The Rational Reminder Podcast - EPISODE 34

[INTRODUCTION]

[0:00:05.6] Benjamin Felix: This is the Rational Reminder Podcast, a weekly reality check on sensible investing and financial decision-making for Canadians. We are hosted by me, Benjamin Felix and Cameron Passmore.

[0:00:16.0] Cameron Passmore: Now we're in the rhythm of one-week guest, one-week us. So we pretty much have that figured out.

[0:00:20.8] BF: Yeah. Today was a good episode. We have this intention and we often don't do it, because we probably scrambled to prepare for the episodes where it's just us and I end up just talking whatever was on the top of our minds. Our intention is to have— and I've said it before, so sorry if I sound like a broken record. Our intention is to have a main topic that we go over and then we'll talk about a couple articles too. Anyway, today we did that. We talked about savings rates, which is some really interesting financial planning research.

[0:00:50.0] CP: It's also good to dig into some planning stuff and little more chilled on the factor side. Although, we did talk about factors and—

[0:00:57.7] BF: Can't not talk about it.

[0:00:58.9] CP: I know, but this is really important for people financially interested and planning for long-term, there's some really interesting data on the savings rate.

[0:01:07.0] BF: We also addressed our frequent mentions of Dimensional. Some people will be happy to hear what we have to say about that, I think.

[0:01:14.2] CP: Yeah, we appreciate the feedback. Anyways, have a listen.

[EPISODE]

[0:01:24.4] BF: Welcome to episode 34 of the Rational Reminder Podcast. We have a main topic that we want to go through today, which is safe savings rates, which is a really interesting topic that we think you'll find informative, I guess.

[0:01:39.8] CP: Yeah, most people are aware of safe withdrawal rates. This is different. This is the other side of the coin.

[0:01:44.4] BF: It's both sides of the coin. I think that's the thing.

[0:01:46.5] CP: That's the key.

[0:01:47.4] BF: Yeah. It's like the 4% roll is how much you can spend from a portfolio of X amount once you have retired, but the safe savings rate looks at the full cycle. Instead of just looking at, once you have a portfolio and you retired, how much can you spend, it looks at how much you need to save for 30 years, such that you can spend the desired percentage of your income for the following 30 years.

[0:02:10.9] CP: We'll get to that.

[0:02:11.8] BF: Yeah. We have a couple things we want to go through before we get there.

[0:02:15.7] CP: We had a bit of feedback this week from someone that feels that we're talking too much about Dimensional fund advisors.

[0:02:22.3] BF: It's not the first time this has come up. We thought we needed to address it. I guess, the most important thing to keep in mind from that perspective is that this podcast was put together and designed for primarily our own clients and to that audience, Dimensional fund advisors is highly relevant.

[0:02:44.4] CP: Right. Now the audience has grown beyond just our clients, so I think it's a reasonable piece of feedback.

[0:02:50.7] BF: Yeah. I mean, the thing with Dimensional is that if we were talking about Vanguard or iShares all the time, nobody would have this feedback, I don't think.

[0:02:59.5] CP: Because everyone has access to it.

[0:03:01.4] BF: That's my guess. Yeah. With Dimensional, all of a sudden it's this thing that you can't just go and buy, you have to work through a firm like ours. I get it. If someone does not have a financial adviser who is using Dimensional funds, then of course, you feel I guess excluded, or I get how it wouldn't be a nice thing to hear about often if you can't access it.

[0:03:23.6] CP: It was an alternative. You've been building another model that we can use to talk about, right?

[0:03:27.3] BF: Yeah. I mean, we're not going to stop talking about factor investing, because that's pretty core to our beliefs, so we can't change that just because people don't like hearing about Dimensional. What we can do and what we've done is design a set of ETF model portfolios that employ as much as possible the factor investing philosophy using— I mean, there are tons of factor funds out there now, but we've designed some that use the same principles that Dimensional uses in their products. Going forward, our intention is to de-emphasize talking about Dimensional funds and instead, talk about the rational reminder model ETF portfolios.

[0:04:05.6] CP: Talk about the evidence around this, because basically Dimensional uses evidence. We're going to stick to the evidence side of this.

