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Welcome to *Above The Noise Financial Podcast* with the Parr McKnight Wealth Management Group, a team of four advisors separated by 10 years of experience bringing a multigenerational perspective to the most important. Issues in this podcast, we help families go from anxious about planning and spooked by the markets to feeling calm and in control. Join us as we share strategies to bring you clarity, confidence, and structure. It's time to challenge what you thought you knew and cut the money noise. Now onto the show.

Hello and welcome to*Above The Noise Financial* with the Parr McKnight Wealth Management Group. Today in the studio are partners Tony Parr and John Rudi. Good afternoon, gentlemen. How are you?

We're doing fantastic.

Excellent to be here.

Outstanding. Now I got some notes. You sent me some notes and right at the top. We're talking about going from paycheck to playcheck. I love that. What are we talking about today?

Well, [? Eric, ?] I've been doing this for 32 years. And it seems like when I got started, the baby boomers were saving for retirement. So they were in their accumulation phase. And now, they're either approaching retirement or they're into retirement. And one of the key things a financial advisor has to do for those clients is engineer income streams that are predictable, tax efficient, and sustainable. So retirement income planning has become something very important to our clients and as a result, we've really developed and refined some processes around helping clients go from paycheck to playcheck.

All right. That sounds fantastic. Can you tell us a little bit about your retirement income planning process? You said there's a process.

Absolutely. We really begin every conversation around a client's plan. And going into the transition from paycheck to playcheck, there's a lot of planning that happens ahead of that. We begin with looking at what we estimate the lifestyle expenses of a client to be to make sure that we have an accurate estimate of that. So we know what we need to plan for in terms of an annual stream of income. Once we have that number in place, then we really need to make sure it's sustainable and we use our planning software to do that.

But if we can assume that let's say a client needs $120,000 of income, what are the sources that will deliver it? Clients have many sources of income. It's not just from their portfolio, but Social Security will be a part of that. Often, a rental. And not all clients, but often clients actually do some work for fun in retirement as well.

Yeah. That makes sense. I mean, they don't want to fully retire or they've got some other obligations that they want to see through. How often do you see that?

To answer your question, the retirement income planning process is part of an overall planning process that we engage in with clients. So it's not just a matter of looking at their balance sheet and their income statement. We plug all that data, including goals, and values, and their vision for the future into our planning software.

And that answers an important question for clients. Given what they've accumulated and what they want from the rest of their financial lives, are they going to be OK? And there's a very simple number that comes out of our planning software. It's the probability of success. And in our software, if that number is 75 or greater, they know they're going to be OK.

But when clients are approaching retirement, that answers one of their questions. Are we going to be OK? Yes. The next question is, all right. Where does it come from? If I need $120,000 and I'm collecting Social Security, I've got rental property, I've got a private mortgage with one of my kids, I've got a pension coming in, how do I put together all those sources of income to deliver that monthly check into my mailbox that, again, is sustainable, tax efficient, and lasts a lifetime? So that's a critical part of our process and it's really an art. There's a number of things that come into play and a number of risks to that plan that we have to account for in advance as much as possible.

So what are the risks that you're talking about? Are we talking risks that just pop up or risks that we can actually account for?

Both. One of the risks that we talk about right on the front end is longevity risk and that's the risk that you run out of money before you run out of breath. And so I think the first mission is to make sure that we have enough or an idea of a withdrawal from the portfolio is sustainable over time.

Well, life expectancy is going up also, right? I think it ticked down in the last couple of years, but in general, people are living a lot longer and that's due to advances in medical technology. A lot of times, people are not working in jobs that wear their bodies out. And the kind of clients that we work with tend to be more on the wealthy side and they're able to afford the best of care. And sometimes, they're smarter about taking care of their bodies and eating right.

So clients have a number of goals and longevity is one of them. We actually have a client who's stated goal it is to live to 125. So this becomes a real planning challenge. And there's actually a gerontologist that works at the University of Cambridge. His name is Aubrey de Grey and he made the bold statement that the first person to live do 1,000 has already been born.

I'm not sure the life expectancy numbers in our plan can extend out that far, but this is going to become a challenge for planners. And one of the things that we take into account is inflation as well. Inflation is another critical risk to retirement. Things are getting more expensive. And I just take people back to the 1950s. Do you know how much it cost to send an envelope in the 1950s, Eric?

$0.07.

$0.03. And now, I think the most recent increase is up to $0.55 a stamp and that means that it's 5% per year more expensive to send a piece to postage. A gallon of milk was $0.83 cents and now it's $3.50. So the bottom line is things get more expensive over time. You have to build that into a plan.

But John, I'd like to ask you, one of the things that a lot of planners make a mistake on is they take a client's level of retirement income and they do account for inflation, but that can lead to some unneeded pressures on a plan. Do you want to talk about how we account for the different spending levels in retirement?

