KEEN ON
RETIREMENT

Should Your Investments Be More Conservative After a 10-Year Bull Market?

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski: Hello, everybody. Welcome back to another episode of Keen On Retirement, I'm your co-host Steve Sanduski. With me today are Bill Keen and Matt Wilson. Guys, how are you doing today?

Bill Keen: We're doing good here, Steve, how about you?

Steve Sanduski: Doing fantastic. Always looking forward to these days when we get together and have a conversation here on the podcast. So Bill, why don't we start with, I know you recently were appointed to a board, and you are now on the board of Angel Flight Central, so I'd love to hear some more about what that is and what the organization does.

Bill Keen: Thanks for asking about that. Angel Flight Central is just an amazing organization and as we talked in prior episodes and anyone who's listened to me or knows me knows that aviation is a part of my life and a part of our business life as well. But it's a nonprofit dedicated to arranging free, non-emergency long distance air transportation for children and adults that are in situations that are truly compelling human need.

Bill Keen: There's many times where a patient will need to get to either a specialist, or to seek treatment of some kind, and it just doesn't make sense for them, or they can't do the extensive equipment, or just a physical limitation of getting on a commercial airliner would preclude them from being able to meet with their specialist or get the attention they need, or a 10-hour or 12-hour car ride just wouldn't work either.

Bill Keen: So, Angel Flight Central has rallied pilots to donate their time, and donate their airplanes, Steve, to be able to respond when folks in need need to get somewhere. Thank you for asking about that. It allows me to get the word out about the organization, because the objective right now for the organization is to let folks know it's available. These services are available for folks in need.

Steve Sanduski: Then, if someone did have a need, is it based on, they have a financial need as well? Is there any financial limitations or requirements for someone to use the Angel Flight service? And then also if someone wants to utilize this service, what is the process that they go through to actually use the service?

Bill Keen: Part of it could be a financial need, but the other part of it could simply be they're just not able to get somewhere, on the traditional means, by driving or commercially. So we want to be available for them in those capacities. One of the things I might drive our listeners to here is AngelFlightCentral.com is the website, and on there, there's a passenger FAQ, and ways to apply or submit a request. You can either call or you can submit a request right online there.

Bill Keen: A lot of people also ask Steve what does it cost? The cost of an Angel flight is a thank you to the pilot who provides his or her time, skill, and cost of transportation. The help and hope delivered we say is often priceless.

Steve Sanduski: Exactly, yeah. Well, great. Yeah, I'm glad that we're able to share that message and thank you Bill for you and all your colleagues that have planes that are volunteering your services and skills to help these folks in need. Just a tremendous service that you guys are providing and the organization itself. So, what was that website, AngelFlight.org? Is that what the web address was?

Bill Keen: It's AngelFlightCentral.org. More can be learned on that website, sir. So that's a great place to refer folks.

Steve Sanduski: Great. Great. Thank you for sharing that. On our episode today we are going to go through some listener questions. So we always love to hear from the folks that are listening to the podcast, and if you do have any questions, please just go ahead and go to Keenonretirement.com and you can go there and shoot us an email, and we're always happy to hear that. So we got a few that we want to go through today. So you want to just jump into those?

Bill Keen: It's been a while since we've done a listener questions, and we do get these coming in, and it's kind of where the rubber meets the road with this. Some syndicated radio shows all they ever do is basically take call in questions and we like to mix it up with guests and other topics, but I think we do need to do, I think it makes a lot of sense to have listener questions appear on our podcast here regularly. So I'd say let's go ahead.

Steve Sanduski: All right, so Matt, say hello.

Matt Wilson: Yes. Hello, Steve.

Bill Keen: He's here, he's listening away.

Matt Wilson: I am. I'm ready to answer some questions.

Steve Sanduski: All right. Here we go. I got a good one here. The listener says, "I'm 58 years old, and I will admit that I have not been paying much attention to my investment allocations and my 401(k) and my ESOP, in fact, I haven't even looked at them for quite a while. I remember 2009, when we saw nearly half of our accounts go down, and then when I was 48, it wasn't fun, but I knew I didn't need the money for quite a while, so I just left it alone. Now, it's 10 years later, and five years or so out from retirement," so the person is asking, "Should I be making my account more conservative?" What do you think, guys?

