KEEN ON
RETIREMENT

How a Solid Spending Plan Keeps Enough Fuel in the Tank for Your Retirement

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski:	Hey everybody, welcome back to Keen on Retirements. I'm your co-host Steve Sanduski, and this is the podcast where we talk about how you can thrive before and during your retirement years. And I'm here with Bill Keen and Matt Wilson. Hey guys, how are things today?
Bill Keen:	We're doing good here, Steve, how are you doing today? It's been raining all weekend here, and now we start to see some blue sky up there so we're very grateful.
Steve Sanduski:	Yeah, well, it's definitely wet and cold here, and we've got the camera going here, so we can see each other. You said I've got my rugged look on today, so I've got a sweater and a long sleeve shirt, and it's kind of like winter up here.
Bill Keen:	Well I think I'd like to go back out to California where we were a few weeks ago, don't you, Steve?
Steve Sanduski:	I was just talking to my daughter last night out in Charlotte, North Carolina. They were in the mid-eighties, so it's summer time. Well hey guys, we are gonna talk about, would you deliberately take off knowing you will run out of fuel?
Bill Keen:	Now that sounds interesting, doesn't it?
Steve Sanduski:	That sounds like a title you came up with Bill.
Bill Keen:	Oh really? Why would you say that? (laughs)
Steve Sanduski:	(laughs) Because I know how much you love to fly, so I came prepared today. I've got a couple of trivia questions here about flying to get us started here before we jump into the topic about spending patterns and habits and safe

withdrawal rates, and dealing with clients who are trying to make sure they are in alignment with their spending patterns and their income.

Bill Keen: Hopefully, I'm well prepared, I make a good showing here on your aviation related questions

Steve Sanduski: Okay, well here's the first one. When you are sitting in a commercial airplane, you're sitting next to the window, you may have noticed that there are often times is a little dinky hole in the window. The question is, why do airplane windows have a dinky little hole in them?

Bill Keen: So the first thing that I thought when you said that was, I thought you said that the windows themselves were a little dinky.

Steve Sanduski: Well they are that too (laughs)

Matt Wilson: Yep.

Bill Keen: Okay well so there's a hole, a tiny little hole in the airplane windows. Matt would you like to try this sir?

Matt Wilson: A tiny hole in the windows, and I'm guessing it's not a manufacturer's defect if it's in all the windows. I would have to say, it's makes me think something having to do with the cabin pressure, but I don't know specifically what it would be for.

Steve Sanduski: There you go, you got that one right.

Bill Keen: Well done Matt, you actually saved me there because I was going to come out of the chutes probably with not a lot of answer on that first question.

Matt Wilson: Yeah, that was kind of a shot in the dark there.

Steve Sanduski: Yeah, so the hole is necessary to regulate cabin pressure because airplane windows are made up of multiple panels, so the hole helps the middle panel from becoming stressed with pressure during flight. All right here's another good one. What are the white trails that planes leave in the sky?

Matt Wilson: There's some conspiracy theories on this.

Bill Keen: Right, right.

Matt Wilson: We won't go into that. Gosh, my guess is it has something to do with the fuel they're burning off, but I don't know the science behind it.

Bill Keen: That's called a contrail, Steve. That is a ... thank you, thank you.

Steve Sanduski: All right, excellent.

Bill Keen: And you might actually notice that that's not directly behind the airplane, there's always a gap between the contrail and where the airplane is actually located. You didn't get me on that one.

Thank you very much.

Steve Sanduski: Awesome.

Bill Keen: Very good. Sure our listeners are excited about our games, but hey they are interesting.

Steve Sanduski: Well great, well Bill why don't you introduce our topic today, I know this is another important episode that we want to talk about with the spending patterns and habits.

Bill Keen: In the past, we've talked about our financial planning process because the financial planning process is where everything starts.

So one of the inputs to the financial plan is, how much do we need now to live on, to thrive, to prosper? How much do we need to pay our bills to really cover the basics? And then what do need to have a good time? To have margin in our plan?

