

## LONG TERM WEALTH

*In the final installment of the series, Nick Murray, author of *Simple Wealth*, *Inevitable Wealth*, discusses the idea of not owning equities.*

The real long-term risk of equities is not owning them. This is the risk that most people totally underestimate. They reason that what you don't own may not help you, but it can't hurt you – simply because you don't own it.

But *not* owning equities will prove fatal to the achievement of wealth as we've defined it; an income that you cannot outlive, and a growing pool of capital for your heirs. Please note that I didn't say that avoidance of equities *may be harmful* to wealth. The phrase I used – and now use again – is *will prove fatal*.

Particularly as people approach retirement – when the conventional wisdom says you should switch out of stocks and into bonds for “safety” and “income” – the idea that bonds are hazardous to your wealth is bitterly countercultural. Well, countercultural it may be, and therefore terribly difficult to accept, emotionally. But accept it you must, or – sometime during the thirty years you and/or your spouse are retired – you're probably going to run out of money.

Look at the long-term inflation rate, as expressed by the Consumer Price Index. At 3.1% inflation, compounding for thirty years, consumer prices will just about triple. Or, if you prefer, your dollar will lose two-thirds of its purchasing power. Either way you express it, you'll need three dollars of income in order to purchase what one dollar of income will buy today.

Now, maybe consumer price inflation will be less than 3.1% over the thirty years that you're retired. Maybe, instead of tripling, your living costs will only double. Then again, maybe prices will rise more than the trendline 3.1%. We can't know that in advance. All we can do is consult our life experience and our common sense, both of which tell us that (a) it sure feels like our cost of living goes up all the time in real life, and (b) over long periods of time, it goes up a whole lot. Even low inflation isn't *no* inflation, and when you compound even a low inflation rate over decades of retirement, the results are pretty sobering.

Suppose you'd retire in 1975, and all you needed to buy every year was one postage stamp that cost ten cents. And you found that by investing in bonds and CDs, you could get an income of twenty cents – in other words, *twice* your annual living costs. I'm betting that you'd have felt like you were in the catbird seat, and that no power on earth could have persuaded you to invest in stocks – which were still struggling back from the biggest bear market of the postwar period, and which finished the year at Dow 850.

Today, even if your bond/CD income is just where it was in '75, your twenty cents in annual interest can't buy a thirty-three-cent stamp (1999). You've either figured out a way to cut your living expenses by more than 35% - probably slashing your standard of living to the bone – or you're under water. And you've begun eating into principal.

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

How did that disaster befall a nice, “conservative” retiree like you, who shunned “risky” stocks and stuck with “safe” bonds and CDs? That’s easy: you fundamentally misperceived risk (and therefore safety), in not one but two ways. First, you greatly overestimated the risk of holding stocks for the long run.

Second, and this is the theme of this chapter, you fatally underestimated the risk of *not* holding stocks for the long run. So, yes, your cost of living tripled, but your capital would have increased over ten-fold. Much more to the point, even the cash dividend of the S&P 500 went up about four and a half times. Which means that, had you invested in equities for dividend income instead of in bonds for interest income, your cash income would have grown much more than did your living costs.

Why do so many people – heck, why does nearly everybody – get this wrong? The reality of long-term erosion of purchasing power stares back at you, not just every time you stick a postage stamp on a letter, but everywhere you look.

I paid \$3,000 for the top-of-the-line Ford Galaxie 500 in 1968, and \$30,000 for a Ford Explorer in 1998. My first apartment in beautiful, historic Brooklyn Heights, New York rented for \$185 a month in 1966; today, one of my daughters pays more to rent a parking space in the very same building. (I’m guessing the apartment rents for \$1800, at least.) I vividly remember when I was in college – and John F. Kennedy was a president, not an airport – buying a summer suit for \$50. I have trouble finding a really good dress shirt for \$50 today.

How many dozens of these examples can you think of from your own life? How clearly is the slow, relentless uptrend in your living costs a part of the reality of your personal experience? And why, when it comes to investing for – and during – retirement, does this most vivid reality get obscured, overshadowed by...something else? What is the hypnotic force that causes even very intelligent retirees to cast aside everything they know about real life, and start intoning, over and over again, “Safety. Income. Yield...”

A part of the answer, I think, is that we are unconsciously assuming something closer to our parents’ life expectancies than our own. This is only human: we know what we’ve seen, and we don’t know what we haven’t seen yet.

Finally – and most importantly – I’m convinced that the culprit is **culture**, in several of its aspects.

First of all, the defining psychological/economic event of the last century for Americans was the Great Depression of the 1930s. This long, bitter economic contraction is associated in most people’s minds with the stock market crash of 1929, the assumption being that the crash caused the depression. It didn’t.

