



Solving the Retirement Income Crises...Important and Knowable

"The Real Risk in Retirement is outliving ones income"- Nick Murray, Author

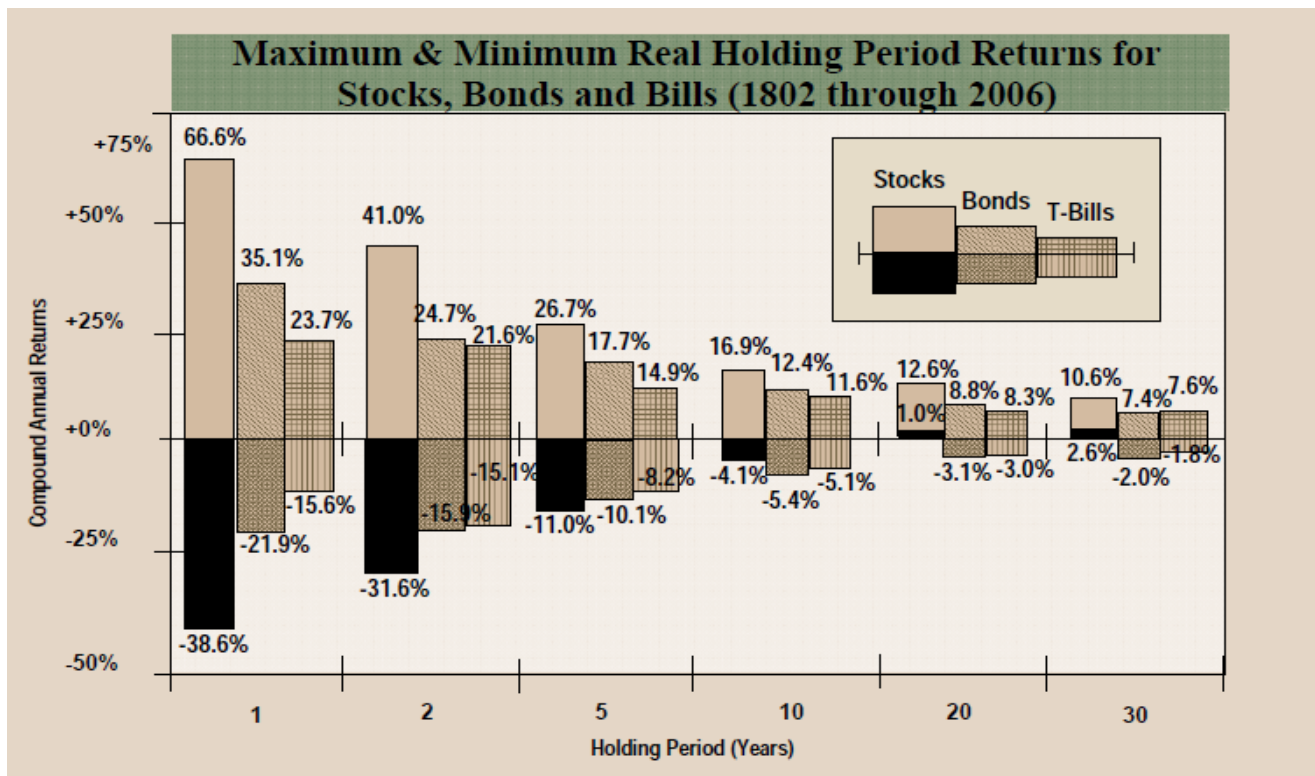
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As you read through my last month's article (if you haven't... stop, go back and read it) I had formulated a fairly strong case of what I believe investors need to focus on is both the Important and Knowable, rather than what the financial media nauseously tries to drive home which is the Important but Unknowable- in the short run. In reading the entire series of articles I have written this year for Dbusiness, the average investor should realize that the financial media, driven by its need for eyeballs, will continue to be the premier source of "The Important but Unknowable."

Remembering that they are a business and need to do what is necessary for them to make a profit-which is from advertising dollars (revenue) that are driven by the highest level of eyeballs to its site(s). Therefore, what should investors be focusing on if it is not the financial media's short term issue de jour? It is what author Nick Murray is quoted above, "The Real Risk in Retirement is outliving ones income," in my view is both Important and Knowable.

To understand this concept, let's look at a simple yet powerful example using a US Postage Stamp. In 1946 when the baby boomers started to populate the U.S, let's say the only thing they had to buy to cover their cost of living (i.e. food, electricity, gas) was represented by the then three (3) cent postage stamp. Now, fast forward to 2010 and that same US postage stamp needed to cover the same cost of living is...forty-four (44) cents. This is a fourteen (14) fold rise in the cost of living over the average baby boomers life, otherwise known as the Consumer Price Index (CPI). And one other thing, it is Important and Knowable. Said another way, since we are in the automotive capital of the world, the average cost of a Ford vehicle was around 1,500 dollars and the average cost of a house was around 5,600 dollars in 1946 (yes, I can hear you say that this is the price your home has dropped back to).

Accepting the income crisis the average investor may find themselves facing at one point, the continual rise of the cost of living both now and in retirement, investors should be asking what asset class has historically kept up with this rising cost? In his book, "Stocks for the Long Run," Professor of Finance at the Wharton School Jeremy Siegel provides us with the historical real rate of return (net of inflation) of different asset classes from 1802 through 2006, below in the chart.



Source: Jeremy Siegel-Stocks for the Long Run. Fourth Edition. This was a one-time study completed in 2007. Stock returns are based on the compounded returns of U.S. Stocks from with dividends reinvested and do not account for applicable fees or charges. The information presented is to provide you with an understanding of historic long-term performance and is not presented to illustrate the performance of any specific security.

As witnessed from the chart above, the returns from Stocks, Bonds and T-Bills have had a wide range of variances based on the holding period (i.e. how long you held on to the asset class). As an example, looking at the holding periods, over any five (5) year period from 1802 through 2006 stocks have ranged from a positive 36.7 percent return to negative 11.0 percent return. However, notice the time frame where the real rate of return of stocks goes from a positive 12.6 percent to positive 1.0 percent in the twenty (20) year holding period. In other words, the worst an investor would have returned in stocks over any twenty (20) year holding period since 1802 is a positive 1.0 percent per year and this is net of the cost of living increase. Now compare this to the asset classes of Bonds and T-bills...interesting.

Knowing this historical fact, according to Jeremy Siegel, why do so many retirees go into retirement wanting to own a larger portion of an asset class that has historically not been able to keep up with the rising cost of living (over twenty plus year periods) they may ultimately face? What would an investor rather own a larger portion of; a rising income investment or a fixed income investment? And here lies one of the reasons for the potential retirement income crises facing the average investor-possibly too much of a fixed income investment going into a rising cost retirement. I am not recommending investors own one-hundred percent equities in their portfolio at retirement, however the above chart may encourage investors to discuss with their CERTIFIED FINANCIAL PLANNER™ professional the correct allocation based on both living expense and risk tolerance.

Hopefully, with the newly acquired knowledge by retirees that over time an investor's purchasing power risk has increased with the rising cost of living, yet the exact opposite typically happens with the principle risk of owning equities by decreasing over time, will lead them to a more productive retirement. Let's face it; all the facts in the world won't matter if the investor can't keep themselves getting scared out of one of the asset classes that have historically helped the average retiree to *stay in retirement*. I would have to say that this is quite important and now knowable.

Past performance is no guarantee of future results.

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