Yeah. It's one of the things that we talk about with clients. Many financial advisors make a mistake when they put a number in for spending and then the inflation adjusted over 30 years. That can lead to the result of having too much spending at the end of the plan and not enough at the beginning of the plan.

When people retire, they have a lot of things that because they were working, they couldn't do. They want to travel more, maybe there's a purchase like a big RV or a boat. And so a lot of times, we want to make sure that there's enough spending on the front end. And the first phase of retirement we often refer to as the go-go phase, and that's really where clients may have that extra income, that extra travel, the extra expenditures. And that might be from age 65 to 75.

And from 75 to 85, we might call that the slow-go years. And during that period, it might be a little bit less. Maybe still some travel, but just a little bit less. And then once we get beyond 85, we call those the no-go years. And we just see that a lot of those activities that come right at the beginning of retirement just trail off later in retirement.

So to be specific on that, John, if we put in $120,000 or $10,000 a month as the desired spending level, and the planning software adjusts that for a 3% rate of inflation, in 25 years, that 90-year-old is spending how much?

About $250,000.

And unless health care expenses really accelerate, I don't know too many 90-year-olds that are spending a quarter of a million dollars where they started out spending $120,000. So is it really necessary to adjust for inflation all the way through retirement or can we do some different layering of income in the planning software that we use? Maybe you can talk about that.

Yeah. So the way we layer it is we actually will take a look at what the client's necessary expenses are and we'll often take that number and we will inflation adjust it over 30 years because the cost of living does go up every single year, especially for those basic necessities.

But then we look at what is actually going to happen or what is the desired lifestyle in those phases? The go-go, the slow-go, and the no-go years. And we'll plug in an extra, let's say, from 65 to 75, an extra $25,000 a year. And then in the slow-go years, it might not be $25,000 a year. It might be 15 and so we take a step down. And then in the no-go, it just falls off and so it's just the basic expenses.

So we might put in let's say $100,000 as the base layer of spending and that goes up by 3% all the way through their life expectancy. But then you layer on an additional $25,000 in the first 10 years of retirement. And when that falls away at let's say age 75, then you layer on another layer of spending at that point. And then by the time they're 90, it's simply that first number that you put in there. So it doesn't cause clients to unnecessarily sacrifice by pressuring the plan to have them save more money than they need to or be more aggressive with their investment portfolio.

And it's just our desire to have clients have the best life that they can, but we do need to account for that spending wave, go-go, slow-go, and no-go. And I think that's a nuance that's really critical for clients and it's wonderful to be able to illustrate that for them so they can live the best life that they can given the wealth that they've accumulated.

Like you said, it takes pressure off. I would think that anybody approaching that is they're going to stop getting a paycheck from their job, or they're closing down their business, or selling their business. There's got to be a lot of anxiety. And anything you can do to curb that is obviously beneficial. What else do you do to ease that anxiety?

We meet with clients more often when they're in this transition phase because it is difficult and causes some anxiety for people when they have that last check. And then they go into retirement and they realize that now, they're going to have to live on their nest egg. And so they also have a lot of extra time when they're used to going to work on a full-time basis and now, they have a lot of time. One of the dangers is they can log on and look at their accounts and the daily swings. And so there's a lot of extra coaching that goes into the transition to retirement and I think that's a really important part of it.

John, I think another important part where you've done an especially good job with clients is you'll actually go out to their house and download their cash flows, their expenses, their spending habits onto spreadsheets and you'll bring in data from the credit card, and the bank statement, the checking account and you'll put it all together so maybe for the first time, a client sees exactly what they're spending.

And then we can have the conversation with clients about how that spending gets reconfigured in retirement so we know what a real number to put in the plan is. Because a lot of times when we first ask the client how, much do you think you're going to need when you retire, it's an outright guess and we want to make sure we nail that number with a high degree of specificity. So doing your downloads and your spreadsheets, I've seen clients go through that with you and that's just a wonderful service to offer.

One of the things I think clients get from that is they understand where their money is going and they can see pretty clearly what is a necessary expense and what, if things were to turn, whether in one's own life, a health care event or something like that, some of the spending that could be redirected in other areas as well. So I think knowing where your money is going is important because it allows us to know what could be redirected.

So John, I have a question for you. A lot of clients come in and say, does that 4% draw rate still matter? Is it still real? Is that something we can count on? And I think about this because let's say, 30 years ago, interest rates were a lot higher. You could get a lot more on CDs and bonds that you do now. We've had a 10 year bull market in stocks. Stocks have basically gone up straight for 10 years with a few hiccups along the way. If a client retires with $10 million, can they spend $400,000 a year just pulling that from the portfolio?