And so we wanted to devote an entire episode to that today to give our listeners some perspective and for the many clients that we have that listen to our episodes, they've been through this process multiple times with us, but it's always good to revisit a spending plan, what makes sense, and share with our listeners just some of our experience about all aspects to this as we move forward.

Steve, I wanted to ask you something, you mentioned it earlier. But if I was coming from Milwaukee down to Kansas City, and you were going to board the plane with me, which you've agreed to do at some point here in the near future, and I told you that I did the pre-flight, but I didn't worry about the fuel in the airplane this time. I was just going to guess this time on it, would you feel comfortable with that?

Steve Sanduski: I'd say you're flying solo Bill

Bill Keen: Okay, well when we're doing flight planning, one of the key things pre-flight work and flight planning, one of the most important things is to make sure we have the fuel covered for the trip. Of course, it seems just obvious, and in aviation as well we have fuel minimums that are required, reserve requirements that are based on when we're flying, what time of day, whether we are VFR or IFR flying into clouds, how much we have to have left in minutes of fuel when we get to our destination and then even alternate destinations in case our airport that we're headed to happens to be closed for some reason.

Just like that is the financial plan and I think about a pool of assets that someone has, a life expectancy, the spending that needs to happen. And the question is, do we have enough resources to get to our destination? Or are we just hoping that we get up in the air, and that we catch that tail wind that may or may not be there, and we make it to our destination by happen stance luck or by chance? I'll tell you, just lime flying across the country, and making sure we have prepped for our fuel, we want to make sure people have prepped appropriately for their spending in retirement. So one of the places that we start with this, is where "experts" say are safe withdrawal levels. A gentleman by the name of William Bengen, was the first to bring this out. And he says that a diversified portfolio, with a 4% withdrawal rate, so if you think about a million dollars, putting this in perspective, that would be $40,000 a year coming off that million dollars, to live on. And in his case, the research that he had done, he had determined that that was a "safe" withdrawal rate, assuming that you increase that $40,000 per year over the course of a 30 year life expectancy for inflation. And he said in nearly every scenario, someone taking 4% out, there still would have been money at the end of the 30 years. What we've determined is that folks don't, one, that they don't just spend in a straight line. So they don't start out spending one amount in their life, and continue that same spending path for the rest of their life. There are fits and starts, and increases and decreases around their spending that we, in reality, need to plan for.

Matt Wilson: Yeah, its interesting, you know, that research that you've got, it was 4% a year adjusted for inflation for the net 30 years, so that plan is assuming is that you are increasing your spending year over year, and its compounding over time. And what we found, is that spending over time tends to be either flat, or actually goes down. So there's more up front, but then in the later years in life, spending actually decreases. And so that's a much different outcome than the compounding of the 4% a year that Mr. Bengen described.

Bill Keen: Yeah, so could you imagine Steve, you retire and let’s say you're in your sixties ... you're not going to retire anytime soon on us are you Steve?

Steve Sanduski: Not planning on it

Bill Keen: Okay, all right good.

Steve Sanduski: Neither is my wife

Matt Wilson: Okay, podcasting isn't a very stressful job.

Bill Keen: We're getting good reviews with your help here, so ...

Steve Sanduski: Like golf, I can podcast well into my seventies.

Bill Keen: Perfect, so all right, can you imagine retiring, lets say in your sixties, and you are moving around more, you're active, you're traveling, you're doing things, you're checking off items on the bucket list so to speak and it cost money. And so naturally you think, "I will spend more at that point in my life", and when I get out to my early eighties, the odds are you'll probably be spending less and its not because you have to, it's by design and by desire to be closer to home, to be less active, we do see, and plan for it at least at the end of life. So typically the last three to five years, possibly a long term care expense kicking up, really to a point where you have to make some plans and considerations for it.

Matt Wilson: Yeah, JP Morgan, so they came out with some data, they looked and analyzed their customers of the bank, their credit card, debit card, so their kind of banking and financial patterns, and they have some numbers. Now I have not seen this in practice, this dramatic, but that spending decreases by about 30% from somebody in their sixties to when they reach their early eighties.

