Managing Risk in Retirement - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number Chicago-312. Welcome aboard. With me today is Tim Mullooly and Brendan Mullooly, who was born in Chicago.

Brendan M: It's true. I was.

Tim Mullooly: So I think we wanted to start with two pieces that kind of talked about the same thing from Christine Benz, who works for Morningstar, and I'm pretty sure they are located in Chicago as well.

Brendan M: Also. Sure, that's appropriate.

Tom Mullooly: There you go. Wow.

Tim Mullooly: The first article that she wrote was titled, Is It Time To Rebalance? She looked at what the market's done this year. It obviously dropped a lot in the first quarter, and then bounced right back for investors. Would now be a good time to rebalance? Look at the allocation that you have between stocks and bonds, and see if you need to make any changes based on what's gone on this year.

Brendan M: It could also be looking at the mix within. You could do it across your asset classes. You could do it within your asset classes. Meaning within stocks, have large caps done better than small caps, or vice versa, and what has that done to the mix? How far has it strayed from where you began and what you set out to do?

I just think the conversation surrounding rebalancing is a lot healthier. It's basically rebalancing is market timing, in a sense, because you're making a call to sell stocks, buy bonds, vice versa, or sell something, buy something at a certain point in time. However, it's rules-based market timing, and so I feel like it's less destructive than a decision to say, hey, I want to sell all my stocks, or hey, since I got all out, I need to get all back in now. You're making these incremental moves around the edges to try to stay on a track that you laid out at the beginning.

So, I think it's a more constructive way to think about making some adjustments to your portfolio. Because there are parameters set out at the beginning, so it's controlled.

Tim Mullooly: Yeah. I think it can also help kind of scratch an itch for an investor if they want to be doing something during this market environment. Like, oh, I feel like I should be doing something. Well, having rules and doing a rebalancing is making moves in your account, it's just doing it in a smarter way.

Christine, throughout the two articles that she wrote, was saying how obviously this is more of a risk management tool than a return maximizing tool. Because it's almost counterintuitive to trying to maximize your returns, because you're selling what has performed better and grown in a larger scale in the account, and it's kind of scaling that back. But when I thought about it, I thought it could actually end up helping the performance if it optimizes the behavior in the account. Do you know what I mean?

Brendan M: Also, over the longer term, I think mean reversion will be helpful. So I think when you've rebalanced in the short term, like out of something that's done well, it may not be a positive over the short term for your performance. But over the life cycle of an investor, I think it'll be good because you're admitting that you're not going to nail it, but you're saying like, hey, this thing's had a nice run and this thing's kind of lagged a bit. We believe it on both, because we have him in our portfolio, so why don't we just bring them back to where we originally put them out.

Tom Mullooly: Christine's article, the first one, about Is It Time To Rebalance, as you had alluded to, she looked at a 50/50 portfolio, whether it's stocks versus bonds or value versus growth or US versus non-US. Then she said, hey, if you rebalanced like once a year, here's where you were. Or three years, or five years, or even longer.

So just to kind of put things in perspective, if you had a 50/50 stock/bond portfolio in June of a year ago and you were looking to rebalance now, you're probably somewhere around 48% in stocks and 52% in bonds. The value versus growth thing I thought was really pretty interesting, because growth has done really well, value has not of late. A year ago, if you had put 50% into growth and 50% into value, now the growth side is 56%. pretty big jump there.

So these are good rules to have. Some people want to go in on an annual basis, same day every year. Some people say, hey, when it gets to this point, this threshold, we're going to go in and rebalance. It's really kind of up to the advisor and the client what works best for them.

Brendan M: Yeah. I mean, we went into our portfolios earlier this year and rebalanced, because if you waited a full year on a 50/50 stock/bond portfolio, it hasn't budged much, meaning it's 48/52. But at the end of March, beginning of April, we saw our 50/50 portfolios get to almost 40/60, meaning 40% stocks, just because of how much the market had gone down.

We use more of a threshold-based operation here, and so we saw that drift in the portfolio. That's significant enough to make a move, and so we used that as an opportunity to buy some stocks and sell some bonds to just bring people back to the risk levels that we set out in their portfolios.

Tim Mullooly: Properly rebalancing on a schedule like that helps people stay in line when drops in the market happen because they're allocated the way that they should be in terms of risk. Like the example that Christine gave, if you hadn't rebalanced your 50/50 stock portfolio in 10 years, what you thought might've been a 50/50 stock portfolio was actually 69/31 stocks/bonds. Then something like what happens in March happens and you're like, why is my account going down so much, I thought it was a 50/50 account? But you haven't rebalanced and it's actually closer to 70/30, so you're catching more of the brunt on the downside than you probably wanted to.