I hate to say, it depends. The 4% rule is just that. It's a rule of thumb. And so we take a more specific and tailored approach to how much can you take from your portfolio? There are instances where the initial draw rate on the portfolio are higher and where they are lower. And where we coordinate a higher withdrawal with a Social Security claiming strategy or with the Roth conversion or other things, we have to make an individual plan. But I think that rule is still relatively valid for someone who is turning into retirement in their mid-60s if the goal is not to run out of money.

But if when you account for other factors such as, how much do you want to leave to the next generation or as a legacy to the charities or causes that are most important? Or what sort of net worth do you want to maintain in retirement? Or let's say you want to increase your net worth in retirement. If that's the case, then we really need to consider a lower withdrawal rate for that particular client.

That's a very well said. I think about client goals. And for a lot of them, they want to spend their last dollar with their last breath and get all that they can out of their capital. Others have more conservative strategies where they want that big cushion at the end either to give to their kids, their family, or philanthropy.

And it's kind of like the tale of two clients. I remember meeting with a client both of these long ago. We were talking about that final number. What do you want your final balance sheet to look like? And he said, when my dad passed away, all he left me was his class ring and his tackle box. He said my wife and I were going to enjoy our lifestyle. And as far as the kids, we gave birth to them, we raised them, we helped them with houses, and cars, and education. And their goal was not to leave a big pot of gold at the end of their rainbow.

And then we met with another client who had two adult daughters that had gone through a couple of rough marriages and they actually said that they would be willing to compromise their lifestyle in retirement so they could have a large amount of money to leave to their daughters so they would not, I'll never forget the phrase, so they would never be beholden to another man. So it's all about personal preference, and life experience, and making sure we manage those numbers well in the plan and we ask those important discovery questions to really understand our client's DNA when it comes to their families and their values.

Tony, how does your team deal with taxes as far as the impact on retirement income planning? Because you hear about the death tax, you hear about estate tax. There's always taxes, right? How does your team handle that for your folks?

I think it's important for clients to understand that they don't have to pay. They can manage their tax strategy. And it's not about what you make. It's about what you keep. And John is the real expert around taxes, so I'd like to prompt him by saying, John, tell me about buckets and brackets.

Clients, when they have a portfolio, that portfolio can live in different accounts with different tax statuses. One tax status is tax-deferred accounts. These are accounts where clients generally put money in and get a current tax deduction while they're working for it.

On the flip side in retirement when they take money out of a tax-deferred account, every dollar that they take out is a dollar that is added to their income tax return at ordinary income tax rates. Another tax bucket is taxable accounts and those are funded with after tax dollars and row. And as they grow, any realized gains, interest, dividends are taxed in the year they received. So it's not tax-deferred. It's taxed in the year it's received.

And then there are most people's favorite account, which is a tax exempt account. And that's where once it's in there, and it's funded with after-tax dollars, once it's in there, it grows income tax-deferred and comes out income tax free. So depending upon the mix of those accounts on a client's balance sheet, we can engineer an income where we stay within a certain tax bracket.

And we're not tax advisors. We don't give tax advice, but we work really closely with clients' other advisors, a CPA, a tax attorney, to make sure that we are generating and pulling from the right tax bucket to make sure that the client's income lands where it's best for the client.

And John, we're not tax advisors, but you do look at the brackets that clients are in. And if they're near the bottom of an income tax bracket, you might recommend a retirement account strategy. Could you go into that just a little bit?

The lowest two tax rates in the ordinary income tax schedule or 10% and 12%. And so the cheapest you can get money out of an IRA is in the 0%, 10% or 12% brackets. And so we never want to miss an opportunity to get money out of a retirement account at a low tax bracket. And so if I notice that a client's income could be low, then I suggest they explore a strategy to take some money out of their individual retirement accounts with their tax advisor.

John, let's talk a little bit about another threat to retirees. And I remember a prospective client came in our office, I think it was 2009 and it was after the big financial debacle and big decline in 2008 and early 2009, he had retired in 2007 and the previous advisor had them way too exposed to equities.

So I think two strategies that we should share is asset allocation and building a moat. I call it Noah's Ark money. So when people go into retirement, they really should have between 12 and 24 months worth of spendable income in very liquid short-term investments and that's so if we have one of these major dislocations in the market, they have spendable assets available where they don't have to pull from a portfolio that's down.

So John, you've done the math on this. And if we've got a traditional balanced portfolio, let's just say it's 60% in the stock market and 40% in the bond market, typically, when stocks go down, people run to the safety of bonds. So oftentimes in environments like that, bonds pay their income and they go up in value. So in a 20% market decline if you're in a balanced portfolio, what might that look like?

