The Bogle Perspective

By Editor Test *Mon, Nov 19, 2012*

Jack Bogle commented on investment fees, climate change and gun control at the NAPFA East conference two weeks ago. Jim Otar and Rick Miller presented evidence that, in my opinion, argues in favor of life annuities for anyone in good health.

When Jack Bogle mounted the podium to speak at the National Association of Personal Financial Advisors East meeting in Baltimore two weeks ago, everybody there stood up from their lunches and applauded.

And well they should have. Because by inventing Vanguard index funds that cost only 10 to 20 basis points a year, Bogle eliminated the cost of an active fund manager and opened a niche for fee-based advisors.

Bogle, who was my employer in the late 1990s, is famous for popularizing if not inventing two slogans: “Stay the course” and “Costs matter.” Years ago, he pointed out the obvious but overlooked fact that while fees may represent a trivial fraction of an investor’s principal, they can consume a staggering proportion of his returns in the long run.

His lecture at the NAPFA conference was, as it usually is, passionate and populist. Using simple charts and graphs, Bogle demonstrated that the average investor, after adjusting his or her returns for fees, taxes, inflation, bad luck and errors, is lucky to net 2% a year from investing in stocks and bonds.

Maybe they admire him because he says—and his voice cracks into a disarming falsetto when he gets excited—what most of us can’t say, which is simply the truth. He started doing it decades ago, well before sheer longevity gave him license. Case in point: He ended his talk with a declaration that combatting climate change and controlling the proliferation of firearms are the country’s two greatest imperatives. “That has to be stopped,” he said about guns.

Whether investors agree or disagree with Bogle’s broader opinions, they have certainly endorsed his investment philosophy. As of the end of October, Vanguard was the largest mutual fund family, with over $1.5 trillion in assets (a five- or six-fold increase in 15 years) and a market share of about 17%.

* * *

Only a few of the presentations at the NAPFA East conference focused entirely on retirement income.

Jim Otar, the Toronto engineer-turned-advisor, whose 2009 book (“Unveiling the Retirement Myth”) and retirement calculator (the $100 Retirement Optimizer) have earned a modest cult following, gave a talk called Advanced Retirement Distribution Planning. Rick Miller, the well-known Boston-area economist-turned-advisor, gave back-to-back breakout sessions on Understanding Longevity.

Neither of these speakers strongly advocated life annuities per se, but both of them presented evidence that, in my opinion, argued implicitly in favor of them. Their numbers suggested that most healthy couples with long-lived parents who want to maximize their annual spending in retirement should probably use at least part of their money to buy a life annuity that starts sometime after age 70.

Here's why. Otar's "Zone Strategy" diagrams, which depict the segmentation of clients into those who are underfunded, barely funded, and abundantly funded for retirement, illustrated his contention that the greater the percent of their savings that retirees want to spend each year, the more strongly he would advise them to buy life annuities after age 70—or ignore a high risk of running out of money before they die.

To put that another way: Regardless of how much money you start with, a life annuity can increase your freedom to spend and consume. Those in poor health, or who can afford to live on their investment yield alone, or who value a big legacy over current consumption, are the only ones who *wouldn't* benefit from the payoff that comes to annuity owners—assuming that they live a long time.

Rick Miller's presentation showed just how long Boomer couples (particularly those who are healthy and wealthy) should expect to live, and it's well into the life-annuity-makes-sense range. An advisor today can count on seeing up to three of every ten 65-year-old male clients and four of every ten 65-year-old female clients reach the age of 90, he said. One in eight retired men and one in five retired women will reach age 95.

Ergo, prudent advisors should assume that their healthy 65-year-old client couples will spend up to 35 years in retirement. (Cindy Levering of the Society of Actuaries assisted Miller on the presentation.)

At present, few fee-based advisors recommend life annuities—because the yields (before age 70) are low and because they'd reduce their own fee income if they did. (Annuitized assets don't ordinarily count as AUM.) But if an advisor expects at least one member of a client couple to live beyond age 90, encouraging them to buy a joint-and-survivor life annuity might be the most fiduciary thing to do.

At the very least, a life annuity reduces overall portfolio risk and thereby allows clients to take more risk with their non-annuitized wealth. It could also spare them the anxiety and indignity of worrying about market volatility in their old age, or about running out of money before they die, or about spending the funds they had hoped to preserve for a legacy.