periods where this would exceed 10% in yearly withdrawal, which is obviously not sustainable.

**Wade:** Over historical periods, every year there is a different sustainable withdrawal. In the early 1980s it was rising over 10%, so sometimes 10% might be sustainable, but most of the time it’s not.

**Todd:** What I was trying to communicate was that the actual amount you’re withdrawing as a percentage of the portfolio would break over 10% at times, which is very risky.

**Wade:** Yes, if your portfolio is declining you essential start playing this game of chicken where you don’t make any adjustments, you continue to withdraw the same amount of income which, as your portfolio declines, is going to be a larger percentage of your remaining portfolio balance.
Todd: There are many things that bother me about it. First off, hats off to William Bengen – it was landmark research, it broke new ground. It took our knowledge to a new level and we’re building on top of his shoulders, so hats off to him. This is not a criticism at all, but again, that’s a static model and it’s not realistic because real world retirees, when their portfolio goes down, they feel less wealthy and they lower their spending to keep it at a realistic percentage of their remaining assets. That’s how real world retirees operate. Similarly, if the portfolio doubles, they tend to spend more, as they should. This takes us into the whole concept of static versus dynamic withdrawal models. What dynamic withdrawal models have you run across that you find more interesting?

Wade: There are different dynamic models. I was at Moshe Milevsky’s conference last year and Anthony Webb was presenting. He’s one of the authors of one of the dynamic models that I like to talk about.

Todd: And you can go ahead and cite him as a resource on here if you want to go ahead and give the website. I will add it to the show notes.

Wade: Anthony Webb is a researcher at the Center for Retirement Research at Boston College, which has a lot of great material. They have a good blog, the Squared Away Blog, and so forth. But he summarized this all in one sentence – ‘You can’t expect to have a constant spending stream from a volatile portfolio.’ So that’s the whole story right there. If you’re using a portfolio of volatile assets you can’t assume you’re going to be able to use a constant spending stream.

Todd: Yeah, it just makes no sense – life is dynamic, your portfolio is dynamic, how can your spending model be static? It makes no sense.

Wade: The most basic alternative, which would be the opposite, would be to withdraw 4% of the remaining account balance every year. That’s very different from the 4% rule – if you’re going to withdraw 4% of the remaining account balance each year you’re never going to run out of assets because as your portfolio declines you just withdraw less and less of it. But you have no way to budget for the future because you can’t predict what you’re going to be able to withdraw next year because it depends what happens with the portfolio this year, assuming you have a portfolio of volatile assets.

Todd: So that might be the other extreme of the equation. Have you seen other models that you prefer that bring a bit more balance to it?

Wade: Getting closer to what is going to match with economic theory in terms of an optimal dynamic strategy, something approximating that, and Anthony Webb has done research on this, is using the IRS RMD (required minimum distribution). The IRS publishes their required minimum distribution percentages and they’ll start, for most people, at age 70 and a half, but if someone inherits wealth there could be cases where they have RMDs for earlier ages. The IRS publishes a table of those RMD, required minimum distribution percentages, so one alternative is to simply use the IRS RMD published number to see what percentage of your remaining assets you can withdraw each year in your retirement. But that’s also going to make budgeting very difficult. It’s going to work much better than always withdrawing 4% of the remaining account balance because, as you get older, you can start planning for a shorter remaining time, which means you can start using a higher withdrawal rate. So the IRS rules account for that, it’s just one divided by the remaining life
expectancy. And those are conservative numbers. They’re based on assumptions that, for example, it’s a married couple with one spouse 10 years younger than the other. So it’s based on a conservative estimate of life expectancy and each year, as someone ages, they’ve survived longer, their remaining lifespan lengthens as well – not on a one to one basis, but their lifespan continues to extend outward as they age. So if someone, for example, is 65 and they plan to live to age 95, when they hit age 90 they better be thinking that they might live longer than age 95. That time horizon for them is going to continue to increase but not on a one to one basis – a 90 year old is not going to need to plan for another 30 years of retirement beyond that. That’s what the IRS rules are doing.

Todd: How do the IRS rules relate to the fact that there is no such thing as life expectancy for an individual? It works for the IRS and insurance companies because they’re dealing with a large pool of people. But if we’re using IRS tables built on a large pool of people for a single individual, how does that work?

