Brought to you by:

0:03

JIM: One of the greatest fears people have when facing retirement is the fear of outliving their money and joining us today is Alexandra MacQueen who is an instructor in Personal Finance at Schulich School of Business at York University in Toronto, Canada. She recently coauthored a book with Dr. Moshe Milevsky called Pensionize Your Nest Egg where they cover some tools on how to have your money last as long as you do. Welcome, Alexandra.

0:29

ALEXANDRA MACQUEEN: Good morning.

0:30

JIM: It’s such a pleasure to have you and I know we were talking just before we started the interview that you work closely with Moshe Milevsky and for those that don’t know Moshe, he’s a mathematician and he’s a university professor in Toronto and, right now, he’s on sabbatical speaking around the world and you’re his more than ample fill-in. You’ve worked together with Moshe to write some books and it’s probably some of the most impactful books that I’ve seen on retirement because you’re taking the math and science, taking the emotions out of the whole retirement process, and quantifying how people can be making smart decisions and how they have to factor in different things because when you’re in retirement, it’s a whole different phase than when you’re accumulating toward retirement so welcome, Alexandra. It’s great to have you here.

1:20

ALEXANDRA MACQUEEN: Thank you very much.

1:21

JIM: So, let’s talk about that transition because I know with most of the clients that I work with, psychologically speaking, I tell every client, and this is what I’ve experienced, it takes a year or two for them to even deal with that transition, that it’s a very anxious time because you’re going from working and saving money to living off that next egg, so can you talk a little bit about what does that transition to retirement do and what people have to do to prepare themselves for that.

1:48

ALEXANDRA MACQUEEN: For sure. I think that there’s two important things that we can inadvertently overlook when we’re planning for our retirement or for the retirement of the people that we work with and the first is we forget you only get one chance to do this so unlike, for example, in your working years, if you lose a job or decide to change directions, you know you have another kick at the can but, with retirement, it’s such a high stakes decision and if we make a mistake, it’s very, very difficult to do it over. I mean, are you going to say, okay, I changed my mind and go back to work, I’m 65, I’m 67. This is not a decision that people want to have to make. We want to get it right the first time so both psychologically and financially, the stakes are very, very high. The second thing is that I feel as though people’s approach to retirement income planning is often informed by decisions or conversation that are no longer valid so if we think about maybe how mom and dad retired or an older relative and maybe they had a defined benefit pension and their retirement was kind of seamless. One day, they went to work. The next day, they weren’t working but they still kind of got a paycheck from work but it was in the form of a pension as opposed to a working paycheck. We can get very kind of caught up in feeling anxious about am I doing this right and, also, by getting informed by conversations that don’t really serve us anymore. People don’t appreciate how different retirement is from working life and how different it is today compared to retiring 20, 30, 40 years ago.

3:16

JIM: And, you know, I look at probably one of the worst things that could happen was the decade of the 90s where we had record returns and then people took early retirement and used that knowledge of, wow, I’m earning 10%, 11%, 12% in my retirement accounts, I can just count on that and draw and, all of a sudden, their retirement accounts went down very quickly and sometimes were eliminated because of these unrealistic withdrawal expectations based on a buy-and-hold strategy they had over the last 10 years so that’s a lot what you’re talking about, right?

3:49

ALEXANDRA MACQUEEN: That’s right. The other thing, of course, and you know this as well as anybody, if I think about my parents and even my grandparents and their retirement lives, people expected to work, you know, 30 to 40 years and then have 10 to 15 years of retirement but we’re now looking at a situation where people are still going to work the same number of years, we haven’t added any years to that side of the balance sheet, but our retirement is going to last 20, 30, even, in extreme cases, 40 years, so all of a sudden all of the work we do in our working lives to set us up for retirement, we have to make sure those dollars work extra hard. We’re preparing for a situation which, really, no generation has ever seen before.