Matt Wilson: Yeah, kind of a lot to unpack here. Considering they said that their account went down by half in 09, I would assume they're mostly equity, it's mostly in stocks, because of that comment. Even though they're playing this off as, "Hey, I didn't pay much attention to this over the last 10 years." I think that's actually probably been a good thing for them. Because we find that when folks are wanting to react to the market and other dynamics that they actually tend to underperform by making the wrong moves at the wrong time. So that actually has probably been a good thing for them.

Matt Wilson: But now, as they're getting closer to retirement, yes, it is one thing to think about, "Okay, how do I make my account more conservative?" And one of the reasons behind wanting to make it more conservative, and we talk about this too, and to use an aviation term, we call that the glide pack.

Bill Keen: Yes, we do. Matt knows how to say things that I like, doesn't he, Steve?

Steve Sanduski: He does. He does.

Matt Wilson: The glide pack is how do we go from 40,000 feet at cruise altitude while we're still working all the way down to retirement, which may be landing on the ground, but you know at the same time, when you retire, you're not done investing. We expect people to live, if they're in their mid-60s, to live another 30 years, especially a married couple. One of those spouses is very highly likely to live until their 90s. We have to invest even at retirement and in retirement knowing that we want to preserve our purchasing power. So just by making the account more conservative.

Matt Wilson: We want to make sure we've got enough set aside that if the market does go down, one, two, three years before it gets back to even again, that we don't have to sell anything during those periods. That's step one, that's going to be different for everybody in terms of how much money that is, and then that leads us kind of back into how much do we have in stocks and bonds based on that allocation?

Matt Wilson: If this person is mostly in equities and they think they might retire the next five years, we would being that process and say, "Yeah, let's start looking at shifting one to two years of your income needs into more conservative investments.

Bill Keen: We talk about the long-term nature of money, and it's a great point, Matt, that you mentioned, a lot of people think that glide slope is to get you completely out of the market by the time you retire. That's not the case you mentioned, no, a good portion of your assets are going to still be 30 year in duration, because you don't need all your money back the year you retire. Then, we have many clients that are, while we encourage them to enjoy their resources while they're living, and not just pass everything on to the next generation, of course everybody has their own desires about what they want to do, but a good portion of the assets that are invested, at least our experience has been, is actually for the next generation. Anyway.

Bill Keen: So now you're talking about longer than potentially 30 years, I like the glide slope analogy, I kind of made a joke about it there, but I can tell you when you're at 40,000 feet, or 30,000 feet, and you need to be down to a certain altitude by a certain time, you need to be very tactical about what your descent rate needs to be to get to that point, and it's a great analogy.

Matt Wilson: Yeah. Because it's not just, "Hey, okay, I'm retired, let's now just shift everything into cash and CDs." I mean, that can be a way to do it, but that's definitely not what we think is the most prudent way, and the way to maximize your lifestyle in retirement.

Matt Wilson: Now, we're not advocating that someone should have all their money in stocks, there is a balance to it, you know, there is a large portion of our clients that do have a majority of their investments in stocks, or at least more than half, especially in their first years of retirement.

Bill Keen: As you mentioned, probably good that they weren't looking at it, of course, you can be, if your assets aren't set up appropriately, then you should be looking at things, at least making sure they are, right? But there is some aspect to not obsessing over these things as well. Sounds like this person actually is asking the right questions.

Matt Wilson: Yeah, yeah. Depending on how their ESOP is structured, maybe they have some company stock in there, and they could be privately held, so there's pieces to that as well that have to go into the equation about what are the asset classes that we own, what's the volatility of those asset classes, and how much money do we need to live on, and how much is social security, and do we have a pension? It's hard to just answer something in a vacuum like this. But it is definitely the first step into putting a plan together.

Bill Keen: That's right.

