

Adjustments

Coronavirus has brought adjustments in many ways. Sheltering-in-place, social distancing and face masks are adjustments made in lifestyles to combat the virus. The direct impact of these measures has been an historic increase in job losses and unemployment. Dramatic adjustments have been forced on many as the financial impact has been lessened but not eliminated by governmental policies to date. Financial markets have adjusted dramatically as well, with sharp stock market declines in March followed by meaningful recovery in April. A look at some important past relationships can provide perspective and implications for investing and spending in the post Coronavirus environment.

PERSPECTIVE

Investors have many goals, one of which is to accumulate and maintain capital to support future spending. Success is measured by the ability to sustain a desired level of spending. Key variables in this determination are time horizon, portfolio composition, asset returns and rate of inflation. **Table I** compares historical and perspective data for a common 25-year horizon. To further focus this analysis, only two assets (10-year U.S. Treasury notes and U.S. stocks) have been used in equal amounts to construct a portfolio. As can be seen, inflation and returns have varied widely over time and forward estimates currently are well below long term averages. Lower returns ahead imply potential spending adjustments.

Reference often is made to a 4% rule for sustainable spending from investments. Its popularity has much to do with relationships of more recent decades. Looking back to earlier periods of lower returns provides added perspective. **Chart I** shows trends in portfolio returns and inflation relative to a 4% spending rate adjusted for average historical inflation. An inflation adjustment is critical to ensure that the purchasing power of spending is maintained. In general, real spending was sustained throughout 25-year periods when portfolio return was higher than spending rate plus inflation. Such was not the case when either portfolio returns fell short or inflation accelerated faster than returns.

Past outcomes only can provide reference when planning for an uncertain future. Uncertainty suggests the need to consider a range of potential outcomes and their probabilities. **Table II** shows probabilities of success for a range of annual spending rates. Historical probabilities are actual outcomes; i.e., in 77% of all rolling 25-year periods ending April 2020, an inflation-adjusted 4% annual spending rate was achieved without depleting assets. With forward estimates from **Table I**, modeled outcomes of future success probabilities are lower. An 80% level is recommended for planning future spending. An adjustment of -0.5% in spending rates is indicated for the future. Of course, guidance will vary widely depending on individual circumstances including financial position, time horizon and risk tolerance.

INVESTMENT IMPLICATIONS

Looking beyond Coronavirus remains challenging as securing both lives and livelihoods remains the highest priority. The concurrent impact on physical and financial well-being is unprecedented. Basing decisions on sound principles is important as ever, even as adjustments are made to current healthcare practices and future financial expectations.

TABLE I

BONDS, STOCKS & INFLATION				
Rolling 25-Year Annualized Comparisons				
	RATES OF INFLATION	BOND RETURNS	STOCK RETURNS	50/50 PORTFOLIO RETURNS
1921 - 2020				
Average	3.6%	5.4%	10.9%	8.5%
Maximum	5.9%	10.9%	17.4%	13.6%
Minimum	0.8%	1.6%	5.4%	4.9%
Last (4/30/20)	2.1%	5.9%	9.2%	8.1%
Forward Estimates	2.5%	3.2%	6.2%	4.7%

INFLATION = U.S. CPI; BONDS = 10-YEAR U.S. TREASURY; STOCKS = TOTAL U.S. MARKET; 50/50 = BONDS & STOCKS

CHART I

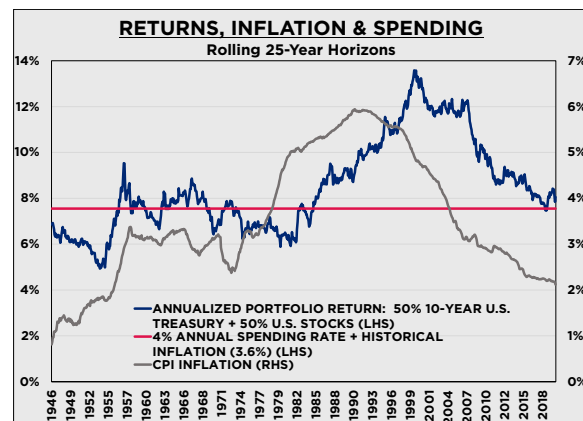


TABLE II

PROBABILITIES OF SUCCESS		
Rolling 25-Year Annualized Comparisons		
SPENDING RATES	HISTORICAL (1921 - 2020)	FORWARD ESTIMATES
4.00%	77%	70%
3.75%	81%	74%
3.50%	85%	77%
3.25%	90%	80%
3.00%	93%	84%
2.75%	95%	87%
2.50%	96%	89%
2.25%	97%	92%
2.00%	98%	94%