Client's Corner

What Is the "Conservative Investor" Trying to Conserve?

IF YOU HAVE AN INVESTED NET WORTH OF A MILLION DOLLARS, and 30 years later still have that million dollars, then at long-term trendline inflation of 3%, you've lost about 60% of your money.

Wait, what? Didn't we just observe that you'd preserved your million dollars? Indeed we did, and indeed you have. That is, you've successfully maintained the same number of units of the currency you started out with. Unfortunately, you've lost 60% of your purchasing power. And in the long run, purchasing power is the only rational definition of "money."

Let's turn this around. Assume that, as you step into retirement, your first-year living costs (above and beyond Social Security) are budgeted to be $100,000. At trendline 3% inflation, what will it take in the 30th year of retirement to buy just exactly what $100,000 bought the first year? The answer: about $240,000. If your income—or simply your ability to withdraw—from your investments doesn't increase by something like the same percentage, you may be going to experience some real hardship.

Historically, fixed-income investments like bonds don't provide such a rising income. Historically, mainstream equities—let's use the S&P 500 as our proxy—do.

A high-quality 30-year 6% corporate bond that you might have bought as a new issue around the beginning of 1992 has just now been redeemed—still paying 6%. But during these three decades, the cost of living about doubled. Yes, inflation ran somewhat below average during this period—but it was very far from nonexistent.

On the other hand, the cash dividend of the S&P 500 in 1992 was $12.39. In the year just ended, it was $60.40—up just a bit less than five times. Dividends didn't merely keep pace with inflation; they beat the living daylights out of it.

(You didn't ask, but that 30-year bond ended its life where it began—at a principal value of $1,000. The S&P 500 came into 1992 at around 418, and went out of 2021 at 4,766—up just over 11 times. This despite the fact that the Index essentially halved not once but twice in this 30-year period—in 2000-02 and 2007-09.)

This is the time to be sitting down with your financial advisor and thinking about whether your notions of "risky" and "safe" still describe the financial world as it really is.

Between the bondholder and the stockholder—again defining "money" over extended periods of time not as units of the currency but as purchasing power—who was the more "conservative" investor over these three decades? That is, who was more successful at protecting and even enhancing his/her purchasing power?

But wait: it gets worse.

Because as I write the 10-year U.S. Treasury note that was yielding 7.2% in early February 1992 is currently yielding 1.85%. And inflation in 2021 wasn't its average 3%; it was 7%. Thus, at the risk of piling on, it appears to me that a 30% taxpayer buying what may historically be the most "conservative" investment in the history of mankind is bargaining for a current yield (net of inflation and taxes) of something like minus 5%. A rational long-term investor might think twice about doing this—or anything like it.

This is far more than a matter of semantics. If you're like the average 10,000 people retiring every day in this country—and contemplating what may prove to be a three-decade two-person retirement—this is the time to be sitting down with your financial advisor and thinking about whether your notions of "risky" and "safe" still describe the financial world as it really is.

Everything proceeds from your definition of money.

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Sources: S&P 500 levels and dividends: Standard & Poor's, NYU Stern School. CPI inflation: U.S. Bureau of Labor Statistics, rateinflation.com. 10-year Treasury yields: macrotrends.net.