Steve Sanduski: Good. All right. That's a good info on that one, and yeah, Bill, you mentioned that they said, "I didn't need the money for quite a while, so I just left it alone," so there's certainly been some research that suggests that the less often that you take a look at your portfolio the better you tend to do, because we have these behavioral issues that tend to get in the way and some emotions that cause us to sometimes make decisions at just the wrong time. Another value there of an advisor, like you folks are, just to help people not make those behavioral mistakes at exactly the wrong time.

Bill Keen: That's right.

Steve Sanduski: Good. All right. Let's take a look at a second question here, and this is an interesting one, one that I think you guys see fairly often, maybe not this specific situation, but the overall situation, which is there is somebody who's trying to sell you something, and they have a bias, or they have an incentive to sell you something that may not necessarily be in your best interest, so I think you'll kind of understand what I'm talking about here, so here's the question.

Steve Sanduski: They say, "I'm about to retire, and have an acquaintance that is telling me that I should invest in rental properties to create retirement income. I'm not sure exactly how that would work, and I also don't have a lot of expertise in this area. I'm being told that it's a great way to have an income stream and an asset that will go up in value." They also say that, "It's important to know that this acquaintance is a real estate broker who is wanting to sell me real estate properties." They say, "I'm not sure exactly how to proceed, or if this is even a good idea at all." Then they finish by saying that most of their liquid assets are in a 401(k) and an IRA. So, a good one there, so what do you guys think about this one?

Bill Keen: Again, there's a lot of aspects that come to mind for me on this. The first thing I would say anytime someone asks about, investing in hard assets like real estate, especially where there will be renters. I know this might sound elementary, but a lot of people don't think about how difficult it is to deal with renters and then to be on the hook for when the proverbial toilet won't work, or the air conditioner is out, or there's a problem.

Bill Keen: So, now all of a sudden, you've gone from becoming a passive investor, to someone who's very, very actively involved. Unless you have a management company, which now hits into that retirement income that they're suggesting could be a possibility, or unless you actually love it. We do have clients that actually enjoy working on houses, working on condos, keeping things up, managing renters.

Matt Wilson: There's definitely a lot of sweat equity that comes along with real estate. Part of the process, I mean, it's always when people bring these up, I always ask them those question. Do you want to be a landlord? Because you have to want to be a landlord to make this work.

Bill Keen: I think so.

Matt Wilson: Yeah. If you don't, you're going to end up paying out any of the profits that you're going to make out to like a management company and what have you, so now you're just betting on owning real estate as just an investment itself, and not necessarily as an income stream. That payoff could be way down the road. So, we have to ask those questions first to really dig into how important is this for you.

Bill Keen: You think there's a way, Matt, that they can, even if they did use a management company, they still could squeeze out some current income from it? Or do you think management company cuts into a good portion of it?

Matt Wilson: Well, so then it's how do we pay for the property? Because if you do have the cash set aside and you're just going to pay cash for it, yes, there could be then some positive cash flow when it's all said and done. There are some tax benefits with rental properties. It's based in your come. So if your income is higher, you may not realize those tax benefits, but if you're lower income, it's usually less than 100,000 or so, you're able to at least experience some of those tax savings. So that can help in your cash flow situation.

Matt Wilson: But, you have to have the cash. Now this person specifically said, and this is more common for us too, where majority of someone's liquid assets are in a retirement account, like a 401(k), or an IRA, and it is possible to buy real estate with retirement assets, but it is more different than if just this money was in your bank account. So, there's rules around one, will your custodian even allow it? So that's the person or the company that has your IRA. We use Charles Schwab as our custodian, Fidelity is a custodian, TD Ameritrade, you might have your local bank as a custodian. So you have to check with them first to see if it's even possible.

Matt Wilson: Then, there's rules around paying for it. You can't do a 60-day roll over, like you normally would think, and that's where you can take money out of the IRA, and then put it back within 60 days. That doesn't work, because it has to be the same property. So you actually have to buy the investment with your IRA. You can't take the money out and then put it back in. Then also there's prohibited transactions, which basically mean if you do something that the IRS doesn't like, all your entire IRA now is taxable.

Bill Keen: Even if the portion you didn't use to buy the house?