Brendan M: Yeah.

Tom Mullooly: I think the hard part of rebalancing is actually doing it. We speak to a lot of individual investors, folks that are trying to manage the account on their own, and a lot of reasons why they come to us is because they say, I should have done this, and I didn't, or it felt really uncomfortable doing it, so I didn't do it. I know that I probably had a good opportunity to rebalance in April or even in May or even in June, but I didn't do it because I'm nervous, because I'm scared, because I'm afraid of making a bad decision.

Brendan M: Yeah. Or the other one, like Tim said, because somebody got greedy and didn't rebalance their conservative portfolio after a number of up years.

Tim Mullooly: I think it's more likely that case. People just get greedy. No one's going to want to sell out of their stocks while stocks are going up.

Brendan M: Things are going well; I'll know when the tides are going to turn.

Tom Mullooly: Yeah, how many times have we heard that?

Tim Mullooly: Then the problem is now it is time to rebalance and they don't want to do it.

Brendan M: Right, because when the market's going down, then it's like the deer in the headlights moment. You're like, all right, I should have done this already. I didn't do it. Now I'm frozen. I can't do anything.

Tom Mullooly: Well, that kind of spilled over into another article that Christine Benz wrote on Morningstar this week, Five Ways That Rebalancing Can Benefit Your Retirement Plan. Those were the reasons for a retirement plan, which we'll get into in a minute, but rebalancing in general makes a lot of sense.

Tim Mullooly: Yeah. I mean, she also said how much value someone puts on rebalancing really does, in her opinion, depend on what stage of life you're in. For younger investors it might not be as important to rebalance. You might be able to let things go for a little bit. But for people that are in retirement or closing in on retirement, you want to make sure that your allocation is exactly in line with where it should be. So I think staying on top of rebalancing is more important for people in retirement.

Brendan M: Yeah. I mean, you're managing risk by rebalancing. So especially if you're relying on your portfolio, you can refill the side of the portfolio, meaning bonds, to make sure that money is there for you as you're going to need it. Because I'm sure that that guided how you crafted that stock bond mix to begin with.

But I think you've got two purposes there. The practical one is making sure that the cashflow that you're going to need from the portfolio is there and coming from something like bonds that are more stable so you don't have to time the sale of stock when you need money. Meaning regardless of what the market's doing, you're going to have to pay your bills on a monthly basis, so you don't want to have to make a decision like in March or April of this year where your stocks are down, you've got to sell them while they're down.

Tom Mullooly: To be clear, what we're talking about is taking the amount of money that you need from the bond side of the portfolio because it's normally a lot less volatile. It's not living off the interest. We've done a video or two about that as well. Yeah, you're right, we want to have something that's fairly stable in value that's going to give us some ballast in the account, but also provide a source for cash when we need to make withdrawals.

Brendan M: Yeah. I mean, there's the practical reason, which is you're going to need income from the portfolio. Either you're collecting income from it now or you're going to soon. The other one is like the more emotional reason. So if you're approaching or in retirement, just the volatility of your portfolio, not only is that important to withdrawals, because obviously if you're taking money from a portfolio and selling stocks while they're down from it, that doesn't bode well for the future of the portfolio in terms of longevity, but also like emotionally you just don't want to see your money moving around that much when you are later on in life and you don't have as much of a runway as somebody else might who is still accumulating.

Tim Mullooly: Yeah. Definitely, it'll make you feel uncomfortable watching that happen, for sure.

Tom Mullooly: Right.

Brendan M: I think in the bigger picture, we do a lot of planning work for clients in terms of working on their cash flow and their balance sheet. So we get an idea of what their cash flow needs may be over the period of time that we can see into the future.

Tom Mullooly: It's really important. I mean, one of the most cringe-worthy things that I would hear early on in my career was a client sending in a check and they would say, I'm not going to need this money for a while, or I'm not going to need this money at all. Then we find out a year down the road or two years down the road, hey, I need that money back, or I need some of that money. I wish that I was back then doing what we're doing now in terms of understanding how this money that we manage for clients fits in with the overall picture.

Tim Mullooly: Yeah. I think having a plan and sticking to that asset allocation, too, like you know what the dollars are for, rebalancing plays right into that. Same thing throughout retirement. There are things that come up along the way in retirement plans, like Christine mentioned, it can help with some of the tax obligations that you're going to have in retirement rebalancing. You can set things aside in your rebalance to help cover your RMD for that year so you don't have to worry about, like Brendan said, selling your stocks potentially to cover an RMD at maybe in inopportune time during the year or something like that. So there were a couple other reasons other than just reducing the risk and staying on the asset allocation that Christine covered as well for the importance of rebalancing.