4:28

JIM: And, you know, the other that I think complicates that is when you look at the parents and grandparents that have retired before the new retirees of today, they definitely had those defined pension plans or defined benefit plans where they had that guaranteed paycheck coming in and, today, that’s been replaced here in America with 401(k)s and IRAs and things like that where people are responsible for putting their own money away for retirement. The other thing that I see is I’ve been in the business 30 years and, when working with retirees 30 years ago, they could have a bond portfolio with the higher interest rates supplying them a pretty decent cash flow or they could even be in CDs that might have been paying 6%, 7%, 8% or even more and not have to take a lot of risk and have some decent cash flow. Well, recently, I saw that CDs, the average one year rate is under 0.3% and bond interest rates are at pretty much all-time lows so those traditional investments of our parents and grandparents aren’t going to be able to do the same thing that they did years ago and then you couple that with what you said, living a lot longer, so how do retirees know how to compare and contrast these risk factors they face in retirement and we always hear about inflation, inflation, inflation. It seems like we don’t have that much inflation. Is that a bigger risk than the longevity risk or what are you seeing or what are you finding and how are you advising clients to deal with these risks?

5:52

ALEXANDRA MACQUEEN: That’s such a great question. In my own sense, exactly what you said, inflation seemed to have dropped off radar screens as a significant risk that effect retirees over long periods of time. However, it’s still important to point out that even at low rates of inflation, even at 0.5% or 1%, the impact over a long period of time can still be substantial but that conversation also really underscores the impact of longevity. All of these risks, when they only occur over a short period of time, are relatively manageable. It’s this long, long retirement, this increased longevity and longevity risk that really amplifies any other risk that we might experience in retirement so living 10 more years than your parents, living 10 more years than the average is the biggest risk, the biggest and I think the least appreciated risk that retirees today face so let me give you an example of how to think about longevity risk. We all know that average life expectancy is increasing. You see that in the newspaper. People know that the old life expectancy might have been 80 or 82 years 20 years ago and, now, maybe it’s 84 years or 86 years, but that simply means that 50% of the population is expected to live that long. You or I might live much longer than that because the standard deviation, to borrow a little bit from the math professor for a moment, the rate at which people live before or after that average is quite high. In fact, it’s comparable to stock market risk.

7:18

JIM: And, you know, I deal with this all the time. I talk to clients and when you ask them how long they think they’ll live, they all pick an age like close to life expectancy. One of the problems with a lot of those life expectancy tables, that’s based on someone being born and what their average life expectancy is with all of the risk of the teenage wild and crazy years and all that and childhood diseases and all those things. Once you make it to retirement age, the life expectancy is quite a bit more because you didn’t die those first 60 or 65 years and, with medical technology continuously improving, people are living longer and longer. One thing I see a lot of people falling into a mistake and that is they assume a lower life expectancy and they say, you know, if I live much beyond 80, I’m not going to worry about it and, yet, you see centenarians as one of the fasted growing age groups, it would really be unfortunate to be your last 20 years of life being broke.

8:15

ALEXANDRA MACQUEEN: Yes. To me, this is the question that kind of underpins the conversation about how to protect against longevity risk. When you have an event like that, living a very long time, much longer than you expect, but has a low probability, it might happen for you, it might not. It’s definitely not 100% probability, maybe it’s more than 10%, you don’t know. If you have an event like that that has a low probability but a high cost, do you budget for it or do you insure against it? My vote would be this is a place where insurance can help.

8:44

JIM: Well, that’s great and let’s take a short break. When we come back, let’s start talking about some of those solutions so please stay tuned.

8:51

BREAK

9:18

JIM: Welcome back as we continue our interview with Alexandra Macqueen who is coauthor of the book Pensionize Your Nest Egg that was released in Canada in 2010 and they just came out with a US version in 2015 and, before the break, we were talking about the risks in retirement and I think there’s no greater risk than the risk of longevity because if you look at some of the other risks in retirement, the stock market volatility, the sequence of returns, healthcare, all these different issues that people face in retirement, all become much greater when you add longevity. Just to kind of make a point, if you’re going to live six months in retirement, we don’t need to do a lot of planning but if we’re going to be living 20, 30, 40 years in retirement, all those risks become compounded and, Alexandra, you know, just before the break, we were talking about a lot of those risks and we just talked about some of the potential solutions and what are you recommending or seeing that people do to address this longevity risk?

