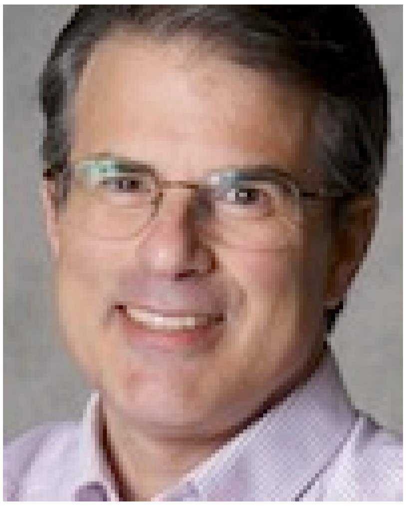
The Pfau Phenomenon

By Kerry Pechter *Thu, Oct 10, 2019*

In a decade's worth of presentations, books and research papers, Pfau has arguably pierced the resistance of independent advisers to the floor-and-upside retirement income method (and to annuities) to a degree that others have not.



Wade Pfau's arrival as a retirement income guru became clear to me during a presentation held long ago in the Merton Miller Forum at Dimensional Fund Advisors's modernist headquarters on Bee Cave Road in the brown hills west of downtown Austin, Texas.

Pfau wasn't present at that session (part of a Retirement Income Industry Association (RIIA) conference), which focused on **BlackRock's CoRI** planning tool. But, during the Q&A period, one of the advisers in the room raised his hand and said to the speaker, "I hear you, but *Pfau says*…"

For me, that was Pfau's tipping point. For others he may have arrived earlier. Armed with a Princeton Ph.D. in economics, Pfau, 42, has steadily gained respect over the last decade as an academic on whom advisers and annuity issuers can rely for firm evidence that the most efficient way to fund personal retirement is to blend investments and annuities.

His now-solid reputation is based on producing prize-winning articles for the *Journal of Financial Planning* and other adviser publications, directing The American College's Retirement Income Certified Professional (RICP) program, and logging a lot of miles on the adviser conference circuit.

And, not least, by writing books on retirement income planning. Two years ago, the self-effacing Iowan self-published ***How Much Can I Spend in Retirement: A Guide to Investment-Based Retirement Income Strategies***. He followed it with ***Reverse Mortgages: How to Use Reverse Mortgages to Secure Your Retirement***.

[In the interest of full disclosure: Pfau's books have been offered as premiums for new full-year subscribers to *Retirement Income Journal*.]

Safety-first

Now Pfau has published the book I've been waiting for: ***Safety-First Retirement Planning: An Integrated Approach to a Worry-Free Retirement***. It pulls together everything advisers need to know about the various kinds of income-generating annuities and how they fit into a retirement income plan.

"Safety-first" retirement planning simply refers to a belief in funding all of one's essential expenses in retirement—the core liabilities—with guaranteed sources of income like Social Security, pensions and, if those two don't cover the essentials, with an annuity that produces guaranteed income for life. Excess savings can be invested in risky assets.

This idea is not new. In fact, during my stint in retirement product marketing, I asked my boss to summarize our official position on single-premium immediate annuities, and that's essentially what he told me. It's a concept that Pfau's predecessors and peers—Zvi Bodie, Harold Evensky, Moshe Milevsky, Joe Tomlinson, Steve Vernon et alia—would not dispute, especially where "constrained" (i.e., strapped) retirees are concerned.

In fact, "safety-first" planning strongly resembles the "floor-and-upside" methodology behind the Retirement Management Analyst designation developed by Pfau, Michael Zwecher and others under the guidance of Francois Gadenne a decade ago at the (late, great) RIIA.

But Pfau, perhaps in part because of his Princeton stamp-of-approval, has arguably pierced mainstream independent advisers' resistance to this general concept (and to annuities) to a degree that others have not. Most advisers, indeed, are still quite attached to the "4%" safe withdrawal rule (which is really a preserve-and-grow-principal philosophy that works best for high net worth retirees).

His diligent and thorough calculations, explanations, and Monte Carlo simulations give advisers—especially advisers unfamiliar with insurance products—the intellectual confidence they need to recommend annuities to clients entering retirement.

Advisers, it seems reasonable to say, are risk-takers, and the fear-driven risk-reduction aspect of annuities (not unlike the risk-reduction aspect of index investing years before) alienated them. His charts and graphs have shown that annuities are justifiable on the basis of greed and not just on fear.

More specifically, he has articulated the proposition that by replacing the bond allocation of a total return portfolio with income annuities, you can get higher yields than bonds, while allowing the retiree to take more risk with his or her equity allocation. The result is higher utility, as Pfau writes on page 277 of the new book:

"All income annuity participants, both the short-lived and long-lived, can enjoy a higher standard of living while they are alive than they would have otherwise felt comfortable with by taking equivalent amounts of distributions from their investments."