Matt Wilson: That's right, yeah. So, if you are uncertain about this, and especially if it's IRA money, we'd tell you to just be very cautious with what you're doing, and for most people, after we go through that, I mean, that's 99% of them, they just realize, "Okay, that's probably not something that I want to start engaging in." Because essentially, you're buying a job. I mean, most people go into retirement not wanting to have a job, so you're buying a job. Part of these prohibited transactions too even applies to rental properties that you might use for a partial vacation home, because that's another common question. "Hey, we'd like to vacation at such and such place, maybe we should buy a rental property and then rent it out, and then we can use it too." Well prohibited transaction doesn't necessarily allow you to use it.

Bill Keen: If you're using your IRA money.

Matt Wilson: IRA money, yeah. Now, if you're just going to finance it, well, you're really not going to. Let's say the IRA money is off the table, and you're just going to finance it, you're not going to make any money until the note is paid off most likely. So that's a whole nother scenario where we can plug that into a financial plan, but it's not going to show a payoff for usually 10 to 15 years or longer, because you've got a mortgage on this. If you're going to take the money out of the IRA to pay off the mortgage, well, now you might be paying 30% more for the property. You start doing that math too and it's like, "Well, I don't know if that makes a whole lot of sense either."

Bill Keen: That would be if you took money out of the IRA or 401(k) to just by it out right.

Matt Wilson: That's right. Because you got to pay the income tax.

Bill Keen: Sure, as opposed to buying it somehow inside the IRA, which is questionable at best.

Matt Wilson: Yeah, inside the IRA, I mean, there's a lot of sticky rules around that, even sweat equity isn't necessarily allowed. You've got to basically hire out everything, you've got to pay all the bills with the IRA money, income that you might receive. So if it is like a rental property, a lot of times that income is taxable to you, even though it's inside the IRA, because it's considered what they call unrelated taxable business income. So there's pieces to that. So, you start kind of going through all that stuff, and yeah, it can definitely make it a lot more difficult.

Matt Wilson: And if this is not something you're interested in, now you add that on top of everything else, and it can not make a lot of sense. Now, we do have some clients that have built up real estate portfolios, and the funny thing is the ones that have been doing it for a while, yeah, they might have some nice income streams, and they might have a nice portfolio properties. Many of them have told us, "I'm looking to retire, I think I want to sell all this stuff." Because it's a job, I mean, it's been a second job for them building it up that way. Now as they look at retirement they're like, "I don't want to have to deal with all this stuff."

Bill Keen: Right, they're wanting to simplify their lives, and I said questionable at best, the other thing that's questionable at best here in this particular question is, and I think our listener may have drawn a little bit of ... been intuitive about this, they said, "Maybe important to note," I think you said, Steve, that they had a broker was an acquaintance of theirs, but they're also the broker trying to sell them the property. So that might lend to somewhat of a conflict of interest in this advice, do you think?

Steve Sanduski: Yeah, absolutely. So what I'm kind of hearing here is there's really no free lunch that this real estate stuff it's almost like a second job and, Matt, as you were just saying here at the end, that one of your folks that you're thinking about actually has built up a nice real estate portfolio, but now they're like, "Well, this is a lot of work. I think I want to sell this stuff so that I can really retire."

Matt Wilson: It might sound like we're anti real estate, which we're definitely not, I think there's merits to that asset class, it definitely doesn't have the volatility like the stock market does, because the asset isn't priced every day.

Bill Keen: It has the volatility, it's just not price, because you don't know what the price is, right?

Matt Wilson: Yeah, so I mean the volatility isn't necessarily there, because if you only price it a handful of times a decade, because you're never looking to sell it. You know, you don't see the volatility. And the reality is ... I think that helps people feel more comfortable with real estate, because they don't see price movements like they do with the stock market. Now returns, they can be good or bad with real estate too, because there's a lot of leverage involved as well. If you're taking a mortgage out, and you're only putting down a portion, you're now using someone else's money to buy a property. If that property goes up in value, you might have doubled the amount of money you put down. So that can actually feel attractive, but it can go both ways.

Matt Wilson: Market prices go down. They don't have to go down very much either, and you might have lost all the equity that you put into it as well. So there's leverage involved, and there's tax benefits too with mortgage interests. So that helps people feel a little bit more comfortable with real estate. But again, there's a lot of work to make it profitable in the long run.