[0:04:11.1] BF: Yeah. We're getting away from the product, moving more toward the ideas, but we've given ourselves an alternative product that we can talk about without stopping and talking about the factors that we believe in. We think this is going to be better for the overall audience. Now, I guess the thing to keep in mind is that the podcast was still built for our clients and we're not taking funding from advertisers or anything like that. Our primary audience is still our clients. We're going to do our best not to alienate non-client listeners and we're doing that by talking about our new model ETF portfolios, which we'll launch in a future episode.

[0:04:51.0] CP: I've always found it interesting how Dimensional is such a polarizing character in the industry.

[0:04:56.1] BF: Because you're basically saying these products are great, but you can only access them if you pay our fees.

[0:05:00.4] CP: Right. It's the access side of, I think. That really alienates people who want to have a broad number of suppliers in their offering.

[0:05:09.2] BF: Anyway, so we're mostly done talking about Dimensional, but not completely done just because it is still highly relevant to our clients. As much as possible, we're going to talk about our ETF model portfolios that have the factor tilts. Again, we're going to talk in more detail about how we design those in two weeks' time.

[0:05:27.3] CP: The world is exploding with asset allocation ETFs, which I think is a great thing.

[0:05:31.8] BF: We just did a YouTube video on them. Right after it launched, or maybe it was a couple days before it launched, BMO also came up with their own.

[0:05:41.5] CP: Three, I believe. 60/40, 40/60 and 80/20 on decision ETFs.

[0:05:45.9] BF: Now we've got iShares, Vanguard.

[0:05:48.8] CP: Vanguard's got the full suite.

[0:05:50.5] BF: They've 20/80 all the way up to a 100% equity. 20 fixed income, 80 equity. Horizons has had their total return balanced ETFs for a while now. Now we've got BMO in the mix too. I mean, it's interesting. Probably a good thing for investors. It would probably be a better thing if only one company had made them, because then it makes it easier to choose. I think that now there will be more—

[0:06:11.8] CP: It's a lot better to choose the asset allocation as opposed to individual funds.

[0:06:16.8] BF: That's what I mean.

[0:06:17.1] CP: We don't know about the behavior around individual funds.

[0:06:19.5] BF: I know, but now we have this problem of people— if you don't have the context to think about which one is better and they might have tracking here, because they are all using slightly different methodologies. All of the sudden, the BMO 80/20 fund does better than the Vanguard one. You think people will be wanting to switch? I wouldn't be surprised.

[0:06:37.2] CP: Maybe. This has great rates. I mean, the balance is very similar between them all. They're all solid companies, but I think this is great for investors.

[0:06:46.4] BF: Of course, it's great for investors. I haven't dug into the BMO ones yet, but the Vanguard and iShares we dug into pretty deep when we did the recent YouTube video. I think just from what I observe online, people seem to be getting hung up on the asset allocation ETFs in terms of you should only buy this new RSP, or you should never buy this new taxable account. Or do these make sense in ETF and saying, people are getting all caught up in that as opposed to just—

[0:07:12.2] CP: It's pretty small potatoes you're talking about.

[0:07:14.4] BF: Yeah. I mean, the problem in the registered accounts is form withholding tax, but we ran the numbers on that for the 80/20 Vanguard and iShares. You're looking at about

20 basis points of unrecoverable form withholding tax in that account. Now how could you do better, which is the only reason this matters if you go out and buy US listed ETFs for Canadian and international stocks. You can get your unrecoverable form withholding tax down for the 80/20 to maybe five biggest ones.

[0:07:42.8] CP: Then you got to compare to manage the asset allocation and rebalancing. That's the tradeoff.

[0:07:47.4] BF: The currency. You got a bit of a cost to conversion. You might say 15 basis points by going US-listed. Yeah, you're adding complexity, you're adding mental overhead and depending on how you do the foreign exchange routing potentially significant cost. In either case, routing complexity.

Then in the taxable accounts, I've seen people getting caught up about this too, where there's this thought that well, you shouldn't buy this in your taxable account, because they are using just regular total market bond funds. Because we've been through this interest rate environment where rates have been coming down, down, down, down, down for such a long time, a lot of bonds have gone up in price.

[0:08:23.2] CP: Premium bonds.

