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JIM: Welcome to today’s program. Today we have a financial advisor who’s spoken around the country to other financial advisors about strategies on how they can help their clients optimize their social security benefits while at the same time making sure that they have a predictable income stream that will last as long as they do. Today I want to welcome Greg Gagne. Welcome, Greg.

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GREG: Hey, Jim. Great to be with you.

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JIM: I’m so glad that you could join us. I was thoroughly inspired and motivated not only by your talk for myself personally but to share your insight with all our listeners because I heard you at the national conference for the National Association of Insurance and Financial Advisors, which is the largest professional organization for financial advisors and I just thought you did a great job and I think we’re kindred spirits because I think there’s been a shift in focus, especially when it comes to advisors where we go from what your assets and liabilities are to more it’s about the cash flow. Would you agree with that?

01:04

GREG: I agree with that, Jim, 100%. It is the cash flow for particularly our retirees.

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JIM: One of the things you talked about when we were in San Diego for that conference, you talked about clients’ plans working from the ground up. Describe what you meant by that.

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GREG: Thank you. What I mean by that is a lot of the software that’s out there and a lot of the websites that are available for consumers help them to do a risk profile-style quiz to try to determine what their ability or willingness to take risk might be and I actually think that’s inaccurate in helping a client to plan because that’s just sheerly psychological and what we do in our firm is we’ll talk about their willingness and ability to take risk but then we’re going to build their plan from the ground up, as I call it. What I mean by that is we take a look at their annual expenses and then based on that, we build out a model to accommodate those expenses vis-a-vis their guaranteed income from social security assuming they have, any defined pension benefit plans, and then a distribution from their retirement account, either mandatory or even before age 70-1/2 so that we have enough money coming in to meet the annual expenses on an ever-inflating schedule right through age 100. We start that model typically by solving it at a modest rate of return, say 4%, and if it holds together exceptionally well at a low rate of return, then we know that we can have a conversation with our client that they don’t necessarily need to take excessive risk for no reason at all other than they took some profile quiz that said that they can handle it. Conversely, if their cash flow shows that they’re going to run out of money at that modest rate of return, we will keep adjusting their rate of return until it solves. Let’s just say 7% or 8%. Then we can have a meaningful conversation as to why that client may need to take additional risk to try to obtain their objectives. It’s a much better way, we think, to get the client onboard with understanding the risk that they’re taking and why they’re taking the risk that they might take and we call that from the ground up.

03:02

JIM: I agree with that completely because it’s matching up their need and then educating them because if you were to survey clients at the end of 2008 or early 2009 or back in 2000/2001 what their risk profile was, it was a lot different than it was at the end of 1999 where people thought you know what, I just throw money at this stock or that stock and we’re going to be millionaires overnight because I remember a survey back then and they said what kind of rate of return would you see as a satisfactory rate of return? The average respondent was 37% is what would be a reasonable return. People were so out of whack because the market was going straight up. Then when the market crashes, then everybody’s a conservative investor. It’s like after 9/11 everybody wanted to go to war and now after years of war, everybody wants to pull out so I think you hit the nail on the head when you say it’s a psychological profile but it’s affected by the news of the day and investing isn’t about today. It’s about long-term right?

04:01

GREG: Oh, I would suggest that emotions are best kept out of investing.

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JIM: I think that’s where an advisor is so important. I keep telling people on the internet, you can get all the information you want and all the knowledge that you need but you don’t get the wisdom and most of us are just serving as a coach for our clients, keeping those emotions in check from getting out of whack and not making the wrong decision at the wrong time. You talked about the real danger and I’ve seen a lot of people talking about this, that danger zone of retirement, which is basically the five years before and transitioning to the five years after and the sequence of returns and how dangerous that can be for someone new in retirement. Can you expand on that and how do people hedge against this risk?

04:45

GREG: Yeah, sure thing. It is a real dangerous time for a variety of reasons. One, the client’s never experienced having to set themselves up to start what we call deccumulating. They’ve been accumulating all the way up until the time where they’ve transitioned into retirement and they’re unaccustomed to slowing down the savings or, in fact, taking money out of a portfolio and starting to have that add sustenance to their lifestyle for their retirement years. You take that issue coupled with a crash in the market like something we experienced back from December 2007 heading into March 2009. That could be a psychological game changer on the client’s ability to maintain a retirement lifestyle so what we try to do to circumvent that is in that cash flow modeling that I was discussing in the first question is that we build what is known as income for them to try to have enough income coming in on a guaranteed basis each month, usually from either defined benefit pension plans, social security, a combination of the two of those, or maybe an immediate annuity so that we can get a fixated amount of money coming in every month regardless of market performance so that we can cover the basic needs of life. In doing that, that takes a lot of the pressure off the market timing issues that psychologically these new retirees face if the market decides to misbehave. Not only that, if you don’t have some form of a foundation in your plan and we suffer a repeat of what we just went through back in 2008, those folks who might have been planning on taking out 4% to 7% distributions in their early retirement when they tend to have higher expenses and more desire to travel because they have their health. If you couple that with a 38.5% decline in a 12-month period of time, all of a sudden their portfolio is cut in almost half. Critical that as an advisor we prevent that from occurring to our clients by making sure that we have the ability to have a paycheck coming in. All the client needs to do is wake up.