Bill Keen: Would you say that using publicly traded indexes of REITs, not the non-traded REITs, but now I'm talking about the publicly traded REITs, or even maybe the index can give you exposure, some exposure, to the real estate asset class without any of the complexity that we just described here in the last 10 minutes?

Matt Wilson: Yeah, those can as an investment. But I mean, most people forget, a lot of people, own a house. If you look at your net worth statement, let's say you have a couple million dollars in retirement assets, and you might have a $500,000 house, you've got a total net worth of 2.5 million bucks, you've got 20% tied up in real estate already of your net worth. Do we want to add more to that or not? You start to maybe slice it up and think about it that way, and it's like, "Maybe we've already got the exposure that we need."

Bill Keen: I think that I heard some cautiousness in their question, and they probably were right in being a little bit cautious about maybe making this transaction.

Steve Sanduski: Yeah.

Bill Keen: Okay.

Steve Sanduski: All right, so let's take a look at this third question that we have, and it's a fairly long one, so I think what I'm going to do is basically summarize it and what they're saying is that their father passed away back in 2012, their mother just passed a few months ago, and they're inheriting some money and the money is basically in the form of about $600,000 in a brokerage account of stocks and mutual funds, then $100,000 is in their mom's IRA. And the person who's asking this question, this person and their wife, they're about three years out from retirement, making a good living of about 150,000 bucks, and so they're just trying to figure out what is it that they need to do with these assets and what can they do to maybe avoid some taxes? So what are some of your thoughts on how you would proceed in a situation like that?

Matt Wilson: Yeah, this is coming up more and more often too just as our clients are retiring and their parents, a lot of cases, are still living, but they're getting up there in age, and now we're seeing some inheritances coming into play. We get this fairly often about, "Well, I'm going to inherit some money. What kind of tax liability do I have?" Because most people aren't familiar with the estate tax rules, and even some of the tax rules around inheriting property. The nice thing about it is an individual can leave over $11 million to their beneficiaries without any estate tax.

Matt Wilson: So right there, we don't even have to worry about any estate tax. Now that doesn't mean there aren't other taxes. So, number one, no estate tax in almost all cases. But number two, in this person's situation, they said $600,000 in a brokerage account, nice thing about that is they receive a step up in cost basis on that $600,000. Let's say that their mother, was it the mother or father? Whichever passed away, let's say they only deposited 300,000 in that account, now was worth 600,000, there would be a $300,000 capital gain.

Matt Wilson: Well, when you pass away, your cost basis is reset. So the beneficiaries, they receive the basis as of the person's date of death. So if it's worth $600,000 at the date of death, and they immediately sell it, they pay no capital gains tax.

Bill Keen: Right, and this listener did say that it was just several months ago that their mother had passed, so odds are the securities haven't rallied a whole lot, but if they did, it would just be the difference, right, it would just be the difference from the date of death to where securities were today that they would pay. In this case, it would actually be short-term capital gains, if they all were liquidated though, and we're not saying to liquidate everything at this point, are we?

Matt Wilson: That's right, I mean, the IRS looks at it like you, when you inherit the money, they look like you just invested it. So they reset your cost basis. So if it's only been 60 or 90 days, and you do have a gain, that would be a short-term gain, which is taxed a little bit higher than a long-term capital gain, which is the investment that you hold for over a year. So there's a little bit of digging to do, okay, how do we maybe reallocate these assets to minimize any tax liability. Because if it was an older person, they might be a little bit more conservative. So there may not be a lot of gains inside there.

Bill Keen: When clients have inherited assets, and brought them over to us, we always recommend that they bring everything over what they call in kind, which means that the securities come as they are, and they're just literally electronically transferred as they are, and that allows us to be able to see exactly what the tax liabilities would be and manage around that, where it makes sense and is prudent.

Matt Wilson: That's right.

Bill Keen: A lot of times if they were to tell their old advisors too, their parents advisors in this case, that they were leaving, those advisors may, and especially if they're on a commission basis, they might sell everything out without any consideration of the taxes, but then also to generate commissions on all those trades as well, like kind of one last time before the assets left. So, in my mind, it's always important to say, "Hey, transfer everything in kind," and let your new advisor, hopefully that they're disciplined and they do these things, make sure that they're maximizing those things.