The perception that forms our collective unconscious, however, is of a stock market crash as the root cause of the greatest economic disaster of all time – and of a stock market that didn’t recover for years and years. Even aging baby boomers, born much too late to have any personal memory of the depression, were raised by people who’d been scared and sometimes shattered by it. And those well-meaning people programmed us, almost pre-consciously, with the mantra, “If it happened once, it can happen again. If it can happen again, it *will* happen again.” Dad and mom may be gone now, but in the deep recesses of our fear-based unconscious, that tape may still be playing.

Another important way culture blots out reality is linguistic. Words have tremendous power to shape our perception of the world, particularly when everyone around us assigns the same meaning to those words. If the entire culture has told you all your life that, in retirement, stocks are too risky and bonds are safe, I can hold

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

a 1975 ten-cent stamp and a current stamp in front of your eyes for five minutes every hour on the hour for a year. And you're still going to believe – nay, to *know* – that, in retirement, stocks are too risky and bonds are safe. (It takes a village to raise a bad investor.)

To grasp the point I'm going to make – and to begin to take your own cultural/linguistic temperature on these issues – please reach into your pocket or wallet, and take out one American greenback. Doesn't matter what denomination it is; just haul out one piece of that precious printed paper, and hold it in both of your hands, making heavy eye contact with the dead president (not to slight Ben Franklin or Alexander Hamilton) pictured thereon. Got it? OK. Now: please tell me what you are holding in your hand, *using only one word*.

I'm willing to bet the one word you used was *money*. That's your first mistake. Don't worry, it's *everybody's* first mistake, so powerful is the cultural of language. That's the whole point.

The thing you're holding in your hand is *currency*. In no long-term sense is it *money*, if by money we mean a constant, reliable store of value, as in "If I hold on to my money, I'm safe." Currency is a terrific medium of exchange; without it we'd be doing things like bartering oranges for Buicks, which gets pretty cumbersome, especially if the orange grower and the Buick dealer don't speak the same language.

But if, ten or fifteen years into retirement, you go out shopping for oranges (or a Buick) with the same number of units of the currency you've always had, and discover that oranges (or a Buick, or the maintenance on your condo, or a month's supply of your medicine) now cost twice as many currency units as they use to, then you learn – vividly but much too late – that currency isn't money. And that, even as you were carefully safeguarding the number of currency units you had, you were *losing your money*.

You see, in the long run, the only sane definition of "money" is "purchasing power." If my living costs double while my capital, and the interest thereon, remain the same, my purchasing power has halved, and therefore – there is no other rational way to look at it – *I've lost half my money*. (And when my inexorably rising living costs catch up to and then surpass my fixed income, that's the beginning of the end.)

By the same token, if my living costs double and my dividend income from stocks also doubles, my purchasing power has remained the same, so *I've preserved my money*.

As soon as you're able to make the all-important currency/money distinction, one by one the other cultural/linguistic dominos begin to fall. If money is purchasing power, "risk" is that which threatens purchasing power, and "safety" is that which preserves and enhances purchasing power *over time*.

Well, then, since bonds and CDs provide a very small return net of inflation (and since even that small margin is all but wiped out by current income taxation), it becomes difficult to see how they offer true safety – that is, how they safeguard your purchasing power/money. What bonds/CDs are good at – and this will turn out to be the only thing they're *any* good at, as you'll see when we redefine "income" and "yield" – is stabilizing the number of units of the currency you have at any given time. Sorry, but what good is that, since *currency isn't money*.

Stocks, on the other hand, are exceptionally efficient in preserving – and considerably enhancing – purchasing power. (Moreover, the increasing values of stocks are taxed at capital gains rates, which have historically been much lower than ordinary income tax rates.)

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

But you give something up – or, more precisely, you trade something off – to get equities’ far greater real safety. Being much more volatile than bonds, stocks subject the number of units of the currency you’ve got at any given time to much wider fluctuations. But again, why does the long-term/multi-generational investor care about that, since *volatility isn’t risk and currency isn’t money*?

We’ve just seen that “risk” and “safety” not only don’t mean what you were acculturated to think they mean, they actually mean the opposite, once you define “money” not as currency but as purchasing power. We can therefore quickly – and by exactly the same logic – dispense with the adjectives “conservative” and “speculative.”

These two words, as our culture uses them, amplify – or are used interchangeably with – “safe” and “risky.” Our linguistic reality-distortion field implies that those investments most likely to limit fluctuation, i.e. to hold nearly constant the number of currency units you own, are “conservative.” By the same fatally flawed cultural reasoning, those investments subject to great variability in price (i.e. they can go down a lot in the short to intermediate term, which is what frees them to go up a lot in the long term) are to be regarded as “speculative.” I’m hoping you already realize that it’s the other way around.

