

CALCPA

Retirees' Investment Portfolios:
Should There Be A Difference?

May 18, 2021

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Background

- Traditionally, as individuals aged – portfolios became more conservative
- Rules of thumb...
- Is “conservative” in your clients’ best interest?
- Some thought leaders challenge this belief

Background

- 1940 – a 65 year old typically lived 12 ½ more years
- Today – a 65 year old man can expect to live 19 more years – a woman 21 ½ more years
- For a couple age 65 one of them can expect to live until age 90
- Will planning for cash flow and long term care needs to life expectancy succeed?

Investment Risk

- Risk: A term used to imply uncertainty of return and potential for financial loss
- In 1952, Dr. Harry Markowitz in paper "Portfolio Selection"
- The variance (or standard deviation) of a portfolio is used as the definition of risk.

You Can't Spend "Human Wealth" (Capitalized Labor)

- 45 years ago – Irwin Friend & Marshall E. Blume – for planning purposes capitalize labor 'til age 65
- 20 years later – Sherman D. Hanna & Hye-Kyung Lee - the amounts in "risky" investments (such as stocks) is dependent on the % of total wealth including human wealth
- Human wealth is irrelevant when earnings from labor ceases

Structuring A Retiree's Portfolio

- Consider personal, financial and estate planning goals
- Consider risk tolerance, time horizon, health, other factors
- Factor in known cash flow sources (pension, Social Security, annuity, dividends, interest, net rentals, RMDs from deferred accounts)
- Consider assets that can be converted into cash (real estate, artwork, collectibles, jewelry & other tangible and intangible assets - cryptocurrencies), AND other investable assets

Henry K. "Bud" Hebel (analyzenow.com)

- "The Retirement Myth" - Challenges notion that individuals spend less in retirement
- Uncertainties: inflation, tax rates, health, investment returns, sequence of investment returns, other
- "The elderly who have money spend it."
- Challenges fixed percentage of portfolio withdrawal rate
 - "When needed, elders alter their spending habits"
- Costs of medical care, medications, and long term care can dwarf other discretionary spending
- "It is an absolute myth that there is some way to preserve constant purchasing power throughout retirement in any place other than the theoretical world"