[0:08:23.7] BF: Exactly. We got this issue of premium bonds. Now premium bonds are relatively taxed inefficient, compared to say a par bond, or a discount bond, or a GIC. We ran the numbers on that too and with where things are at now, I think it was— yeah, it was 14 basis points of tax inefficiency, I guess you'd call it for holding the premium bonds, as opposed to par bonds or GICs.

[0:08:49.4] CP: That's a temporary phenomenal one.

[0:08:50.9] BF: That's the thing. You look at the chart over time and the problem is when you have coupons that are much higher than your yield to maturity. Three or four years ago, there was a big gap. That gap has been narrowing as rates have come up. I mean, you got to think about it, even if rates stayed flat and bonds are just being issued at par, at par, at par, the premium bond issue still goes away over time.

The only time this is a major issue is we have a long period of falling rates, which we I mean, structurally can't have. Well, it's unlikely that we would have that again over the next 30 years like we had in the past 30 years.

[0:09:28.5] CP: Speaking of BlackRock and Vanguard, I saw an article this morning the *Financial Times,* I don't know if you've seen this yet, showing that BlackRock and Vanguard pulled in 57% of net global long-term fund flows last year.

[0:09:42.1] BF: It's unreal.

[0:09:44.1] CP: Mind-boggling number. Get this, I didn't realize this number. There's 95,000 funds worldwide in the database from 4,000 different companies. This phenomenon, I'm going towards the passive that is really largely driven in the US, the little table at the bottom. It looked like Canada still has net inflows into active, if you can believe it. Whereas passive to active in the US is 5:1 ratio. It's unbelievable how the US is leading on this. I don't know what it is about that marketplace, if it's awareness, if it's the Jack Bogle Vanguard phenomenon.

[0:10:15.5] BF: Well, that's what Rick— Rick Ferri talked about that one when we spoke with him. He talked about well, it's the Vanguard-effect which is well-known, but the way he positioned with— I don't know if this was during the episode or afterwards. The way that he positioned was fascinating to me, where Vanguard has an incentive to spread the message of low-cost index investing, whereas every other company is disincentivized to do so.

Then Canada, we don't have Vanguard the way that the US has Vanguard, because of the way that Vanguard is owned in Canada. They don't have the same incentives here as they do in the US.

[0:10:46.4] CP: The incentives in the US is to drive the cost per unit hold or lower, because it's a true mutual company.

[0:10:51.8] BF: Right. Whereas, the Vanguard Canada entity is not a true mutual company. Then all of the other financial institutions, like they're only getting an index investing now, because they see the money is going there anyway. If they don't get in, they're toast, but it took them a long time, because they had obviously rather keep their active business, which is orders of magnitude more profitable.

[0:11:10.6] CP: Let's talk about this cool paper that we came across in terms of factor investing. I think we found it from a Rick Ferri post, talking about the successful investors who invest into factor funds versus portfolios of factor funds.

[0:11:25.6] BF: It was a good study. I read it twice. When you send it to me, I told you it wasn't that good. I read it a second time and it's actually really good. I looked at data from the crisp survivorship bias free mutual fund database for US funds and then they looked at Morningstar data for global funds from 1990 through 2015. The way they do the comparison was actually interesting. They're using CAPM Alpha as the measure of a performance.

[0:11:51.4] CP: Not too much jargon in there.

[0:11:53.5] BF: Well, just like risk-adjusted performance from the perspective of market risk. If two funds take the same amount of market risk but one has better performance, the better performance is Alpha. Now that's interesting when you think about factors, because you look way back to the factor research initially and that was the problem; when you're looking through— looking at factors through the market risk lens, people were noticing that while small CAP stocks are producing alpha, they're producing consistently higher risk adjusted returns same as value stocks. Originally, people are saying, "Well, markets are inefficient," but then the factor model just gets updated and all of a sudden, markets are efficient again.

[0:12:31.8] CP: Efficiently pricing the risk.

[0:12:33.3] BF: Yeah, exactly.

[0:12:34.7] CP: Because I found that factor funds tended to outperform the funds themselves. However, the investors in those funds— I think this is the key. The investors in those funds underperformed. There could be a bunch of reasons for that. I mean, obviously it's bad timing, but what is causing the bad timing? You have a pool of investors that are overconfident in their skill?

