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BOOK REVIEW

Secure Retirement: Connecting Financial Theory and Human Behavior

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Reviewed by Michael Zwecher, PhD

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Secure Retirement: Connecting Financial Theory and Human Behavior

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In the introduction to *Secure Retirement: Connecting Financial Theory and Human Behavior*, author Jacques Lussier poses the following question:

> *What is the purpose of the asset management industry beyond allowing for greater efficiency of capital allocation? Some fortunate individuals seek wealth accumulation beyond what is needed for maintaining their lifestyle during the later stage of their lives. For the great majority of individuals, however, it is about financing a home, funding the education of their children, achieving a comfortable and enjoyable life during the last decades of their lives, and perhaps also leave something behind for loved ones or for a cause that is important to them. These are the investment goals that matter. In these objectives, on many levels, the industry has failed a large portion of the general population.*

This paragraph sets the tone for the book in two ways. First, it shows that Lussier is explicitly tying accumulation of wealth to its ultimate purpose. This may seem obvious, but too often creation and growth of a portfolio are taken as an end in itself, rather than a means to an end. Second, it shows a recognition that the industry still needs to find avenues to expand the toolset for helping clients solve the retirement problem. Naturally, it is well beyond the scope of the book to proffer new tools, but highlighting early on that the toolset is limited helps readers keep the issue in mind as they read.

Lussier does a good job of finding a level that is engaging, useful, and informative. In that spirit, this is not the book where one can find depth of information about the pro-forma budgeting process or a compendium of product choices, but it does help to lay the foundation for jumping off into those areas. The pension management orientation of the author's approach makes it a natural addition to the bookshelf for those on the accumulation side of pensions. Additionally, it will be of wider interest to those who work on the liability side of pensions, as well as advisors who deal with private clients, academics, and intrepid nonpractitioners.

In many respects, *Secure Retirement* is a retirement portfolio-management book. It addresses the wider problem of portfolio management rather than just the retirement problem. For the CFA audience, it may be a natural segue into work and study in the retirement arena, because it purposefully sticks to approaches and tools that are the bread and butter of portfolio management.

Chapter 2 provides a view of retirement planning under certainty. It offers an engagingly written tour of the usual problems of insufficient saving, lower-than-expected returns, starting later and having to catch up, retiring sooner (whether planned or not), living longer, and a section on making all of the wrong choices. Although none of this is new material, it is presented thoughtfully and compactly, providing an ideal opportunity to frame the coverage of subsequent chapters.

Chapter 3 focuses on the accumulation period, though the coverage includes both the initial accumulation portfolio and an overview of glide paths. It includes a discussion of the paths to retirement that different patterns of returns would imply. In particular, it looks empirically at the difference in retirement-date totals under different glide assumptions.

However, putting the notion of portfolio weights—especially a glide path—into a chapter on accumulation, rather than thinking of any glide path as part of the transition phase, takes the focus off accumulation. And the book's treatment of what needs to be done is far different from its treatment of how to do it. The author largely defers the discussion of lifecycle planning until much later, which may leave readers asking, "I see what you are doing, but why is this the right thing to do?" Additionally, the generic nature of the weightings, untethered to lifestyle relative to wealth or risk tolerance, says little about retirement security for those whose portfolios don't hew close to the mean. Contained within appendix 2, there's some discussion centered on lifecycle consumption and investment decisions, but framed within the limited spectrum between constant relative risk aversion versus prospect theory approaches. An advisor would need to robustly augment and supplement the material presented in order to be prepared for a wider array of client types.

On the plus side, the structure of Chapter 3 will be familiar enough to any CFA to provide a natural treatment of the familiar territory of portfolio allocation and the myth of time diversification. There are nice discussions related to the means, variances, and paths of returns that help illustrate the nuances of the accumulation phase. Lussier's presentation of the multiple arguments around portfolio weights and glide paths is broad enough to foster many approaches to the accumulation problem.

Chapter 4 temporarily jumps over the transition problem, leaving it for Chapter 5, and works the decumulation problem. Right up front, Lussier illustrates the difficulties associated with the sequencing of worse-than-average versus better-than-average returns. A sequence of bad returns early in retirement draws down the retirement portfolio rapidly, so the shrinking portfolio needs stronger advantageous returns in subsequent periods. Lussier provides a thoughtful set of examples to motivate the path dependency, i.e., the risks of the return sequence, under decumulation. He goes over a range of decumulation possibilities and covers the issue of longevity and changing income needs. However, there is scant coverage of unanticipated consumption needs, inflation (covered, in part, in Chapter 5), or the volatility of inflation. There is a discussion of basic annuities[1] and Social Security, but this, too, is kept at a high level rather than approaching the depth of detail needed for planning with any particular couple or individual client. Despite being a light introduction, it is a helpful section for furthering the discussion of longevity risk.