Wade: An individual could adjust the numbers but an individual is still going to have a similar type of probability distribution on their remaining life expectancy. This is, again, taking a percentage of remaining assets based on this average remaining life expectancy. But it’s not a case where you might say your life expectancy is to live to age 75, for example, because nobody can plan to live exactly to their life expectancy. There’s a wide distribution around that, so you have to plan to live longer. With these IRS RMD rules, that issue is not at play because every year you have a new life expectancy based on living longer and you continue to withdraw a percentage of your assets based on that. Again, it’s fairly conservative. I’ve done Monte Carlo simulations about this strategy and even with my assumptions where I assume future returns are going to be lower than the historical averages, more often than not, when you use the simple IRS RMD rules, your spending continues to increase throughout the retirement period. These growth rates and the distributions are faster than the reductions in the portfolio, so more often than not your spending increases throughout retirement and, in a sense, that can make it too conservative.

Todd: That’s what I noticed. If spending increases in retirement and yet research shows that real world retirees decrease spending on a nominal basis during retirement, how does that jibe?

Wade: It means that the IRS rules are going to be too conservative so you could use something more aggressive. Another strategy that Anthony Webb, and his co-author Wei Sun, looked at was basically you spend all the interest and dividends you get from your portfolio, plus the required minimum distribution.

Todd: Oh, wow.

Wade: So it’s a rule of thumb, it’s something that’s still easy to work with, and of the rules of thumb they were looking at, that was the one that performed best.

Todd: What do you mean by ‘performed best’?

Wade: They have to use some sort of utility maximization framework where they have assumptions about how people feel. Whenever you get into these dynamic strategies, spending is not constant. Some years it can be higher, some years less, so you have to translate that – what does that mean? For someone who is risk adverse, in retirement what risk adverse means they can’t or they don’t want to experiences big drops in their spending, so any time spending is forced to drop that’s going
to get a really negative weighting. So doing an analysis where you translate this lifetime spending pattern into how that works out for people in their budget, what they found was optimal and they were comparing the 4% rule, the IRS RMD rule and, I think, a constant 4% of the portfolio and then this. That’s the strategy that provided the best tradeoff, of spending as high as possible without letting it fall too low to get the most lifetime satisfaction for the individual.

Todd: Fascinating – and for listeners who want to find out more about Anthony Webb and his work, where would they look?

Wade: They could Google his name along with IRS RMD and they should be able to find his study on that.

Todd: Are there any other dynamic withdrawal models that have caught your attention that seem interesting and are worth noting?

Wade: The one we were just talking about is something people could implement easily. David Blanchett, another popular retirement researcher, who is at MorningStar now, with three co-authors, did something where they also tested the IRS RMD rule but they came up with something called the “mortality updating constant probability of failure” approach. So it’s like the RMD case where mortality is being updated from year to year, the remaining life expectancy gets revised as people continue to live longer, and then trying to make a constant probability of failure from a Monte Carlo simulation, testing it that way and trying to figure out, again with an underlying utility maximization framework, parameters for what’s an acceptable probability of failure. They basically coming up with something like this where they tell you what’s a reasonable withdrawal rate to use from year to year throughout retirement. So it’s not a constant inflation adjusted amount but what percentage of your assets can you spend from year to year in retirement, and that’s another related type of approach. There are other dynamic strategies. William Bengen had one of the earliest where he had a floor and a ceiling, you start at some withdrawal rate but then if the market goes up you let your spending increase up to some maximum level and if the portfolio goes down your spending decreases to a minimum level, so there’s a range of outcomes. Whenever you’re willing to let your spending drop you can start with a higher withdrawal rate, which is basically what he found doing that, and whenever you put in some sort of hard floor, that you’re not going to let your spending fall below some minimum level, you’re always exposing yourself to the possibility of wealth-depletion. So that’s another approach. Jonathan Guyton has another famous approach. He created the Guard Rails, which has a number of rules to define how much and when you can take out from your portfolio. Things like if the portfolio drops in value you don’t take an inflation adjustment, you never increase the portfolio withdrawal amount by more than 6%, and if the portfolio’s declining in value, which pushes up the percent of the remaining portfolio that you’re withdrawing, when that happens there’s going to be rules to reduce your spending. I think if your current withdrawal rate increases by more than 20% then you cut your spending by 10% and vice versa – different rules that he applies. You can increase your initial withdrawal rate because you have flexibility to reduce your spending when the portfolio drops.

Todd: What about varying portfolio withdrawal rates based on your starting market valuations and interest rates?