Tom Mullooly: We'll link to these articles in the show notes. I just wonder off the top of my head, how many people over the last couple of years said I said, I feel stupid having money sitting in the bank doing nothing when I can buy utility stocks or some other mutual fund that's going to throw off some dividends or some income that I can use and they may or may not realize the level of risk that they're taking by doing something like that?

Tim Mullooly: I mean, that's what we talked about in the video this week, too. It's definitely not the smartest strategy for retirement income, something that's steady and reliable, because those things can disappear pretty quickly.

Tom Mullooly: Brendan, you pointed out an article that was in the Wall Street Journal this week about folks who are 65 and older who in the last couple of months have just been dumping stocks because they need the money. I've got to believe that some of these folks originally probably would have had a better allocation towards some fixed income in their account, but for whatever reason now they've tipped the scales and they had too much money in stocks. Then they saw the market going down and they freaked out sold stocks at probably the worst point that they could and said, I just don't have 10 or 15 years to make this money back, or what if the market goes down another 40%?

Brendan M: Yeah. Not to be like a total jerk or anything, but I saw the quote in there about the 10 or 15 years thing, and that guy was 62 years old. He does have 10 or 15 years for that money to continue growing. It's just making sure that it's right size. Meaning, yeah, you're going to need to pay the bills over the next three, four, five years, ten years, you're going to have to make sure that that money is there, and maybe that money shouldn't have been at risk if this dude was 100% in stocks or something like that. It sounded like the guy was basically all in stocks and then made a decision to just pull the plug.

62 years old, I mean, you can do the math. If you don't want to have your money invested in anything or something super short term, take the amount of money you have and figure out how much money you're going to need each year from it and divide it into the total and if it doesn't throw off something that's 20 or 30, if you don't have 20 or 30 times your current income, not even banking on any inflation whatsoever, then you're not in a position to be 100% out of the market because you're going to need some growth over that period of time. So going all out, even if it feels good now, just means you're going to have to get back in at a certain point later.

This guy isn't alone, because I saw stats from Fidelity floating around this week that said between February and May, it was 25 to 30% of people aged 60 to 70 sold all of their equity. All of it. All.

Tim Mullooly: That's nuts. That's nuts.

Brendan M: A quarter to a third of everybody on Fidelity's platform. I saw people quoting and people were like, there's no way that's true, and Fidelity commented on it and said that's the data they have and it's from their platform, which is, I mean, pretty huge. They have tons of 401k assets and they're a huge custodian out there, so this isn't like some little drop in the bucket. 15% of all investors sold all of their equity. So like the older cohort there is kind of skewing the numbers, but there were people under age, 60 included in this too, that decided they were getting all out.

So, yeah, maybe some of these people were opening brokerage accounts with money that should've been in the bank, but this largely could have just been people in their 401ks and IRAs and stuff too. Which, I mean, I don't know.

Tim Mullooly: The thing about these people that are taking all of their money out of stocks, I think at some point they're going to realize that they do need to have some money in stocks, and then they're not going to know when to get back in. There was another example of some guy in Illinois. He was like, I know in general that markets always go up or go up eventually at some point over the long run, but then he also said that he didn't put any money back to work from the great financial crisis through today because he couldn't find a good time to put money to work.

Tom Mullooly: That's 10 years out of the market.

Tim Mullooly: Right. That just speaks to all of these people who take all of their money out and then try and put it all back in or get back in at some point.

Brendan M: It's so much harder than you think. The podcast last week, we talked about the chart from Ed Yardeni that had several reasons every single year since 2009, reasons you could have been scared, reasons the market went down temporarily. So yeah, to think that we're going to just get through all the turmoil that we've experienced on front half of 2020 and there's going to be smooth sailing or like blue skies ahead where it's just going to feel great to put everything back to work, that's fantasy land. That's never going to happen.

If we ever do reach a point where there's no fear and people are just dumping their money into the market; I would take that as a contrarian signal to say stuff is too good right now. If it feels great to put all your money to work, something is wrong. It's not going to feel great, but you have to do it because unless you're going to save 30 times your income need for retirement, which is just unfeasible for most people, then I don't see how you're going to survive with a portfolio that doesn't have any growth in it.

Tim Mullooly: I think it just speaks to having a diversified portfolio, like Christine was saying, between stocks and bonds. But I know there was an article in MarketWatch this week with Suze Orman, where she said, in quotes, "You'd have to be crazy to have money in bonds right now."

Brendan M: I think you'd have to be crazy to listen to this woman.