That's data that they've got based on a long swath of customers to support that. I see people not necessarily decreasing it that significantly, but what I find is that the compounding of the inflation adjustment, which we plan, it’s not as significant or as necessary on an annual basis, people aren't taking those.

Bill Keen: To Matt's point, if you have a 1 or 2% inflation rate actually in your spending, as opposed to a 3% inflation rate, that dramatically changes the probability of success of a plan. Again we always like to plan conservatively, but we are just sharing today what we've experienced in the real world. I've been at this for 25 years, and I've gotten to see plenty of folks retire and literally get used to and settle in to a spending level, and it might be because of the nature of our client base, we deal with a lot of engineers, we deal with a lot of people who have lived within their means for their lifetime, so they get settled into a spending pattern and they are not calling in to us asking for their inflation adjustment every year. It could be partly that.

Matt Wilson: Yeah certain expenses tend to go down. We see insurance premiums, not health insurance, but life insurance premiums, disability insurance, automobile insurance, those become less and less of a cost as you age.

Bill Keen: Travel

Matt Wilson: Transportation, that's right, I mean travel. You're probably not going on as many trips, and depending on where your kids are located, that factors in. Even transportation where families will transition from two cars down to one. So you save a lot of money on that.

Bill Keen: I think it’s important though, that we talk about folks that start out with this in mind, start out wanting to spend more up front, than they know is sustainable.

So when folks get to us, and they get to this point where they are going to be spending, the red light starts to go off in our minds when they get above a 5% withdrawal rate, and they want to sustain that for too long because we know that if we buy a 10 year Treasury today, what's it pay now, 2 1/2% still for a 10 year Treasury?

Matt Wilson: Yeah, or maybe even less. 2.3 I think

Bill Keen: And the bank CDs are still at 1% or so. So almost, its a non-choice choice to have a diversified portfolio, fixed income and equities in a retirement account to make sure that money lasts for 30 plus years. And in that scenario there is volatility, and so when someone is looking to spend more than about 5% of the total, we start to say, "Okay how long do we have to do that for, and is this going to be sustainable and does the clients understand that at some point there may need to be an adjustment downward?"

One thing that we see, if someone is pre-62, before Social Security has kicked in, and maybe their decision is to not take Social Security until later, but 62 is the earliest, and they make a conscious decision through planning to spend down their assets before Social Security kicks in, and maybe they're spending 6, 8, 10% of their asset base for a few years only as a bridge, and then when Social Security kicks in, the plan is to reduce their spending by what Social Security is. And then they get out some Medicare of course, and hopefully premiums are a little bit lower than the self insurance that has to happen on the Exchange is too pre-Medicare.

But where we see people get in trouble is when we've made that plan and then Social Security kicks in, and they don't reduce their spending.

Steve Sanduski: Surprise, surprise.

Bill Keen: That's right, that's right. This could be a big deal, can't it Matt? I mean it's significant.

Matt Wilson: It is. I mean especially that's why we do so much work up front on those plans about, ok, we're going to structure this spending in such a way that it will come out of the assets first, your asset base, and then when Social Security kicks in, heres what's going to be reduced by on the asset spending, which in some cases allows it to grow again because now we got the distribution need in an acceptable range as a percentage of the total. But in the cases where those spending amounts, the percentage of the total gets up high, as Bill mentioned, the volatility of the investment has such a huge impact in someone's result. If that person started, and you know hindsight's always 20/20, and we knew they started at the best time possible, it might of worked.

But considering that we don't know the future, and we don't know what's going to happen, its why we talk about that 4% withdrawal rate as a back of the napkin, and then putting in a real plan that does adjust for things happening, we've done this in many cases where we show structured spending throughout the life of the plan, so it's a base spending amount plus additional spending for travel, or for a charitable contribution, or gifts to grandkids. But those are structured, additional expenses that have a finite period to them, and we can list them as not necessarily needs, where we have to have them, but we can list them as what we call "wants and wishes", and we can talk about, "Hey if we hit a rough patch, we might have to talk about adjusting some of these outside of the base spending items so that we make sure your base spending is covered".