Wade: I’ve written a research article about that. That’s not talking about a dynamic strategy, though.
Todd: I agree with you. Let’s characterize this so far, so that we’ve got the discussion in context. So far we’re talking about withdrawal rates where you’re 100% pulling from a portfolio. Later in the discussion we’ll talk about bringing other sources of income in and how that affects withdrawal rates. So far our discussion has been 100% portfolio assuming all factors are equal, so what I’m trying to do now is bring in the idea that all factors aren’t equal at all times, so your withdrawal rates, the income you can bring in from a portfolio, can vary based on the market valuation and/or interest rate at the time you begin your retirement. That adds another dimension to this whole withdrawal rate discussion.

Wade: That’s a fundamental problem with the way some people interpret the Trinity study. That if it tells you, for example, that a 4% withdrawal rate worked in 95% of the historical circumstances, and anyone who’s been listening very closely knows that William Bengen found that 4% always worked. The Trinity study says that it’s a 95% rate – that’s because they used corporate bonds instead of intermediate term government bonds. So, with their study, 4% failed in 1965 and 1966. But anyway, say that 4% has a 95% success rate, the way people tend to misinterpret that is to think that it doesn’t matter when you retire. 4% always has a 95% success rate, and research has shown pretty conclusively that that’s not true. Michael Kitisces had the first study about that. He was saying that when market valuations are low you can increase the initial withdrawal rate but he wasn’t willing to go in the other direction. In the year 2000 when market valuations were so high, there’s not any need to decrease the initial withdrawal rate. I wrote an article about that issue in 2011 in the Journal of Financial Planning where I linked, over 30 year retirements, the maximum sustainable withdrawal rate in each year, to the market valuation level in that year and the interest rates in that year and found that there’s a pretty strong link between withdrawal rates and the market conditions at the retirement date that you can predict with some degree of accuracy, at least based on the historical data. If you retire at a time that market valuations are low and interest rates are high there’s going to be a higher sustainable withdrawal rate and vice versa. Someone retiring in the year 2000 needed to be very cautious about using 4% because in the year 2000 market valuations were 60% higher than they’d ever been in the historical record where we could claim that 4% worked. That was a big driving factor in the year 2000, market valuations being so much higher than they’d ever been historically. You can’t really say that 4% is still safe for someone retiring in the year 2000. It’s certainly not going to have that 95% success rate that historical simulations identify because the situation is different.

Todd: Both you and Michael provided some very important research showing that the actual safe withdrawal rate is highly related to the first 15 years investment returns, and the first 15 years investment returns are highly related to starting market valuations, is that correct?

Wade: Right, that’s the basic mechanism. With the sequence of returns risk the market returns in the early part of retirement really define what happens. I had another article where I did some regression analysis and found that the cumulative inflation and portfolio returns in the first 10 years of retirement can explain 80% of the final outcomes with a sustainable withdrawal rate. So it’s a very disproportionate impact.

Todd: So let’s set some context, because we’re throwing a lot of numbers around and a lot of advanced concepts here, so let’s keep people on board here by setting some context. We started the discussion with static versus dynamic withdrawal rate during retirement for a portfolio. And all of
that discussion was couched in the idea that you’re 100% pulling from your portfolio, that you don’t have other sources of income such as a business, real estate, annuities or anything else. You’re just living off your portfolio bonds and stocks and whatever’s in there. So the opening part is that you’re living 100% out of a portfolio, that’s the discussion so far. Then we broke out dynamic versus static models and then we were talking about how dynamic models better represent the reality of real world retirees and creates a lower pain threshold under a wide variety of circumstances, is that correct? So we can at least point listeners towards dynamic models as opposed to static models for their withdrawal rates if they are pulling 100% from a portfolio. Then we added that it’s not a simple static concept that we’re looking at, that your true withdrawal rate, even looking at all of these models, is really a function of market valuations and interest rates at the beginning of your retirement. Would that be safe to say?

Wade: Right. There’s a strong connection between them.

Todd: Yeah, correlation is not causation but, historically, we can look and then there’s also common sense when we look at the returns in a portfolio and we can see why valuation would make sense as a causative factor. So, while correlation is not causation, the numbers are quite clear. Is that fair to say?

Wade: Robert Schiller and John Campbell in 1996 showed that there’s a correlation between market valuation and real stock returns over the subsequent 10 years. So valuations are linked to market returns, which in turn are linked to sustainable withdrawal rates.