10:15

ALEXANDRA MACQUEEN: So, it’s a great question. The title of the book is Pensionize Your Nest Egg: How to Use Product Allocation to Create a Guaranteed Income for Life, so what is this idea of product allocation? We’re all familiar with asset allocation and we know why we do it for clients and for ourselves. We build these diversified portfolios to protect us against risk and to make sure that we’re capturing the benefits of different asset classes. The same thing is true for retirement income but we’re going to use something different than asset allocation. We’re going to use product allocation. We’re going to take our nest egg and we’re going to spread it across the products that provide benefits and protect us from different risks that are unique to retirement. Before the break, we talked about longevity and you’ve just mentioned sequence of return and market risk and the third one, of course, is inflation. We can take products, whether they’re sort of a generic stock and bond portfolio or an indexed product or a product that provides longevity risk protection so a form of insurance or annuity contracts, we can mix and match them in a retirement income portfolio to make sure that we’re protected from the risks that we face and we get the benefits of those different products to provide income for as long as we need it.

11:22

JIM: Now, I’ve got to admit, I was one of those guys and I’ve seen and there’s still a lot of people talking about these income annuity type products, immediate annuities, and that’s what pensions are, that’s kind of what social security is, they’re a form of annuity and what they do is they provide a payment stream over a period of time and that could be lifetime so it is a perfectly designed product to allow for income to continue as long as someone lives but I’ve looked at those as an investment guy and I’ve always thought, man, I just don’t believe in them and having seen who you coauthored the book with, Moshe Milevsky, along with some others, they’ve slowly had me come around to where I see that as a potential piece of an overall plan but, unfortunately, too many people seem to go, well, I should be all in stocks or all in bonds or all in annuities or all out of annuities. People make the mistake of looking at products and just checking them off the list and I think what people have go to really look at is how does these different pieces of the puzzle fit together to give you a good retirement picture. What do you say to those people that say, you know what, those products don’t make any sense?

12:31

ALEXANDRA MACQUEEN: Well, they may not make sense for any one individual but the point is, so there’s no product that provides longevity protection, so provides income for as long as you are alive even if that’s a very long time other than from the world of insurance and, therefore, there’s people who are like I don’t want that and that’s fine and there’s other people who say now give me as much of that I can take but the point is that what’s right for you, so your individual mix and match will be different from mine based on how risk-averse I am or how much risk I’m willing to take and what your particular situation is. My point is that you could take a part of your nest egg and put it into a persona pension and you’ve covered off that longevity risk. You may or you may not do that but nobody is saying, at least this book is not saying go out at retirement, take 100% of your nest egg and put it in one of these products. We’re saying, look, there’s an optimal mix for you and we’re going to help you walk through these products to understand the benefits they provide, the risks they protect against, and how you can put them into your portfolio in kind of a customized mix that works for you.

13:30

JIM: And, you know, I’ve always used the analogy, it’s called tools in the toolbox, and if you’re going to pound a nail into the wall, a hammer is the best product. You could probably use a wrench with the right end. It’s not going to do quite as good of a job but if you have a full set of tools, you can build a house, you know, and it’s the same thing with retirement. Having these different tools and one thing that I’ve found is for people to be able to stay the course, I see too many people make decisions that are based on emotions, based on a short period of time. For example, you see with the stock market, when the market goes up, everybody wants to buy stocks. When the market goes down, everybody wants to sell stocks and, if you’re in that position, if you’re buying high and selling low, and you’ve got a long time to plan for, it’s going to be a tough go of it to make sure your money lasts as long as you do so you want to explore all the options, all the tools that are available to give you a stable and secure retirement and that’s something you work with your advisor or your team of advisors on to make sure you’re looking at the right mix. Any other issues that you come across when looking at retirement that people should be considering?