Chapter 5 focuses on switching an accumulation portfolio to a decumulation portfolio and covers the transition process in the strictest mechanical sense. As with many of the chapters, Lussier begins with an engaging and well-written introduction. Included here is a nice discussion of the uncertain prospect of future mean reversion, regardless of how the past has worked out, and a section on inclusion of inflation-linked bonds in a portfolio. Considerable attention is paid to down markets, recoveries, and the implications for portfolios in transition.

Chapter 6 provides a first approximation at calibrating a retirement strategy. Simple drawdown rates and lifecycle planning are common approaches, and both are covered. The risks of longevity and return patterns are examined across canonical portfolio allocations using a Monte Carlo approach, all proper for understanding the risks in path-dependent processes. Lussier takes care to note that the behaviors retirees exhibit are often at variance with the simple models of behavior used for templating retirement plans.

Chapter 7 adds a layer of product depth to the financial framework in retirement. First, by examining choices among management styles (e.g., active versus passive) within asset classes (e.g., highly rated versus high-yield bonds), it surveys asset allocation at a slightly lower level than the simple top-line taxonomy of fixed and residual claims. Next, it gives attention to the location of assets in the portfolio with respect to their tax implications and provides an overview of optimizing the portfolio net of tax consequences. Variable annuities are discussed as part of the retirement solution, and reverse mortgages are also given some highlight.[2]

Chapter 8 is focused on completing the financial picture for "John," Lussier's example client.[3] It starts with an interesting discussion about differences between retirement in the United States and Canada. Lussier again takes advantage of Monte Carlo analysis in addressing the risks of the financial plan. To show the sensitivity of parametric choices (e.g., glide path choices), he provides some scenario analysis useful for analyzing the risks of portfolio choices. He also notes the opportunity for inherent feedback and adaptation as the planning horizon shrinks.

Chapter 9 glimpses at challenges looming for the future and gives the author an opportunity to sum up. Three appendixes cover annuities, lifecycle and prospect theory decision-making, and reverse mortgages, respectively.

In all, Lussier (2019) is a valuable addition to the bookshelf of retirement professionals. The high-level view of Lussier's book will be of primary benefit to those in the traditional CFA space who are a layer removed from retail clients. However, as a clearly written tour though the financial aspects of the retirement problem, it will be of benefit to many of those who perform as links in the retirement-security production chain.

For a book focused more or less on asset management for retirement, an exploration of the possibilities for an enhanced toolset would have been beneficial. The industry failure that Lussier highlights provides a natural jumping off point to be more concrete about roadblocks and limitations. At all levels of the retirement problem, the analytical toolset and the product set have constraints and limitations; a chapter confronting some of these outstanding issues would have been a welcome addition.

Secure Retirement does a good job laying out the retirement problem for the canonical example of "John." Lussier lays out the pitfalls for John's planning, John's accumulation decisions, John's decumulation portfolio, and John's transition from accumulation to decumulation. He fleshes out the decisions to bring depth and nuance to solving for the right path for John. John is, of course, an abstraction, and he is not representative of many actual clients. That's not meant as a criticism; rather it's a statement about the scope of the book. It's outside the scope of the book to spend time on variations for John (or a Jane), but those variations are a big part of what makes the retirement problem interesting. Additionally, to the portfolio manager, the transition process may be similar to switching planes at a transit hub, but to the client and the advisor, the transition from accumulation to decumulation portfolio is a lengthy process that often takes more than a decade.

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A financial advisor will need to complement *Secure Retirement* with a good deal of supplementation. For the working advisor, John may best represent a starting point, because he presents few of the characteristics that make the retirement problem a challenge for advisors. John's income and saving profile is quite stable, and a real client's profile leads to different decisions depending on when, and how, they manifest in the accumulation path. The ratio of spending to wealth also varies by client, leading to more options for some clients and fewer for others. John has none of the product preferences and aversions that can constrain advisors. There is no ramp-up in the rate of saving as the transition begins or goes into full swing; John's bequests are no more complicated than lump sum residuals to the consumption/saving decisions. In practice, we know that risk-aversion preferences may lead to net saving early in retirement, implying something other than a monotonic drawdown path; lifestyle changes may be expected, but their timing may be highly uncertain; that news from one's healthcare provider may significantly alter previously laid plans. In sum, pension portfolio managers will find *Secure Retirement* to be a reference for framing the retirement problem, whereas advisors will find *Secure Retirement* to be a useful part of a broader bookshelf.

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ENDNOTES

1. Annuity types and choosing annuities based on interest rate environment is covered in appendix 1.
2. The working principles of reverse mortgages are covered in appendix 3.
3. The planning for avoiding unplanned residual obligations of the first to pass and maintaining lifestyle for the surviving spouse is only given cursory treatment.

REFERENCE

Lussier, Jacques. 2019. *Secure Retirement: Connecting Financial Theory and Human Behavior*. Charlottesville, Virginia: CFA Institute Research Foundation.

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