Todd: So that’s where the discussion has gone so far. I just want to create a context for it going forward, I don’t want to leave listeners in the dust here. There are layers to this conversation that we’re bringing in and the next layer we’re going to bring in is this concept of how your withdrawal rates are affected when you have outside sources of income. You’ve done some fascinating research on what happens when you bring annuity products into a portfolio. Why don’t you bring us up to date on that?

Wade: Before I get into that, William Bengen was answering a simple question – what’s a sustainable withdrawal rate? But then the Trinity study introduced success rates and failure rates. There was an article in the Journal of Financial Planning in 2003 where the author, whose name currently escapes me, was talking about what’s an acceptable failure rate, and he said that running out of assets in retirement is catastrophic. Even a 1% failure rate is going to be unacceptable because it’s such a devastating outcome. That is simply not true. People have other income sources beyond their financial assets. Somebody who has social security and a nice corporate pension, maybe a couple of pensions, a large amount of guaranteed income coming from sources outside of their financial portfolio, for them, running out of financial assets may not be catastrophic. So that changes some of the dimensions for them so that they can potentially use a higher withdrawal rate because they can withstand the impact of running out of financial assets.

Todd: Let’s give a real world example here – let’s imagine that you’re 60 right now and you’re retiring earlier, considering that 65 is the normal retirement age. So you retire at 60 and you’ve got some annuity products, you’ve got social security, you’ve got consulting income, you’ve got a couple of pieces of rental real estate. You see that your base spending can be supported by your annuity products and your real estate so you decide to use a very aggressive withdrawal rate and it turns out
that you blow it and you run out of money, in terms of your portfolio, 25 years later. The reality is that you’re aged 85 and studies show that your spending declines roughly 25% with every decade, in terms of constant dollars, from age 65 to 75, 75 to 85, etc. So the idea of running out of money at 85 is not a big deal, because you’ve enjoyed the bulk of your health, your spending and lifestyle patterns are going to be dramatically different at age 85, so is it really going to be catastrophic?

Wade: That issue of spending declining with age, that’s a separate issue in some ways that we don’t necessarily want to bring into this. This issue is unrelated, even if you like to have a constant spending path throughout your entire retirement.

Todd: I agree with you. I was trying to give a real world example so that people can identify with what you’re saying.

Wade: Right, that’s the idea.

Todd: So go ahead with the annuity products and showing how that changes – because I’ve had a personal experience with a client that I’ll share. It’s fascinating how much it changes things.

Wade: The annuities that I have a lot of reasons to recommend are the single premium immediate annuities. There’s an overhead charge but you don’t really see what that is. You get the annuity payout rate. If you put $100,000 into it you’re going to get this set payout rate for life, and you see that at the time of purchase.

Todd: Just to clarify, you’re making a really important distinction here and I just want to drive it home – we are talking about single premium annuities. We are not talking about variable annuities or other elaborate products. This is the age-old annuity as traditionally was sold.

Wade: Right – this is like the life insurance of annuities. It’s the most simple, basic type of annuity product out there. The reason why there’s a lot going for them is that they protect from longevity risk. They continue with that payout for as long as someone lives, so people who unfortunately die soon end up subsidizing payments to those who live longer. You have that protection – if someone ends up living to 110, subject to the credit of the annuity provider as well as the risk that the state guarantee association cannot keep things up if the annuity provider fails, and people have different ideas about how big a risk that is, but subject to that, people have income for life. That helps to build that floor of income that makes it the safe idea. Along with pensions and social security it makes it less catastrophic if somebody runs out of financial assets because they have a bigger cushion of income to cover them in that case.

Todd: I think what’s making this an interesting retirement planning vehicle right now is that people are income-starved. So maybe explain the very nature of the way single premium annuities work so people can understand why it’s providing a higher yield than a lot of competing products they might be looking at.

Wade: The payout rate the single premium immediate annuities provide is partly the return on the principle, it’s partly interest on the bond portfolio underlying it, but then there’s also mortality credits. The basic idea is, again going back to the 4% rule. If you’re planning to ‘self-annuitize’, if you’re planning to have your financial assets last as long as you live, you have to be conservative with your assumption about how long you’re going to live. The 4% rule was initially based on the
idea of a couple at 65 years old retiring for 30 years, which is much longer than their life expectancy, so that’s a reasonable maximum length of time. That research was done in the mid-90s and now 30 years may not be enough anymore. With a 65 year old couple, there may be a 25% chance that one of them lives longer than 30 years. So somebody who’s going to ‘self-annuitize’ may have to plan for a 35 or 40 year horizon. But with annuities, the insurance provider has a large customer base and each individual doesn’t know how long they’re going to live, but there’s a distribution and when the insurance company has a large number of customers they can play on the averages. They don’t know who’s going to die next year, but they know that 2% of their clients will die next year. They don’t know who’s going to live for 40 years but they know that 5% of their clients will live for 40 years. So they can figure things out and make a payment based on somebody’s life expectancy and from that they have to make some charges to cover business expenses and turn a profit and to cover some of the risk they take if people live longer than expected and so on. But the idea is that they may be able to make a payment based on you living for 20 years, whereas if you’re trying to self-annuitize you have to withdraw from your portfolio assuming you may live for 30 or 40 years. So they’re able to pay you more than you could pay yourself because they’re able to pool that longevity risk across a large population of individuals.