06:35

JIM: I’ve got to throw a disclaimer in there. When we talk about guaranteed income, social security obviously is guaranteed by the federal government but the other sources of predictable income streams such as pensions or annuity payments are something you want to talk to your financial advisor about. Make sure you understand how those might work but the key point there is they’re not subject to the market fluctuation. That is really a key. Here I’ve been in the business about the same amount of time as you’ve been, Greg, and I saw the market crash in 1987. I saw what happened in 2000 to 2002 and then more recently here what happened in 2007/2008 and they were game changers and God forbid someone retired at that point and I had a lot of people I counseled back in 2000/2001/2002. The saving grace of the most recent downturn was people were still reeling and healing from the sting of the previous downturn and weren’t quite as risky but man, you had people that were playing the stock market with 100% of their money in small-cap stocks and everything else when that market crashed in 2000 and they were reaching retirement with this sense of security that everything just goes up. Man, a lot of those people had to go back to work because not only was the market going down at a precipitous rate but they were drawing money out at an unrealistic rate and I call it the death spiral of their retirement plans because they needed a fixed dollar amount and that percentage was growing dramatically that they were taking out because that market was crashing.

08:04

GREG: If you think about it, Jim, at the time that that was all happening, had they just been wise enough to have some predictable cash flow that they could more or less rely on even with the disclaimers that you astutely mentioned, which is accurate and correct. If they had just shut the TV off, not to pick on any media outlets, but if they had just shut off the TV, stopped watching the newspaper, and stayed allocated in a well-diversified portfolio, all of those stresses that they suffered during that period of time would have just been for nothing because they would have recovered nicely and they would have been able to stay in the boat and weather the storm versus panicking and in many cases jumping ship.

08:35

JIM: I couldn’t agree more. We’re going to take a short break. When we come back, let’s talk about the social security system and I know a lot of people make a lot of mistakes because they don’t get all the advice and let’s face it. When you go to social security to ask for benefits, they can’t tell you about all the options. All they can do is answer your questions so let’s talk about some social security strategies when we come back.

08:57

GREG: Sounds great.

[BREAK]

09:28

JIM: Welcome back as we continue to visit with Greg Gagne, who spoke on stage to the National Association of Insurance and Financial Advisors here this last September and Greg in his practice has executed a lot of these new strategies that people have been implementing across the country, which is focusing more on income and predictable cash flow versus necessarily just shooting for the highest rate of return. Let’s switch gears here a little bit, Greg. A lot’s been written about social security and claiming strategies and when the optimal claiming age may be for clients and I know you do something that I do and that is the philosophy it’s not what you make, it’s what you keep and a lot of people trip over sometimes the excess taxation on social security. They don’t really plan. They just go and maybe they talk to a couple buddies at the workplace and they follow what everybody else did versus personalizing it to how they’re going to be using the money, what their retirement needs are, and really customizing and maximizing and optimizing their social security benefits. Talk a little bit about that.

10:31

GREG: Sure thing. Most advisors are learning, if they don’t already know, about the advantages at this point in time of the deferral of social security from a cash flow standpoint but there doesn’t seem to be as much written about, or at least easily accessible, the tax benefits of the deferral of the social security. What I mean by that is those that take their social security early and then start taking distributions from their IRA end up having what we call a tax torpedo where they’re paying taxes on 85% of their social security benefit as a result of failing what’s called the provisional income test. What we advocate or at least research to see if it, from a due diligence standpoint, is the correct answer for the client mathematically is we will look to defer the social security, now knowing that the client still does need some form of income so in order to augment that social security not coming in, we will start an accelerated distribution plan from the retirement account and that has a couple of upshot benefits but by doing that, we actually start lowering and I call it a cash flow bridge basically. We start reducing the size of the 401(k) or IRA and that will have a ripple effect at age 70-1/2 because that’s when required minimum distributions kick in and many times the client starts to lose tax control once that ensues as a result of the RMD required minimum distribution forcing what we call bracket creep. Couple that with then taking their social security benefits and all of a sudden, they start jumping brackets and long story short, if you fast forward down the line, when one of our spouses passes away, all of a sudden we hit this thing we call the widow tax trap where the single person will go from the 15% into the next federal bracket, which is 25%, and then pay taxes on 85% of their reduced social security benefit because we can’t keep both checks. I wish there was a way we could show our clients to do so but they can’t keep both social security checks. It would have been so much wiser to have drawn down that IRA ahead of schedule instead of following a schedule, defer the social security to a later date, and then turn on social security when you’re 66, 67, or 70 years old and then actually enjoy, hopefully, a good portion of that social security check tax-free like it probably should have been in the first place.

