Unmet Expectations

By Joseph A. Tomlinson, CFP *Tue, Dec 21, 2010*

Here's one observer's somewhat disappointed reaction to the special section on Retirement Income Planning in the December 2010 issue of the Journal of Financial Planning.

With the first of 78 million baby boomers reaching the milestone age of 65 in 2011, the timing of the publication of a special section on Retirement Income Planning the *Journal of Financial Planning* this month was certainly appropriate. This piece of research has not arrived on planner's desks (in print or via the Web) without controversy, however.

The always-forthright financial planning industry pundit, Bob Veres, reviewed it harshly. In fact, he called for "an honest debate about whether [the Financial Planning Association's] research department is offering any value with these various reports and studies." Ouch.

Was Veres unfair? Subscribers to Veres' *Inside Information* can read his full review and draw their own conclusions.

But I too was disappointed in this four-part special section. I thought it was too superficial a treatment of what is an important topic for financial planners. In the following appraisal, I'll try to assess the value of the articles in it, which include a write-up of a survey of financial advisors, a Q&A session with advisor Roy Diliberto, an article on creating a "hierarchy of funds" and an article that compares Social Security claiming strategies for couples.

Part I: The FPA Survey

The first section, a write-up of the results of a survey of 425 Financial Planning Association, was entitled, "Planners Find Success with Retirement Income Strategies." The title surprised me. Anecdotal evidence tells me that relatively few planners use retirement income strategies; most of them apply the same old systematic withdrawal strategies.

And, given what I know about America's inadequate savings rate, abandonment of defined benefit plans, and under-utilization of products with longevity guarantees, I don't see a whole lot of success to celebrate.

Systematic withdrawal strategies without guarantees may work fine wealthier for Americans—to whom financial planners unquestionably cater to a wealthier class of people. But planners should consider the use of income guarantees for clients of more modest means.

The JFP survey shows that the decumulation strategies used most frequently by planners are "structured systematic withdrawal " (50%) and the "time-based segmentation," aka the "bucket method" (28%). The methods that do focus on guaranteed income, the "essential versus discretionary approach" and "Social Security and/or pension" approach, are used by only 14% and 4%, respectively.

The times are changing. But most planners are not.

The survey discussion ends by talking about withdrawal rates based on findings that average estimated safe withdrawal rates have increased from 4.4% in 2009 to 4.75% in 2010. Dialog with financial planning heavy hitters Michael Kitces and Jonathan Guyton is also included.

Kitces' original research on the impact of market valuations on withdrawal rates uses historic data to show safe withdrawal rates as a function of the P/E 10 valuation measure, which was popularized by Robert Shiller.

Kitces' "always historically safe" withdrawal rate ranges from 4.4% for the highest (19.9 to 28.7) P/E quintile to 5.7% for the lowest (5.4 to 12.0) quintile. The P/E 10 measure is now around 23 with the S&P 500 at 1240, indicating that 4.75% may be a bit aggressive.

Part II: *"Using a Hierarchy of Funds to Reach Client Goals"*

This article rather grandly declares that it's time to move from modern portfolio theory (MPT) to what the authors call modern retirement theory (MRT). I can't disagree with that. But they don't build much on that. Their core argument simply asserts the desirability of splitting expenses into essential and discretionary, and funding the two types of expenses differently.

The authors propose funding essential expenses with conservative investments and annuities while funding discretionary expenses with riskier products. They recommend an additional bucket for emergencies expenses, funded with highly liquid investments, and a bequest bucket, if desired, filled with long-term volatile investments.

Personally, I believe that a method based on these general guidelines can be particularly useful in helping clients of average means achieve a higher level of financial security in retirement. The fact that it may be more suitable for middle-class clients than wealthy clients might explain why, as the JFP's own survey shows, only 14% of planners use it.

Part III: *"Life Planning Meets Retirement Planning"*

In this brief interview with a JFP editor, advisor Roy Diliberto attempts to articulate the difference between financial planning and life planning. As many advisors can attest, not everyone who excels at *textbook* financial planning can be an effective *life* planner. Life planning requires some of the skills, if not the actual certifications, of a clinical psychologist.

The unspoken topic here is behavioral economics, and the application of behavioral economics theory to decumulation strategies is a new and potentially fruitful topic for discussion. In the past, researchers like Daniel Kahneman and Richard Thaler have explored the behavioral aspects of accumulation, but there's been little discussion of the implications of behavioral economics for decumulation.

The interview with Diliberto, who is CEO of Philadelphia-based RTD Financial Advisors, Inc., raises hopes for such a discussion but ultimately disappoints because of the sheer familiarity of the responses. Not that they aren't sensible. For instance, instead of asking clients, "When do you plan to retire?" he prefers to help clients imagine specific activities at specific life stages. That's perfectly reasonable, but it's not new or interesting.

Similarly, he rejects the assumption that most people will spend less in retirement—but few advisors still assume that anyway. When the interviewer asked, provocatively, "What happens when what clients say about their retirement goals doesn't line up with the actions they take?" Diliberto responds with a reference to clients who feel financially insecure even when they have not reason to. His answers are interesting—but the interview broke no new ground.

Part IV: *"5 Social Security Strategies for Couples"*

In its discussion of the economic impact of various Social Security claiming strategies for couples, this article is quite useful. It helps raise awareness about the financial benefits of delaying claiming Social Security. It also makes clear that, because the benefit level transfers in full to the surviving spouse, Social Security might best be thought of as a "last-to-die" annuity.

However, an article by William Meyer and William Reichenstein in the March 2010 issue of the *Journal of Financial Planning* covers similar ground better. Why do I say that? Fahlund postulates a single instance of a couple where the husband dies at age 80 and the wife dies at 95. Meyer and Reichenstein build mortality tables into their analysis so that they can show probability-weighted results. Second, Fahlund evaluates strategies based on total lifetime payouts where Meyer and Reichenstein calculate the present values of lifetime payouts.

In sum, I had hoped to find fresh, practical ideas in JFP's special section on Retirement Income Planning. Given the importance of the topic, I expected material with greater depth, seriousness and ambition. But my expectations went largely unmet.

You can reach Joe Tomlinson at joetmail@aol.com.