You might be down anywhere between 10% and 12% in a market correction of 20%. If 60% of your holdings are in the market, the stock market, and it declines by 20%, 60% of 20% is about 12%. The good news is we have 40% of our money in high quality bonds, cash, and other fixed income vehicles that often do well in that type of environment. So 10% to 12% is what I would say.

And if they both should go down at the same time, that rule about having 12 to 24 months of dependable cash in money markets, or CDs, or short-term, very, very safe things, that comes into play as well. And that helps ease anxiety about going into retirement. Knowing that you've got that cash available.

And the point there is not to earn the highest rate of return. It's just to keep it liquid, and safe, and available in the event of a market disruption. John, can you talk a little bit about the strategy of interest and dividends, but then we often promote a draw rate with clients. Talk about the difference in those.

So when we look at a client's portfolio and we list out their accounts, the areas where we can source income from, we take a look at what the investment strategies deliver in terms of an interest income stream or a dividend income stream. And oftentimes if it's 2% or 3%, we can deliver that income to the client.

But we often want to look at the gains in the portfolio as well and deliver more than just the interest in the dividends. And that's where we get into a draw rate, which is taking a little bit more than the income that's derived from the portfolio. Usually, hopefully, its gains. So that's what we refer to as a draw strategy.

And if long-term, 2 and 1/2 percent of year of your gains come from interest and dividends and 3% or 4% come from principal appreciation, we really should source some of the client's income from appreciation as well as from the dividends and interest generated by the portfolio.

So one of the things that we account for when we're looking at retirement and income planning is Social Security claiming strategies. And I think that topic deserves its own podcast. And at the same time, I can say that it is important. It becomes really important to look at maximizing Social Security if it's going to make up a large portion of your retirement income.

If it's going to be 40%, 50%, 60% of what you're living on in retirement, it really makes sense to delay taking Social Security by a long shot. On the other side of it, if it's not going to be a huge proportion of your income, then we want to maximize it, but we don't want to necessarily take the risk of delaying Social Security and then not living long enough to capture all the benefits and then to be better off on the other side of it.

And so when we look at Social Security claiming strategies, we look at the client's health because that's an important factor, we look at the client's portfolio, we look at what proportion of their income is going to be made up by Social Security, we also look at their family status. Are there any children in the situation? We look at their taxes. We look at we want to coordinate all these strategies together and Social Security can have a huge impact on that. So that's just a little taste, but I think we'll have to do a podcast on that entire topic.

You guys have a ton of information on this podcast alone about the different steps and different ways you work with your clients during this income planning process. How long does this take normally?

I would say it's always a work in progress. I would say on the front end, there is a lot of education. We come up in formalized recommendations for clients and then we have to monitor and adjust over time. How long does it take? I mean, how long does it take the client? I mean, our meetings are about two hours. And we would cover it within a normal meeting.

Right. I think you make a good point, John. If a new client is coming on board, it's how quickly can they get us all their information? How quickly can we put that all into a plan, generate the recommendations? But if it's an existing client, we're just simply tweaking things along the way.

And our software allows us to monitor spending. So if they tell us that they're going to spend $120,000 a year, we have red flags that go up if it's $175,000 or $200,000 and it's not sustainable. So that's our job, too, is to hold our clients' feet to the fire of accountability.

Right.

Yeah. And that can't be easy. I'm sure that you guys have many, many years of practice of helping them to understand why. So if there is somebody listening to this podcast right now and they're saying, I would like to start this conversation. I just don't know how. Obviously, we'd like them to start it with you. How do they reach you and what's their next step?

I would visit our website, parrmcknightwealthmanagementgroup.com or the acronym, [? parrmcknightwmg.com. ?] And our contact information is on there and I would reach out to us via email or phone call. And feel free to set up a time to talk with us.

Fantastic. Any closing thoughts today?

Oh. I think it's just gratifying to be in this business and help people reach that work optional part of life where they can do what they want and when they want. When I got started 32 years ago, might have been about retiring to Sun City, Arizona playing goff three times a week, and cribbage, and all that.

Now people have different lifestyles during retirement and it's just about having that sense of financial independence and then having a good solid plan behind that. And again, it's about having that sustainable, predictable, tax efficient stream of income that allows them to do what they want to do when they want to do it.

Fantastic. I love cribbage, but I don't want that to be the only thing I get to do in retirement. So right there. Tony and John, thank you so much. This was a great podcast today. And thank you all for listening to *Above The Noise Financial Podcast* with the Parr McKnight Wealth Management Group. If you have not subscribe to the podcast yet, please click the Subscribe Now button below this way when they come out with a new podcast, it'll show up directly on your listening device. This makes it much easier to share these podcasts with your friends and family. Again, thanks for listening today. For everyone at the Parr McKnight Wealth Management Group, this is [? Eric ?] [? Johnson ?] reminding you to live your best day every day and we'll see you next time.

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