And people could really relate to that.

Steve Sanduski: Well guys, I've got a question here. So we've been talking about how much income a client can pull from their assets and retirement. What about the sequence of returns on their portfolio? For example, lets say someone retires on July 1, and over the course of the next 12 months, the financial markets drop 20%, okay? So that's kind of one scenario, so at the start of their retirement, the market takes a drop. And then the next scenario would be, 15 years into retirement the market takes the drop. How do you deal with that sequence of returns and the impact on how much money they could withdraw?

Matt Wilson: We deal with a lot of smart people, and many of them come in with a spreadsheet already pre-planned out for the next 30 years, and its based on an average return, lets say its 6, 7% and they say "Okay I'm going to make 6% of my investments, and spend 4%." Well we've seen these spreadsheets and they work indefinitely because you're making more than your spending every year. And its a linear rate of return.

And the reality is we know, returns don't come in that order. They come in some sort of volatility around them, and depending on the type of investment determines how volatile it is. So we got to have an investment strategy, that can account for that. We like to set aside a specific number of years for someone's income needs, so that when we do hit those volatile periods, we don't have to sell investments at a bad time, we'll live off the more conservative piece, or the more stable piece, during the volatile times. And when markets are up, when those investments rebound, then we can replenish and start doing a systematic withdrawal out of that basket too.

Bill Keen: So there's a couple of things you have to do. When you're taking money out of a portfolio, to Matt's point, you've got to have money outside the market so you don't, won't do one of two things: get caught short, need money back at a bad time or 2. Have an emotional reaction to what you are experiencing in the markets, what you're seeing on the statements and what you're seeing on the news for that fact.

So its so important to think these things through first, so that both spouses if there's a married couple, are on the same page, they understand what they're doing and why, and they're able to increase the odds of getting through it, not just hoping that we get a tailwind at some point and it gets us to our destination, but truly having a plan in place.

Steve Sanduski: Bill and Matt, you guys both know, hope is not a strategy.

Bill Keen: (Laughs)

Matt Wilson: That is right.

Bill Keen: Hope is not a strategy, and I said this, I think last episode but this is apropos for this one, we can't wing this stuff guys.

Matt Wilson: (Laughs)

Steve Sanduski: (Laughs)

Bill Keen: But it's true, we can't wing it. There's no reason to. That's the reality of it, there's just no reason to because you can get out ahead of these things and think through them. Matt, I wanted to throw one more thing here at Steve too, and that's the person who comes into the firm, and says "Guys I hear what you're saying, and I've Googled it, safe withdraw rates on Google, and I see what they're saying, they're saying 4%, 5% maybe in some cases, but I want to spend 10% of the total, and I want to do it in perpetuity because I see the markets have returned 10-11% a year for the last 100 years, why can't I spend 10% of my total? If the market makes 10%, why can't I spend 10?"

"What are you guys talking about 4 or 5% a year withdraws? Why shouldn't I ... I should be able to spend 10. And you guys should be able to, if you are good investment managers, just make more money for me. Be more aggressive. What do you have to say about that?

Matt Wilson: Yeah that's right.

Bill Keen: Oh Steve, were you going to ask us to do that for you?

Steve Sanduski: (laughs)

Bill Keen: Well there's a problem with that, isn't there?

Matt Wilson: I could see the logic where someone would come to that conclusion, they'd say "The markets have returned this, and I should be able to spend pretty close to what the markets have returned", essentially living on the gain every year. But just to what we talked about with the order of returns, it's the same concept, the volatility of that return, it doesn't come in a straight line. So when you're invested more aggressively, you have actually increased the odds of something bad happening. It's almost counter intuitive, you would think "Hey if I am going to be more aggressive, I'm going to have more money to spend later". But if you need money now, and you need to generate income out of that, which might be a combination of dividends and interests, but then you might have to sell some of the investment for, to live on it, that's what we call 'counting on capital appreciation'. And in some years when the market's down, now you're selling more shares, if you're more aggressive, you're selling more shares to generate the same amount of income. So that, those shares aren't there to rebound.