What should a truly conservative investor be laboring to conserve? Why, his money, of course. And what, to the long-term/multigenerational investor, is money? Right again: money is purchasing power. Therefore, those investments are genuinely conservative which most reliably and consistently maintain (and even increase) their owners’ purchasing power. *Stocks are conservative.*

Bonds will conserve money (as we now define it for the long run) only if the currency holds or increases its purchasing power. That is, bonds will maintain purchasing power if there’s zero inflation, and will increase purchasing power if there’s deflation. Judging by the experience of the twentieth century, this isn’t just a speculative posture. It’s a *very* long-shot bet.

Even if you do get zero inflation, and are able to hold the purchasing power of your capital, you’re still not going to be happy, for two reasons. First, interest rates are going to totally collapse, because they rise and fall with inflation. So if you’re hoping for zero inflation during thirty years of retirement, you’d better start thinking about interest income in the 1%-2% range *if you’re lucky*. Be careful what you wish for.

The second reason zero inflation won’t make the bond investor happy is that, if history is any guide, you’re *still* gonna wish you’d bought equities. Jeremy Siegel found that in the nineteenth century, when technological breakthroughs and massively increasing crop cultivation held U.S. prices virtually constant, stocks still returned 7% a year over (negligible) inflation.

But put these issues of the return on your money aside, and let’s summarize the point we’ve been making about the return of your money. To wit: if decades of *some* inflation (as opposed to no inflation) are probable, and if in the long run money is purchasing power, it is equities which are “conservative” and bonds that are highly “speculative” – just as it’s equities that are “safe” and bonds that are “risky.”

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

Finally, we assault the last cultural/linguistic stronghold of misperception: the closely related notions of “income” and “yield.” Here, once again, we will have occasion to marvel at the terrible price which fear induces us to pay for near-term (and ultimately illusory) certainty.

The only thing that matters to the rational long-term investor is *total return*. How does anyone manage to hallucinate that an asset class (bonds) whose total return for the last seven decades or so has been about 6% will be a better long-term investment than an asset class (stocks) whose total return has been 11%? How, you ask? Easy: by completely ignoring the most important (if least certain) component of total return: long-term appreciation (or, in bonds, the absence thereof).

Have you calculated that, as you go into thirty years of retirement, you’ll need to draw 6% a year from your investments?

Well and good. Now there only remains one important question, and when you ask it *this way*, you suddenly see the toxic illusion of “yield” for what it is: Do you want to draw 6% from an asset class whose total return has historically been 6%, or do you want to draw 6% from an asset class whose total return has been 11%?

For it is, I promise you, just as simple as that. The artificial distinction that people unconsciously make between current cash income and principal obscures the one essential truth: *it’s all money*. And the only thing that matters is the total return that the money earns, versus how much you’re wanting to draw out.

You’d never look at the well in your backyard and say, “I can only safely draw out the water that got in there from snowfall; if I draw out the rainfall, I risk depleting the well.” Rainfall, snowfall: *it’s all water*. And as long as you draw out less than nature puts in, you’ll be fine.

If your plan is to take 6% from an asset class whose total return has been 6% from an asset class whose total return has been 6%, (a) you’ve got no margin for error, (b) you’d better pray that inflation doesn’t gradually raise your living costs, because your income is stuck, at least for a while, (c) you’d also better pray that the long-term inflation rate doesn’t fall, either, because your interest income will eventually drop below your living costs, as long-term interest rates follow inflation down. You’re between a rock and several very hard places.

On the other hand, if your plan is to draw 6% from an asset class whose total return has averaged 11%, (a) you’ve got a considerable going-in margin for error, (b) your income can grow over time as companies raise their dividends, and (c) the rest of your total return – historically 5% or thereabouts – can be left alone to compound for your heirs.

Of course, there are going to be years when it neither rains nor snows. In bear markets, your capital will decline significantly, *and* you’ll be knocking it down even further with your regular withdrawals. Mightn’t that cause you to run out of money? That depends on a lot of things: how much your portfolio had been earning before the bear struck, what percentage you’re withdrawing each year, how much the market goes down, and how long it takes to come back.

But if you’ve built in a sufficient margin for error – withdrawing 6% a year as opposed to 8% or 9% - and if you’ve hedged your bet by squirreling away a year or two’s living expenses in a money market fund, so

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

you can shut your equity withdrawals off altogether for a while if the market gets really ugly, the chances are overwhelming that you'll be fine.

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*