[0:12:52.7] BF: Well, the paper says that people— as you'd expect in general from the data that we see, people are chasing past performance. Factor strategies tend to have good past performance and investors tend to pile money and after the past performance has happened. One of the things the paper looked at is smart money, the ones going into the factor strategies and they said they found that no, it's not. You would define smart money as, if the money piles in before the outperformance happens, that's smart money. No, they found it's just people chasing past performance, which is why the investors have underperformance relative to the funds. It's the same study you'd see anywhere.

[0:13:29.4] CP: This is the beauty of having a one-decision portfolio that has a variety of different factors with the constant rebalancing. I mean, look at what happened with small caps in January. [Inaudible 0:13:38.4] did an article on that on the weekend talking about how I think a small cap value is up 20 plus percent in the first month. You'd need to go see the flow of funds after that happened.

[0:13:51.0] BF: One of the other things in the paper that I found fascinating was they showed the data and this is just the US portion. I didn't dig into the global portion they looked at, but they said in the paper that it was similar result. Anyway, for the US funds they looked at traditional actively managed mutual funds and found that only 17% of them produced alpha after fees.

[0:14:12.2] CP: Such a small number.

[0:14:13.0] BF: Positive alpha after fees in the long run. Then they looked at factor funds and they looked at low beta, which I want to talk about in a second too, but they looked at low beta, 52% produced positive alpha, small cap funds 53% produced alpha, value funds 52%, momentum 40%, which is also an interesting point, because we've looked at that data in the past. Momentum looks great in the data, hard to capture. We see that here.

Funds that chase profitability, which is another known factor, 57% produce a positive alpha. Anyway, it was interesting data. Their point was yes, this alpha is real and it has produced good long-term results, but investors aren't capturing it on it.

[0:14:55.3] CP: They can capture it in a rules-based portfolio.

[0:14:58.6] BF: Well, it’s what the paper is saying. They're saying people are chasing factors. Therefore, they're not actually capturing the returns. The data is real. The factors are there. People just need to buy and hold, which is the same as, I mean, that's not new. I think that they’re—

[0:15:11.5] CP: Well, it's the same as the overall market is another factor.

[0:15:13.9] BF: Their main point was this outperformance is real, but nobody's really getting it. Figure it out people. The thing that I wanted to point out about low beta, I read another article from I think CFA Institute put it out. The art of the whole article was somewhat interesting. It was just talking about, I guess in a way similar to this. It was talking about factor returns versus smart beta returns.

Factor, those were long-short portfolios. That's how a factor is defined. The small cap factor is the return of small cap stocks minus the return of large cap stocks. That's long small caps, short large caps. Now most investors don't actually invest in long-short portfolios. They'll just go a little bit more long small caps, but there's no short.

[0:16:02.2] CP: Yeah. Just do the tilting.

[0:16:03.7] BF: Just the tilting. Yeah. A factor portfolio is long-short, smart beta which is what the article I read was referring to as the long-only implementation is just long. Now the interesting thing about that for smart beta, or sorry, for low beta is that low beta looks really good on the factor side and really bad on the implementation, the long-only implementation side.

[0:16:27.9] CP: Why?

[0:16:28.7] BF: Yeah. The why is why it's so interesting. Low beta stocks, well by their name, they're low betas. They've got relatively low exposure to market risk.

[0:16:38.4] CP: Lower volatility.

[0:16:39.7] BF: It's a lower volatility, but the data show and the factor data show that they have higher risk adjusted returns. Okay, so that's interesting. It doesn't show up as higher returns in the long-only portfolio. The article goes on to explain that they look so good in the factor data, because they're long-short, so you're eliminating the market risk. That makes sense?

[0:17:02.5] CP: I think so.

[0:17:03.1] BF: In the long-short portfolio, there is no market risk. You're only looking at the factor. Then as soon as you get in the long-only implementation, now you're being affected by the low beta exposure, which means you've got lower expected returns because you've got lower exposure to market risk. Anyway.

[0:17:17.7] CP: Bit of a head-spinner.

[0:17:20.1] BF: I thought it was interesting.