14:38

ALEXANDRA MACQUEEN: There’s a point that I want to make. It’s kind of embedded in the conversation that you were just having, which is that if you say, well, you know what, I want to be all in stocks, I want to continue to actively manage my portfolio for the rest of my life, there are circumstances in which some people are going to want to take those decisions off the table and insurance products allow you to do that. If you’re 85 or 90 years old and your strategy has been I’m going to be all in stocks, that strategy relies on you being able and willing to do that kind of detailed investment management or having somebody that you trust very much do that for you. For some people, psychologically, they’re going to feel more comfortable to say, you know what, I’ve purchased a personal pension and I know a certain amount of money is going to come into my account every month and I don’t have to make any decisions about that.

15:23

JIM: You know, a good friend of mine, and I know you said you’ve chatted with him, too, Curtis Cloke, he’s coined the term buy income and invest the difference, so if you have part of your portfolio that’s stable and predictable, you’ve got the other part of your portfolio where you still can enjoy stock market like returns, but don’t make the mistake of all or nothing one way or the other. Make sure you explore these things and make sure you give yourself the best chance that your money will last as long as you do and especially your income. I want to ask you about one other thing and this is something I’ve seen a lot. I’ve had a lot of people talking about this and, you know, us as Americans, we’ve become very asset-based focused. It’s what on the balance sheet, how big is the number, and I’ve seen a lot of people who might have very strong balance sheets and I’ll just use the example of a farmer where they might have millions of dollars of equipment and machinery and land but if commodity prices go down, they could be multimillionaires but starving at the same time because they have no cash flow. The thing is, when we are working, we have our cash flow secured by a paycheck so we’re able to invest the money and work on that balance sheet but when we stop the paycheck that cash flow stops and, now, we need to get cash flow somewhere and we need to really be cash flow orientated and shift from that balance sheet because the balance sheet might not take care of our cash flow needs so it’s a real mind shift that is really had to get our arms around. I know I, as an advisor, it took me years to really come to grips with that focus changing from the balance sheet to the cash flow sheet. Have you found the same thing?

17:02

ALEXANDRA MACQUEEN: Absolutely. That is such a great comment about the farmer because it really underscores the situation that we find ourselves in when we transition to retirement. It’s exactly what you said. I’ve got to take this pile or this nest egg that I’ve carefully, carefully saved and, now, I have to start selling stuff from it and my entire working career has been premised on don’t sell and save as much as possible and how do you do that, especially if you don’t have a strategy. I think that’s why we say you need a strategy that’s personalized to you so that you can understand, here’s what I’m doing and here’s why I’m doing it and here’s how I’m protected.

17:36

JIM: And working with a professional is really, I look at myself a lot of times as a financial coach. It’s not so much picking the right stock or bond or mutual fund or any of those types of things. A lot of it is coming up with a strategy and then being there to help deal with the emotions as the market is going up and down, as challenges come in, to help people stay on course with what their plan is and your resource, the book that you wrote, Pensionize Your Nest Egg, is a great resource to help you understand how these different solutions work and tools in the toolbox so when you have that conversation with your professionals, it gives you a good base, so, again, we can go on our website and you can go on there and we’ll have this book under resources for you but if someone wants to get the book, where is it all available?

18:24

ALEXANDRA MACQUEEN: Just go to Amazon.com, put in pensionize. You know, we created that word to be memorable and to really describe what you’re doing. Here you are, you’re a working guy, you’re a working woman, you’re going to take your nest egg and you’re going to pensionize it. That’s what we want to communicate and have it stay in your mind.

18:41

JIM: Alexandra, I really appreciate you filling in for Moshe. I think you’ve replaced him as our regular guest.

18:47

ALEXANDRA MACQUEEN: I’d be happy to come back.

18:49

JIM: Well, thanks Alexandra and I think this is something that’s going to be very helpful for people. We really have to rethink things. It’s not the same world that it was before. We’re in a very low interest rate environment. Basically, we’ve had 30 years of declining interest. We’ve also got a very volatile stock market, nothing’s really changed there, but we do have this new dynamic of people living longer and longer. I know when social security was designed, it was designed that the average person would never collect a check as far as life expectancies so it is a different dynamic. Make sure you’re prepared, work with your advisors, and make sure you have a plan that’s going to work for you.

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.