Todd: I think you brought up a word that I really want to emphasize here, which is to self-annuitize. What’s happening here that I don’t think a lot of people understand is that when you plan safe withdrawal rates, you’re self-annuitizing and you’re playing the insurance company and because you’re an individual you have to play it very conservatively because you never know how long you’re going to live. It’s an actuarial reality and insurance companies have actuaries to figure this out for them, but it doesn’t work for you. I don’t think people really understand that and so I’m really glad you’re emphasizing this. Safe withdrawal rates are a process of self-annuitizing. You’re pretending to be an insurance company and you’re pretending to be an insurance actuary and that’s one of the fundamental challenges, that you can never know your longevity risk.

Wade: Right, you don’t know how long you’re going to live and there’s no way for you to hedge that risk by yourself, so the only way to do it is to plan to live for an extremely long time, which means you have to behave very conservatively.

Todd: That lowers how much you can spend and that’s why many retirees are finding that the simple, plain, vanilla annuities are an interesting planning vehicle. They provide a yield that they’re having trouble finding in the rest of their portfolio. An example I have is where a client was very concerned about how to put the pieces together and once he used a portion of his portfolio for annuities, suddenly he felt very comfortable because he could put in a base of income that he would never outlive, assuming the insurance company doesn’t go under. He bought his way up to that income level and that allowed him to manage his remaining assets in a much more aggressive fashion and be comfortable with that, recognizing that if he ran out of money he would still be okay.

Wade: That’s a different type of dynamic strategy that’s called essentials versus discretionary, or income flooring. Basically you have this fixed income for life, whether it’s inflation adjusted or not, or there could be complements of both, and that allows you to behave more aggressively with the rest of your portfolio. You can have dynamic spending from the rest of your portfolio, not taking the risk with your basic, essential needs or even your lifestyle goal. If you wish to keep pumping it up to
whatever luxurious vacations or things you might be able to do with those assets beyond what you need for your basic expenses.

**Todd:** What other topics on the income side of retirement planning have we not covered that you’d like to add to this discussion?

**Wade:** Just taking that issue a bit further, there’s the idea of the efficient frontier for retirement income developed by people like Moshe Milevsy and Peng Chen and some of their researchers had an article about it and then I did my own take on it which was throwing everything in a blender. So I was looking at a 65 year old couple and at retirement they could put some of their assets in stock, some in bonds, some in an inflation adjusted single premium immediate annuity, some in a fixed single premium immediate annuity that provides a larger immediate payout but not inflation adjustments and then some in a variable annuity with a guarantee rider, and then I looked at how all the different combinations of those perform in terms of helping to meet a spending goal in an unlucky scenario versus preserving liquidity, preserving financial assets for other potential unexpected expenses and so forth. I found that the frontier of efficient outcomes consisted of a combination of stocks and fixed single premium immediate annuities. There was not a role for bonds in the portfolio, that the safe income for life comes from the SPIA and the remainder of the upside spending and so forth comes from the stock portion.

**Todd:** That is absolutely fascinating. I’ve never found a place for bonds and the way you’ve put that together makes so much sense because the single premium annuity is providing a higher yield than the bonds can.

**Wade:** It’s sort of like a single premium immediate annuity is a super bond. There’s never the maturity date where it pays the principle back, but I guess since there’s never a maturity date it continues to provide a coupon payment for life, no matter how long that life is.

**Todd:** So recognizing that the downside on that is that when you pass that annuity is gone and there’s nothing for your heirs. So from an estate planning aspect there are other concepts involved, but simply for maximizing retirement income out of a wide variety of scenarios, the conclusion is clear. I find that absolutely fascinating – it makes complete sense as you explain it.