[0:17:21.6] CP: Okay, let's get on to safe savings rates. I know you've taken a real interest in this. This goes back to an article in the Journal of Financial Planning back in 2011.

[0:17:31.6] BF: Wade Pfau wrote about it first, I think.

[0:17:34.8] CP: He's the one that popularized the 4% safe withdrawal rate on retirement that so many people have heard of.

[0:17:40.0] BF: Pfau knocked it down. The 4% rule was— I can't remember the guy's name now. Pfau was the guy that took the 4% rule and said that it only works in the US data that he showed globally and based on current price earnings ratios, 4% rule probably doesn't make sense. Anyway, Pfau is related to 4% rule. I can't remember the 4% rule guy's name.

What Pfau said is that a traditional financial planning, which everyone's pretty familiar with, follows four steps, where step one is you've got to figure out how much you need to spend from your portfolio in retirement. If you're going to replace 70% of your income overall, maybe 50% of that has to come from your investments.

[0:18:23.8] CP: There's no taxes taking an account in the study, was there? It just said 50% of your income.

[0:18:29.0] BF: Yeah. The factor taxes in by picking a different number. In his example in the article, he used 50% replacement, but yeah. Anyway, you have got to figure out how much you need to spend, so let's say it's 50% of your working income as an example. Then you've got to decide on a withdrawal rate, so that could be the 4% rule, it could be the 3.5% rule, whatever it is; tons of different data on that. That in itself is a decision, which the spending rule you're going to use. Then you've got to figure out how much you need to save to get a portfolio large enough to fund your desired portfolio expenses based on the withdrawal rate that you want to use.

[0:19:04.8] CP: So far, this is all normal.

[0:19:06.3] BF: This is traditional financial planning.

[0:19:08.3] CP: Traditional retirement planning goes.

[0:19:09.8] BF: Then the last step, step four is figure out how much of your income you need to save to achieve that wealth accumulation goal, such that you can spend whatever percent of the portfolio to fund your desired lifestyle.

[0:19:21.0] CP: Right. The problem with this, and I get this from reading the paper, is that it decouples the savings side of the equation with the withdrawal side. That's the issue here. Those two have historical links that do matter a lot.

[0:19:34.1] BF: Yeah. That's exactly it. When you look at a single period, like if we think about the 4% rule comes from basically the worst 30-year period for a retiree in the US data. What Pfau was saying in his paper is that, if we look at that one 30-year period in isolation that's true, but the preceding 30 years, so the years that somebody would have been saving, tend to have much higher returns. If you retire right before a period that has long a long period of low returns, relatively low returns, it's highly likely that the preceding 30-year period had relatively high returns.

[0:20:12.3] CP: Therefore, your savings rate could be lower.

[0:20:14.3] BF: Therefore, your savings rate could have been lower. You end up not planning too conservatively on the savings side, or too aggressively on the retirement side by decoupling the two time periods.

Pfau suggests as opposed to that four-step traditional financial planning process, he says step one, same as above, figure out how much of your income you want to replace. Then step two as opposed to looking at the historical data to figure out what a safe spending rate is, look at the historical data for the full period, the savings period and the withdrawal period and figure out what historically would be the safe amount to save of your income for the entire time that you're working, such that you can fund your retirement, ignoring the value of your portfolio at retirement.

[0:20:59.9] CP: If you're in a period of lower expected returns, that means it should allow you to have a large withdrawal rate once you retire, because returns would be expected to be higher later, if you believe in these big cycles.

[0:21:13.4] BF: Yeah. That's one of the things that was a red flag for me in the research is that it is assuming that there are cycles. Now there have been. There has been serial correlation in stock returns.

[0:21:24.1] CP: It's a message than not to be too excited if you happen to get a really bad time in the markets. I mean, they talked about how in 2008, imagine if you retired January 2008 and you compare that to January 2009, your portfolio is down 25% to 40%. That 4% is a massive difference.

[0:21:43.1] BF: He says that this is one of the tragic things about traditional financial planning is that you have two people who retire one year apart, one of them happens to retire with a million dollars, the other one happens to retire with $600,000 and they're using the 4% spending rule. One of them is going to spend way less than the other for the rest of their retirement.