Bill Keen: That's right. And I look at this and I say contingency fuel, this is what we call it when you're designing a flight plan and it says, "Which shall be the amount of fuel required to compensate for unforeseen factors." And we apply that same concept here, what happens if we go through another '01-'02? What happens if we go through another '08-'09? So you hear Matt and I talk in our episodes, and we believe in the US, we believe in the power of the great companies here in and around the world and the wealth that can be created and harvested from these accounts, not only from people starting out, but people that are in retirement that need to have growth in their portfolios for some position.

But we have always have a contingency plan for the times where we go through things like the '01'02, '08-'09, and not be forced to sell things at a bad time. And that then precludes us from having someone invested past the point where they have five to ten years or so of their income needs set aside, including the dividends and interest that come in as well. We just can't, and we won't! Here at our firm, we wouldn't accept an account like that if someone asked us to do it. Because it's not a matter of if, but when that situation blows up. The next deep market correction we see if someone's pulling out 8 to 10% of the total or more, and we go through a substantial correction and they're mostly equities, that account will go down, the withdrawals will continue, to Matt's point, it will never rebound.

Matt Wilson: Yeah, it's such a big deal and here's the kicker to that too. We know we are going to go through a market corrections, there's going to be recessions, and we are all going to experience the business cycle here and so, we can actually, if we have enough set aside, we use those funds, not a lot of it but a little of it, actually to buy things with. We can take advantage of those pullbacks and those corrections and use them as opportunities where we rebalance.

Steve Sanduski: So guys, if I had to summarize what you've talked about here today, I's say that first we need to come up with a withdrawal rate that makes sense, historically some of the data shows maybe 4% is a good number, maybe 3 1/2, maybe 4 1/2, but it has to be personalized to that client based on what their savings is, and what they plan on spending and how they want to live. Second would be, we need to have a contingency plan, so just like on a flight, you need to make sure that you've got enough fuel in there to account for the fact that there might be some bad weather, you may have to circle around for a while before you can land, you may have to land at a different airport so you want some extra fuel in the tank there to make sure you don't run out in case something happens unexpected.

Third would be, you want to be able to get small if necessary and live on less than what you were planning on living. Again in case there was some type of unexpected situation. Fourth would be that some people live well below their means and could actually spend more. And sometimes they just need someone to say, "Hey you're doing great, you've got plenty, you got plenty of contingencies, so if you want to take a big family trip, or you want to do something that would be, gosh wouldn't that be awesome? You've got the money to do that, and your financial advisor can let you know we've run the numbers, you're in pretty good shape so by all means go do that.".

So there's four things, anything else that I may have missed that you want to add here to the summary for today's program?

Bill Keen: You know Steve, in most cases, number four is the reality of what we're dealing. Its most people have lived within their means over a lifetime, and they understand the power of process and planning and this spending concept we talked about today. And its us helping them find the balance, like we said earlier.

There are many things that come in and out of play over the course of a lifetime, things we can't even plan for today. New grandchildren, many things that happen, maybe someone finds a passion late in life that he calls a lot of their attention, or they find a charity or something close to their heart. So its one of these things, I've said it early and we continue to say it, the client in the situation has got to be nimble, and then a good a quality fiduciary financial advisory firm that sits across the table and has a personal relationship, have got to be able to be nimble with these clients as well.

Hopefully we've given you a few things today to think about if you're considering retirement, or if you're in retirement, and you have a spending plan in place, or even you don't have a spending plan in place, to kind of say "I'm going to get off the sidelines and stop listening, and I'm going to take some action and get something in place to make sure I'm secure and my family is taken care of."

Steve Sanduski: Excellent, that's a great group of clients at Keen Wealth Advisors, that are living below their means. I mean that's ideal, and just shows that the folks that you are working with are really thoughtful and conscious about how they earn their money and how they spend their money and how they save their money. So that's just fantastic.

So hey guys, great show. Thanks for taking the time and sharing your wisdom here, and we'll look forward to getting together on the next episode.

Bill Keen: All right, thank you Steve. Thanks Matt.

Matt Wilson: Thank you.