Tim Mullooly: She's a personal finance, quote-unquote, expert. I use that term loosely. But, jeez, that is dangerous commentary to throw out there. That's suggesting people should have all of their money in stocks. That's how I think some people will read that.

Brendan M: She's making blanket statements. It's silly. She made another blanket statement about how she wouldn't be putting any money into like a traditional IRA at this point and would do all Roth. These are all things that are situationally dependent. For most people, you've got to sit down and run the numbers on what the tax savings would be for a traditional 401k versus...

Her reason was she thinks taxes have to go up in the future. So great, maybe she has a crystal ball that we're all unaware of, but have to put all of these questions into your own personal situation and figure out what's going to work for you. There are a ton of reasons why you might do traditional and Roth, or one or the other depending, and the same goes for your allocation to stocks and bonds.

I mean just because somebody is super old, or they're super young, it doesn't necessarily mean that they have to fit the conventional wisdom. Some people could have investments, somebody could be our age and have two separate investment accounts. One is for their retirement, where they're pretty much all stocks because they're in their thirties. Then the other account could be for something like in the next 10 years, and maybe that's like super conservative and looks like a retiree's portfolio. Blanket statements are ridiculous.

Tom Mullooly: I honestly think we should just hire whoever is the copywriter for Suze Orman, because this is how she gets press. She writes these ridiculous headlines. People are like, she can't be this crazy to say something like this, but it gets people to click on the article. This is what we've been telling people for years.

Brendan M: Right. Then I sound like the nerd saying, well, it's actually more complicated than that. It's like, well, but it is. You know? But sound bites don't give you space to have any nuance whatsoever.

Tim Mullooly: It's just a shame because there are everyday people out there who take what she says very seriously.

Tom Mullooly: It's the gospel for some people.

Tim Mullooly: It's the only financial advice that they... They see a headline on market watch and like-

Brendan M: Her and Dave Ramsey, too.

Tom Mullooly: Did you guys read the article in the Wall Street Journal about the repo man? The repo man is basically out of business. This is the guy who would go around and repossess cars. It was actually a pretty good article where it talked about how the repo man is out of business, the bankruptcy lawyer is out of business, the used car market is pretty much ground to a halt because of people getting these extensions where they don't have to pay on their car loans.

In fact, there was another article in the Wall Street Journal, Americans Skip Millions of Loan Payments as Virus Takes its Toll. It talked about how students or people who have graduated from college and have student loans are getting a free pass on this. You're getting a free pass for a few months on not paying your car loans. The other side of the market that people don't even talk about, like the repo man, normally during a recession, he'd be printing money right now. The bankruptcy lawyer would have a line out the door. The used car guy would be advertising everywhere. They have nothing going on because we've interfered with the normal market cycle by saying, hey, you can pass on making these payments for months.

Tim Mullooly: I'm okay with that, to be honest.

Brendan M: I know everybody has to eat and run a business, but like these are people that profit on other people's misery, more or less. So, yeah, that's fine.

Tom Mullooly: Someone's got to do it. Someone's got to do that work.

Brendan M: It's not indefinite. These things were where people can not pay on loans and things like that, that has an end date. I don't know what the solution is. Let all these people default on all of their debt? Is that better for the economy at large? Or is it better to have some of these businesses not booming like they might have been because things are bad for people out there?

Tom Mullooly: It's a good question. I mean, my understanding with student loans is that if you have continued to make the payments, all that money that's going in is being applied towards your principal, no interest. So you're actually getting a little bit ahead if you're making the payments.

Tim Mullooly: Yeah. I think when I read that article, I was like, people are not paying, or they're in deferment on their student loans, their car loans, stuff like that, for temporarily a few months. Okay, I'm okay with that as long as they know that the loans aren't being forgiven and that these months are being tacked on to the end of the loan. If that's the case and they know that and they need the money now to live and remain in their house or eat food-

Brendan M: People aren't paying their mortgages either.

Tim Mullooly: Yeah.

Tom Mullooly: We could do a podcast on that.

Tim Mullooly: They don't have jobs either.

Brendan M: I don't think people are just doing this for fun.

Tim Mullooly: No.

Brendan M: I think is what Tim's getting at.

Tim Mullooly: It's survival.

Brendan M: If they're doing it to survive, then so be it.

Tim Mullooly: And that's fine.

Brendan M: If that means the repo man can't come take their house or their car immediately, I think I'm fine with that given the state of things right now in this country.

Tim Mullooly: Right.

Tom Mullooly: All right, lively conversation for episode 312. Thanks again for tuning in, and we will catch up with you on the next episode.