[0:22:00.3] CP: Yeah, because that assumes— that 4% rule assumes that's the number when you retire, you stick to that number with inflation through your retirement, but the practical on-the-ground reality is that most people review these numbers every year to make sure they're on track. We're always coaching people to make sure that they're spending, their need to spend is way less and their ability to spend if possible. It's a discretionary cushion that—

[0:22:23.8] BF: When you take safe savings rate perspective, you don't care about what your portfolio is valued at. The withdrawal rate for two people who have done a safe savings rate planning approach as opposed to a safe spending rate, their withdrawal rates could be vastly different.

[0:22:37.9] CP: Exactly. Exactly.

[0:22:39.3] BF: They don't care. They're not looking at the value of the portfolio. They're not looking at their withdrawal rate, but they are making this assumption about the cyclicality of returns.

[0:22:46.5] CP: How do you see this trickling down to actual advising clients?

[0:22:50.8] BF: I mean, it could be a whole other way about thinking about all of this, because right now, we do think about it from the traditional approach where we've got a wealth accumulation goal. As soon as you implement a safe savings strategy as opposed to safe spending, it changes the whole conversation around financial planning. I guess, one of the other important pieces about this is that if you only look at the safe savings rate to achieve a wealth accumulation goal, because you can do it both ways, right?

You can say okay, if you have a million dollars, you can spend 4%. The other side of that is what's the worst-case scenario of required savings to get to a million dollars? That's still two decoupled scenarios. In the research, Pfau showed that you would need to save in the worst-case scenario to get to your desired accumulation goal, you need to save 37.7% of your income, which is crazy, like no one's going to do that. That's the equivalent of the 4% rule on the savings side, 37.7%. That's still looking at the two periods in isolation decoupled.

[0:23:51.4] CP: We should throw this table that we have here in the show notes, because it does show you based on different asset allocation assumptions how many years in retirement and how many years of saving, what your savings rate should be. They are big differences in the numbers. 30 years of savings and 30 years in retirement, the savings rate is just over 16% of your income.

[0:24:11.8] BF: That is base case.

[0:24:13.6] CP: If you have 40 years of savings, that goes down to 8% to 9%. We're just that 10% rule that David Chilton popularized.

[0:24:21.9] BF: I guess, one of the other big points of this is that if you happen to have a wealth accumulation far in excess of what you would need to fund your lifestyle based on a withdrawal strategy, so if we're saying it's a 4% rule and all of a sudden, you're 10 years away from when you thought you were going to retire and you have enough to fund retirement with a 4% rule, this research is saying that you should not retire at that time, because your ability to get there is probably driven by higher than expected returns, which means in the future, market returns should be lower then.

[0:24:55.0] CP: Lower. That's really interesting.

[0:24:56.7] BF: Yeah. That's one of the other big risks of traditional financial planning is that if you end up with this big wealth accumulation, because realized returns have been higher than expected, then it's not a prudent time to retire. If you're taking the safe savings approach, you don't care about that wealth accumulation. You're just saving a fixed amount of your income.

[0:25:16.2] CP: It's interesting, we had the two meetings last week where people knew what their lifestyle costs are and they've been great savers and they're halfway through their careers now. The plan was just so easy and effortless for them, because they've got low cost structures in their lifestyle, no debt. It's is absolutely no— we're not talking about necessary high high-income people, just your average couple that has just done everything right from the beginning, maximized everything. It's completely effortless. Whereas, other people have no idea what their spending rates are in retirement. Even to get that number. How much do you need per month once you stop working? It's often a challenge.

[0:25:54.5] BF: Oh, that's a big challenge. People never know the answer to that question. Sometimes it takes people two years into their actual retirement to figure out if the amount that we plan for is right. Yeah, that's not an easy nut to crack.

[0:26:05.5] CP: It's interesting. If you have your back up against the wall to save and therefore, you try to take on higher expected returns, if you get those expected returns, it means you should assume Pfau was saying, lower draw down on the other side.