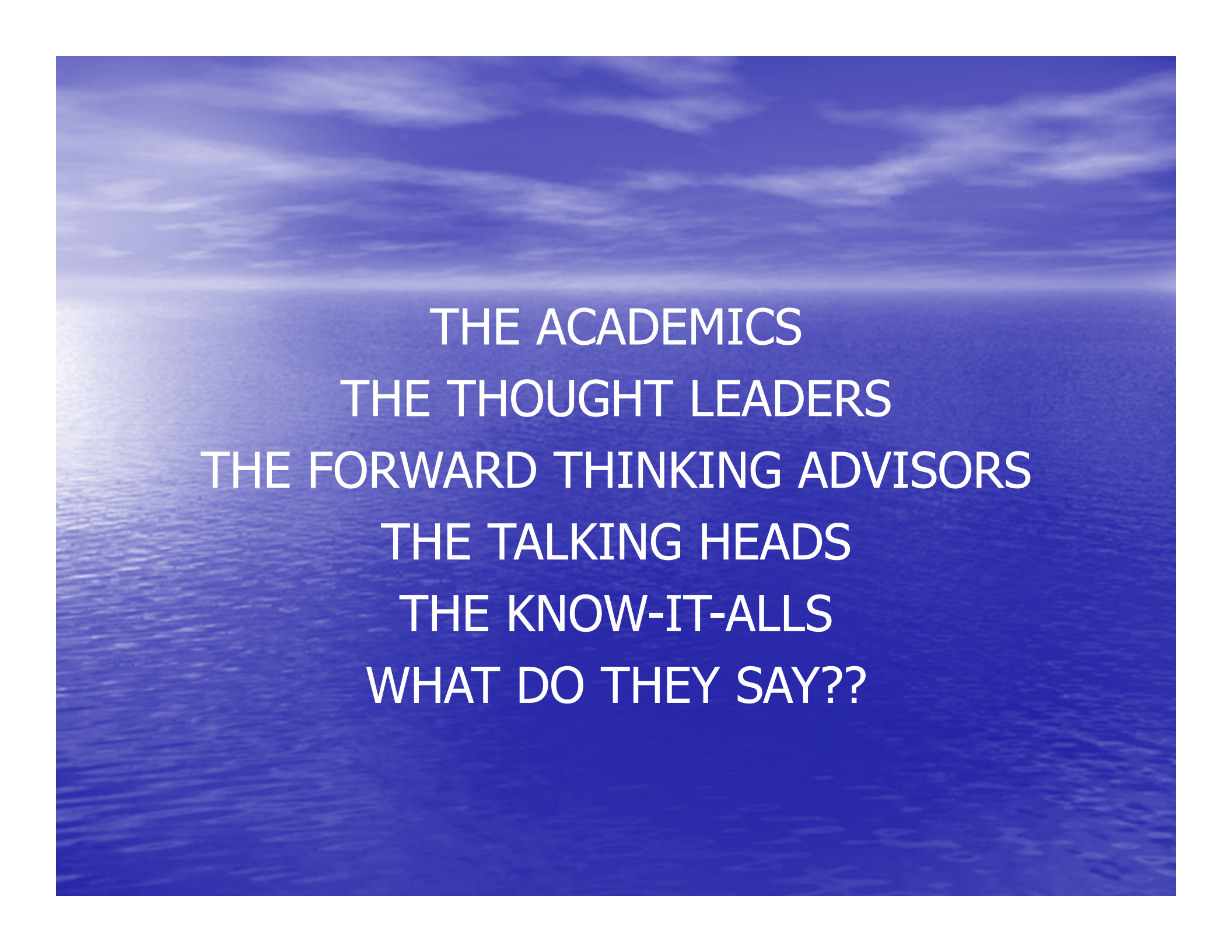
Sequence of Return Risk

“Retirees Can’t Afford to Underestimate
Sequence of Return Risk”

Kiplinger.com

January 6, 2020

<https://www.kiplinger.com/article/retirement/T037-C032-S014-retirees-can-t-overlook-sequence-of-return-risk.html>



THE ACADEMICS
THE THOUGHT LEADERS
THE FORWARD THINKING ADVISORS
THE TALKING HEADS
THE KNOW-IT-ALLS
WHAT DO THEY SAY??

Robert (Rob) D. Arnott CEO Research Affiliates

- Arnott and Andrew L. Berkin - 2015
- 1, 3, 5 years liquidity – rest 100% equities
- 140 years (1871-2011) of bond & stock returns – glide paths (traditional, 50/50, inverse)
- As many haven't saved enough they may have to stay in stocks or other forms of equity investments instead of shifting from wealth accumulation to wealth preservation - they need to accept more risk as they seek suitable returns
- Rebalancing to a static allocation better than "classic" glide path solution

Michael Kitces & Wade Pfau

2013 – “Should Equity Exposure Decrease In Retirement, Or Is A Rising Equity Glidepath Actually Better?”

Their research “proves” that an increasing equity glide path as one ages will result in improved portfolio results which will enable retirees to better meet their cash flow needs.