12:43

JIM: Another point to this is sitting down with your advisor and determining maybe it makes sense to do some Roth conversions too because the income you take from a Roth IRA let’s say later in life, it’s tax-free but it also doesn’t count against you when calculating whether or not your social security will be taxable or not. There’re a lot of strategies you can use to maximize it and I think one thing a lot of people may or may not realize and I always talk about with the social security, let’s make sure we get it as big as possible on the check that you’re going to keep so when dealing with a married couple, you lose the smaller check when one spouse dies in most cases so if you need some income, maybe you take the income. You strategize and look at what’s going to be the optimal check to start collecting now and maybe you collect the one that’s going to be the check that you lose right away because whoever the survivor is, they’re going to keep the bigger of the two checks and by delaying or deferring it, the amount that that check goes up year to year is around 8% and right now, with interest rates being so low and it being all about cash flow. I can think earlier in my career when bond interest rates were better and the market was maybe not having as many big swings as it seems to be having today. I used to have the philosophy take the money and run but in the interest rate environment that we’re in now, it’s really about cash flow and let’s face it. People are living a lot longer and you really need to prepare for that with the cash flow that you get from social security.

14:13

GREG: Absolutely and a planning point on the Roth conversion strategy is precisely what we advocate in our firm for our clients. We call it with these IRAs, we do one of two things. Option number one is we spend the money and then option number two is we save the money so if we don’t need the money and we’re going to save the money, we’ll take the accelerated distribution out before the social security kicks in and we’ll Roth that fund.

14:33

JIM: Yup, it’s just awesome. There’re so many options. You really need to sit down with your advisor. Don’t make the mistake where you just go in the social security office, start collecting the check, and then maybe a couple years later you go into your financial professional and say okay, did I make the right decision? You want to be proactive about this stuff, especially when you’re planning your retirement date. I see a lot of people really retiring too early because they don’t realize some of these tax traps that you talked about and they’re so set on retiring at a certain age that maybe with a little bit of planning, maybe postponing retirement a little bit longer, they can live in retirement without the financial stress of people that maybe go into it somewhat blindly and maybe a little bit too soon. Say you work mostly with seniors and you call the planning crossing the bridge from the accumulator to the deccumulator and as a result planning needs for the client change and I think this is what we’re talking about so talk about that bridge and how you help people cross that.

15:30

GREG: We covered a little bit of that at the beginning but it’s mostly psychological where we have to help our client to recognize and basically have a mindset shift. It actually happened in one of my meetings today, Jim, where the person just was having the hardest time wrapping their mind around the idea that they’re going to need to take money out of their portfolio for the rest of their life because they’re no longer earning a regular paycheck. In fact, their portfolio was going to be providing that paycheck for them and a lot of our clients when they’re accumulating, they’ll have disability insurance and things like that to protect their income so that they can continue to accumulate but I’ll tell you when they’re entering that zone, the five years before retirement or the first five years going into their retirement and that transition, I would say it’s essential that they plan for the possibility of becoming disabled and not affecting their income but affecting their assets, as a necessity from a long-term care situation may deplete their ability or the surviving or healthy spouse’s ability to stay retired. We call it crossing the bridge to deccumulation and shifting from an accumulator to an asset protector, very, very important and I think often overlooked. A lot of advisors, a lot of companies that are out there help people to continue to maintain a growth strategy of their portfolio but very few have the knowledge or take the time to help a client work through the issue of a long-term care situation.

16:49

JIM: I think that’s a great way to finish this topic. You want to protect what you have and really make sure you’re focusing on the cash flow and the best person to go to is go back to your advisor and if you haven’t had this discussion yet, you want to have this discussion and I know I talk to a lot of advisors around the country, as you do, and I know we’re focused on this and I talk to advisors about having this discussion and a lot of them have shared with me you know what? People don’t want to hear it right now. They want to just think that everything’s going to be okay and that they can earn 10% to 12% on their money and they feel they could retire at an early age and they’re not being realistic about their planning and I would encourage everybody listening to this. If you haven’t had a frank discussion with your advisor about how all these issues are going to impact your retirement, you owe it to yourself to have that discussion and your advisor brings to you the wisdom of not only their years of experience but their wisdom in dealing with other clients’ situations and how it’s impacted them and that’s something you just can’t find on the internet or reading an article. You want to have that time to have that dialogue and make sure you’re setting up a plan that’s going to work for you. Thanks, Greg, for joining us. We really appreciate you taking the time. Hopefully, we’ve motivated and inspired a few people that if they haven’t taken the time to plan this stuff, that they’re taking the time now and they’re reaching out to their advisor and making sure that they have a solid retirement plan that’ll work for them.

18:12

GREG: Thank you. It’s been a pleasure.

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JIM: Thanks for joining us this week and tune in again next week as we explore another phase of the Real Wealth process and remember, if anything you heard in today’s show you’d like to get more information about, contact your Real Wealth advisor. Also, if you feel that any of this information would be helpful to a friend or family member, just click the Forward to a Friend button.