[0:26:17.2] BF: Yeah. Instead of planning— You're almost in the safe savings world, you're agnostic to expected returns. Doing financial planning saying, "Okay, we expect a 5% rate of return. Therefore, you need to save this much to get to this amount to fund your lifestyle." You don't care about that anymore, if you're talking about safe savings rate. You're saying, we're not making an assumption about future returns. We're just making the assumption that the worst case 60-year historical period is sufficiently bad, I guess to model the worst future 60-year period. If you save based on that, worst historical 60-year period, then you'll be in good shape regardless of expected returns.

[0:27:04.8] CP: Interesting.
[0:27:06.5] BF: You're not even saying, "I need to save this much, or I need to get to this goal." People always say what's the number—

[0:27:10.6] CP: No, you're focusing on the habit as opposed to the target.

[0:27:12.7] BF: Correct. You're saying the target is meaningless. This approach is saying there should not be a wealth accumulation target.

[0:27:19.0] CP: You could have it in your scenarios, but it's not about the number. It's about the process.

[0:27:23.1] BF: It's being strict with the process, where if you do hit— because people will still have, even if you don't define one, people will still have wealth accumulation goals.

[0:27:30.5] CP: That has enormous appeal behaviorally, because if people have this number that you have to hit, you can see people saying, “Yeah, we'll get to that next year.” Whereas, the process is day-in, day-out, month-in, month-out.

[0:27:43.1] BF: Yeah. It goes beyond that. One of the things that Pfau talks about in his article on this is that if someone is way below their intended wealth accumulation goal when they're getting to retirement, assuming that they've been saving based on the safe savings rate, if they're below what would be their wealth accumulation goal, they may get discouraged and stop saving. They may delay retirement unnecessarily, but it's just because market returns were lower than expected up until retirement, which means we have higher expected returns going forward.

It completely flips financial planning on its head. Completely ignores wealth accumulation targets. Completely ignores spending rates. The only thing we care about is how much you save. We make the assumption that if you follow that, if you save with whatever that number is, you'll be okay. It's worth really quick just running through the— if we look at the 50% replacement scenario. Say we’re saying that you need to replace 50% of your final salary and say you're accumulating for 30 years, the safe savings rate is 15.64% of income for a 20-year retirement and a 40/60 asset allocation.

Then if we say 30-year pre-retirement, 40-year retirement, safe savings rate goes up to 22.19%. There's a massive impact from asset allocation too. That was for 40/60. If you’re 80/20, 80 stocks, 20 bonds for a 30-year accumulation and a 40-year retirement, the safe savings rate drops to 16.54%. 6% your income different savings amount. Anyway, I thought this research was fascinating. I think that we'll definitely think about getting more serious with actually using this when we're doing financial planning.

[0:29:24.5] CP: Even at the other end, if someone that loves what they do, if you want to save for 40 years for 50% of your final salary in a 60/40 and you have 20 years of retirement, it's seven and a half percent savings rate.

[0:29:36.3] BF: That’s true.

[0:29:36.8] CP: Also knowing what makes you happy and where you want to be. 80/20 is just over 6% savings rate.

[0:29:43.4] BF: That's true. This gives a whole different way of thinking about asset allocation too, because it directly relates— Geez. It directly relates how much you're saving to your asset allocation. Because now you can say, if you want to save a little bit less, well I guess we already knew this. If you want to save a little bit less of your income, you can take more risk. Or if you're not comfortable taking risk, it means you need to save this much more of your income.

[0:30:04.6] CP: Well, the fire numbers here too, right? 20 years of saving, 40 years of retirement and you want to be conservative in a 40/60 portfolio is 47% of your salary.

[0:30:13.7] BF: That is interesting.

[0:30:14.6] CP: We'll fill this table on the show notes.

[0:30:16.1] BF: Yeah. I think for further research on this one, just like Pfau took the original 4% rule and applied international data and applied current price earnings, so he said it's not really 4%, it's probably more like 3.5% or 3%. I think there's further work to be done on this as well, because Pfau used historical S&P 500 data, just US stocks.

[0:30:37.1] CP: There's no MERs and there's no taxes, but it's still a good guideline and we should do more work on this.

[0:30:40.8] BF: Yeah. I think we could dig into this and do some more.

[0:30:43.8] CP: All right. That's it for this week.

[0:30:44.8] BF: Yeah. That’s it.

[END]