Matt Wilson: Yeah, they even mentioned that they have an IRA that they inherited. So, we've talked about estate tax, we've talked about capital gains tax, but the IRA is still subject to income tax. That's even for the next generation, for the beneficiaries. Because the IRS says, "No one's paid income tax on this IRA, because it's all been pre-taxed money that's been growing tax deferred. Until the money actually comes out of the IRA, there's been no income tax. As the beneficiary, you're going to have to start pulling money out of this IRA based on your life expectancy, which will generate a little bit of income tax." And in their specific situation, they mentioned they have an income of about $150,000. So until they retire, most likely we would recommend just taking the minimum out, but we would do out tax planning work every year and kind of look at how much they need to pull out.

Matt Wilson: Is there some ways maybe to pull out a little bit more especially if they're in a lower tax bracket, based on certain situations, but that is one thing too that people forget. Is that there's going to be some income tax on the IRA. But it's not all taxable in the year you receive it, because they allow you to stretch it out over your lifetime.

Bill Keen: Unless you didn't know that, and you just pulled it all out, which we've seen people do before getting referred over.

Matt Wilson: Yeah, sometimes people will ... this is rare, but it does happen, where one of the children, let's say you're one of four siblings, and your parents pass away, and they left an IRA. They might've, in some cases, we hear where people left the entire IRA to one child as the beneficiary and said, "Distribute this." Well, what would have to happen then, is that child, would have to receive it, take all the money out, pay income tax at their bracket, and then distribute what's left. IRS likes it when you do that, because now paid a bunch of taxes.

Bill Keen: Yeah, but then in those cases, the one sibling that inherited is now creating an accounting and trying to show the other siblings how much tax they paid. One, you're disclosing what bracket you're in, and two, it seems like in some cases, the other siblings aren't buying the fact that, "Hey, wait, what is this? No, we didn't know there was taxes. Just give us our fourth of the total gross value." And it becomes a problem.

Matt Wilson: And you lost the stretch, which there's a lot of benefits to that. So there's a lot of reasons not to just list one person as a beneficiary or as a joint owner too, that's another thing that we see people list their children as joint owners and a lot of reasons not to do that. I mean, one, a joint owner does have access to those assets, so they could be doing something they're not supposed to, which most people won't, but you never know. Two, if that joint owner is in an accident or subject to some litigation, any of those joint assets can be pulled into that. Then three, you lose some of the step-up in basis as a joint owner as well. So a lot of red flags, or a lot of no-nos around listing someone as a joint owner versus just as a beneficiary.

Steve Sanduski: Well, a lot of detail there guys. So it just goes to show that some of these situations can get fairly complicated and that if you don't really know what you're doing in this area, just one little mistake can be extremely costly, and that's why it's so important to have expert advice like you guys here at Keen Wealth Advisors. So I appreciate you guys really going into some detail there and talking about some of the nuances in these different questions that the listeners have brought to us. So, any final closing thoughts from either of you guys?

Bill Keen: A good financial advisory firm will bring kind of a sanity check to our clients when these situations arise. We had three totally different questions today and these were questions that we think the specifics of the questions are things that we see every week in the firm. Just by sitting down, taking a breath, pausing, running these things by an advisor that you trust and respect, and having that advisor come back with objective thought on these things can make a huge difference and not just making knee-jerk decisions. I think this was a nice, broad question base that we got to answer today and if anyone out there is experiencing any of these issues, or anything else, just know that we're available to sit down and help you think through these things and hopefully come up with a decision that makes sense for each individual's plan.

Steve Sanduski: Excellent. All right, well, again, the website keenonretirement.com, if you want all the show notes from all the episodes that we've done, you can also get in touch with us from that website as well. So guys, thank you for the episode today. Bill, congratulations again for being on the board of Angel Flight Central, and all the great work that you and your colleagues are doing through that organization and I appreciate it. So we'll look forward to the next conversation on the podcast.

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

Matt Wilson: Thanks.