**Wade:** If you annuitize with the single premium immediate annuity, those assets are gone. There’s nothing to leave to heirs, but there’s the potential that the freedom and relaxing sensation of having those income needs met will allow someone can to behave more aggressively with the rest of their portfolio than they would have otherwise. On average, because stocks on average outperform bonds, they might even be able to leave a bigger inheritance than otherwise. So there’s more to the issue than just the loss of the inheritance from the amount annuitized.

**Todd:** And there’s also concepts of life insurance and we could go on and on and on. I was just trying to have a whole picture here. Anything else you want to add?

**Wade:** I think we hit a lot of the highlights there.

**Todd:** In summary here, we started out with the concept of static withdrawal rates and we worked with the assumption of 100% coming out of your portfolio, which is where most discussions end – that’s where most people begin and end the discussion. Then we took it to the next step to static
versus dynamic rates, and Wade brought in several models for you to work with. And then we said supposing we’re going to go beyond 100% out of your portfolio and brought in the idea of annuities and other sources of income and how that affects it, and then Wade’s finishing here with the concept that bonds really have no place in a portfolio once you look at all the variables that are possible. Wade, for people who want to follow up on your research and learn more about you, where can they go?

**Wade:** I try to maintain a regular blog. I have a website – [retirementresearcher.com](http://www.retirementresearcher.com) - and there’s some material there that I still haven’t got updated, so there’s going to be a link to my blog or if you just search for ‘Retirement Researcher Blog’ you’ll find my blog through Google. I try to update it regularly. So that would be the place to find me on the web.

**Todd:** So everything’s located at retirementresearcher.com. Alright, Wade, thank you very much for sharing your insights and I look forward to having you on the show again.

**Todd:** And one final concluding note to try and wrap this up and bring some perspective to today’s complex discussion. I wanted to make sure you have a context for how this fits into your overall wealth plan. One thing that might be helpful is to think of retirement planning as an onion and we need to first peel back a couple of layers of the onion to understand the information shared today.

The first layer is the entire retirement planning or wealth building process understood in two distinct phases. The first phase is asset accumulation designed to answer the question “**how much money do I need to retire?**”. The second phase is asset decumulation or “how much can I afford to spend in retirement?” One is converting income into assets, and the second is converting assets back into income.

The asset accumulation or first phase is what gets all the attention, but the other half of retirement is equally as critical to get right. I had Wade on today to discuss the various safe withdrawal rate and spending strategies for a traditional portfolio because he is the top expert in the field for doing this right with traditional portfolios, but I also wanted to close by pointing out there is more to this picture we didn’t discuss that must be mentioned for a complete overview. That’s the second layer of the onion.

In other words, not all portfolios are traditional asset allocation portfolios. For example, if you build your retirement portfolio using income producing rental real estate then none of this is applicable because you would limit your spending to the positive cash flow from the real estate.

Similarly, you could build your retirement portfolio with just dividend paying stocks and limit your spending to just the dividend income thus never touching principal and eliminating this entire discussion.

In other words, before you can go to the third layer of the onion which was today’s discussion you have to first get clear what approach you are using during the asset accumulation phase. Non-traditional approaches outside of the usual stock and bond portfolio cause different decumulation strategies than we discussed today.

Stated another way, this podcast was exclusively about spending a traditional portfolio with strategies that allow you to spend **principal as well as interest**. Today’s third layer of the onion
specifically addresses the most effective ways for managing the decumulation phase where you are spending principal from your paper asset portfolio to support lifestyle.

That’s what makes the discussion complicated because you are dealing with two unknowable risks that must be managed so you don’t run out of money. You have an unknowable life expectancy to amortize your assets over, and the second unknowable risk is you are attempting to convert an inherently volatile and unpredictable portfolio into a stable income stream. Both of these two uncertainties create inherent complication thus explaining all the various angles on today’s discussion to deal with those problems.

However, none of those problems exist with some less traditional approaches to asset accumulation at the first and second layers of the onion.

So anyway, I just wanted to take you through the layers of the decision process to help you understand how today’s information fits into your overall strategy since these ideas aren’t well understood.

You can either pursue non-traditional portfolios and avoid all this complication, or you can pursue traditional portfolios in which case you must get this stuff right to maximize your spending during the decumulation phase without running out of money before you run out of life.

I hope these insights are helpful for you. And if you are enjoying these podcasts a great way to give back is to head on over to iTunes and subscribe or leave a review. Thanks again for all your support, telling your friends, and spreading the word. The podcast is growing in popularity and it is all because of your support so thank you.

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