David Blanchett

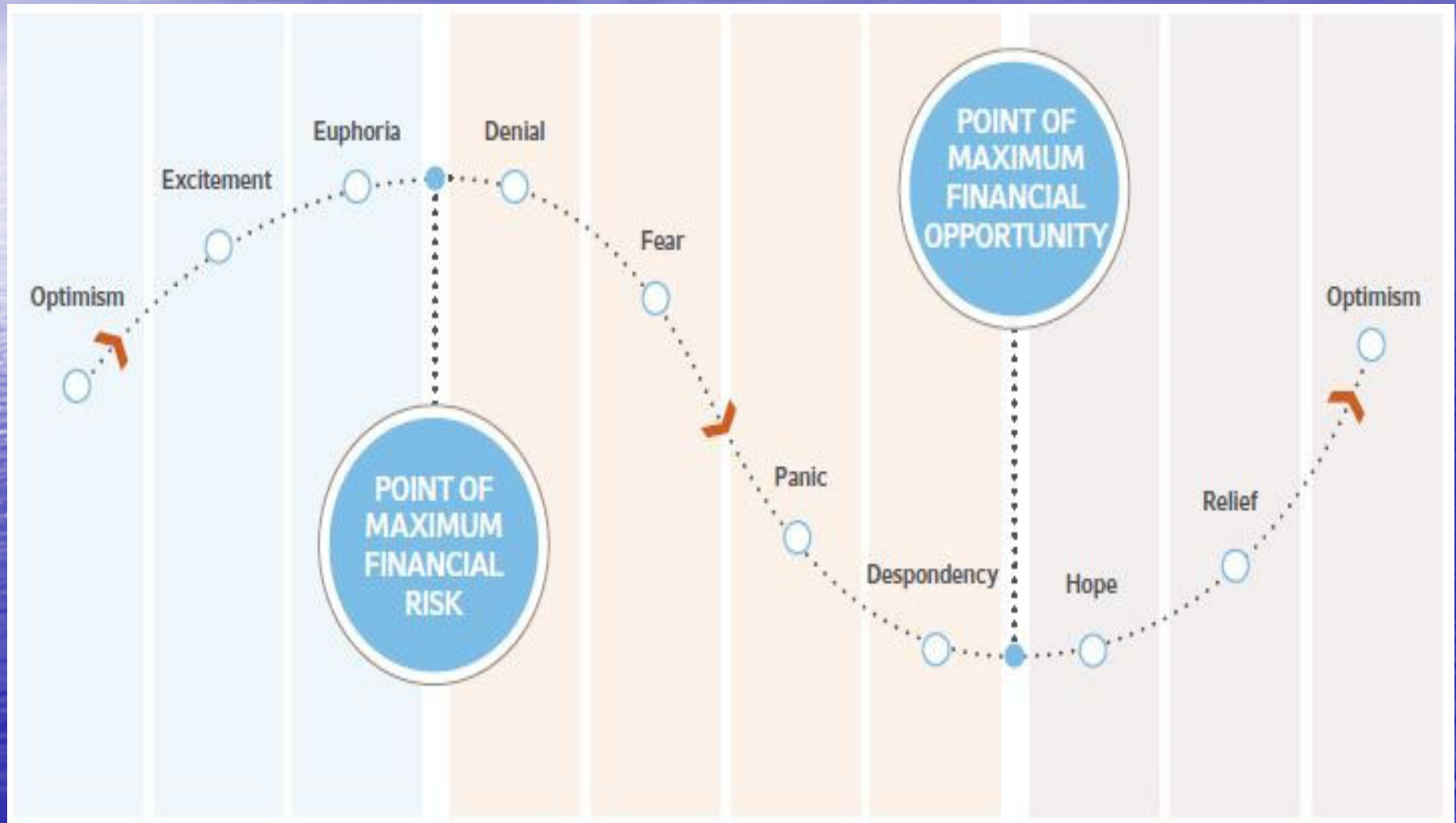
“The Best Asset Allocation for Retirees Initial Conditions and Optimal Retirement Glide Path Shape” – Advisor Perspectives 2015

- Long-term average bond & equity valuations suggest increasing equity glide path best
- Current environment models suggest a decreasing equity glide path best
- Since Great Recession continuing through the pandemic – low interest rates/high equity returns.

Warren Buffet 90/10 for Retirees

- Letter to trustee of trust for benefit of wife
- 90% Equities (S&P 500 index fund)
- 10% Short term government bonds
- He believes will outperform most portfolios
- Might not pass the fiduciary standard

The Market Cycle of Emotions



James Shambo

Lifetime Planning Concepts

How Do Emotions Impact Investment Decisions?

Study of Behavioral Finance

When I asked him if he intended to use an increasing equity glide path ala Kitces & Pfau he replied: "HELL NO!"

Altering the Traditionalists' Mind Sets

Equities may become more acceptable when elder understands the need to generate cash flow

Our portfolio recommendations:

- Immediate pay annuities and how to draw them down
- At least one year spending in cash equivalents
- Interest and dividends not reinvested to help replenish the next year's spending needs

What Should the Retiree Do?

- Research leads to disparate conclusions and opinions
- As much art as science involved
- Human behavioral responses must be factored into advice and action
- Data must be distilled into advice and counsel given to clients
- Investors must come to their own conclusions about portfolio allocation

THANK YOU FOR YOUR TIME AND
ATTENTION

DISCUSSION, QUESTIONS AND ANSWERS