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New investment realities

Steps to steady your portfolio

Today's economy seems packed with difficult problems. The severe hardship of economic closures during the pandemic was followed by widespread supply chain bottlenecks upon the reopening. The resulting price spikes were thought, at first, to be part of an inevitable transition back to normal, but that proved not to be the case. Inflation has been stubborn, and at times at levels not seen in more than a generation. The Federal Reserve has raised interest rates at the fastest clip in its history.

Unfortunately, raising interest rates inevitably reduces the market value of bonds. That's just how the math works. Those who can hold the bonds to maturity do not suffer any losses, but those who must liquidate early will have to recognize the value decline. That has weakened the underpinnings of many financial firms, and 2023 has already seen the second and third largest bank failures in U.S. history.

During the pandemic, the phenomenon of remote work took hold. At many firms, remote work has been fairly successful, and some employees have been reluctant to return to the commuting grind. Bottom line, commercial vacancies have spiked in downtowns around the country. According to a recent *Wall Street Journal* article, a prestigious building in San Francisco that was valued at $300 million in 2019 is looking for a buyer, but has lost most of its tenants. The projected selling price is in the $60 million neighborhood—an 80% markdown.

San Francisco may be a special case, but there can be no doubt that commercial real estate values are under pressure.

Stocks and bonds have been on a roller-coaster ride during this volatile economy. After suffering a 4.38% loss in 2018, the large company stocks represented by the S&P 500 grew by 31.49% in 2019 and 28.71% in 2021 (including dividends), as the worst effects of the pandemic receded. But then inflation proved not to be transitional, and the Federal Reserve was forced to act. Stocks lost 18.11% in 2022, and long-term government bonds lost an eye-watering 26.08%! Here is more detail on the performance of the indices:

Recent total returns, stocks and bonds

Year	Large-cap stocks	Long-term government bonds
2018	-4.38%	-0.57%
2019	31.49%	12.16%
2020	18.40%	16.65%
2021	28.71%	-5.41%
2022	-18.11%	-26.08%

Source: M.A. Co.; Kroll 2023 SBBI Yearbook

Balancing act

To avoid the extremes of one asset class or another, one needs to employ an asset allocation strategy for smoothing portfolio performance. Some of the riskiness of an investment portfolio can be mitigated in this fashion. Here are the returns of various mixes of stocks and bonds in the last five years.

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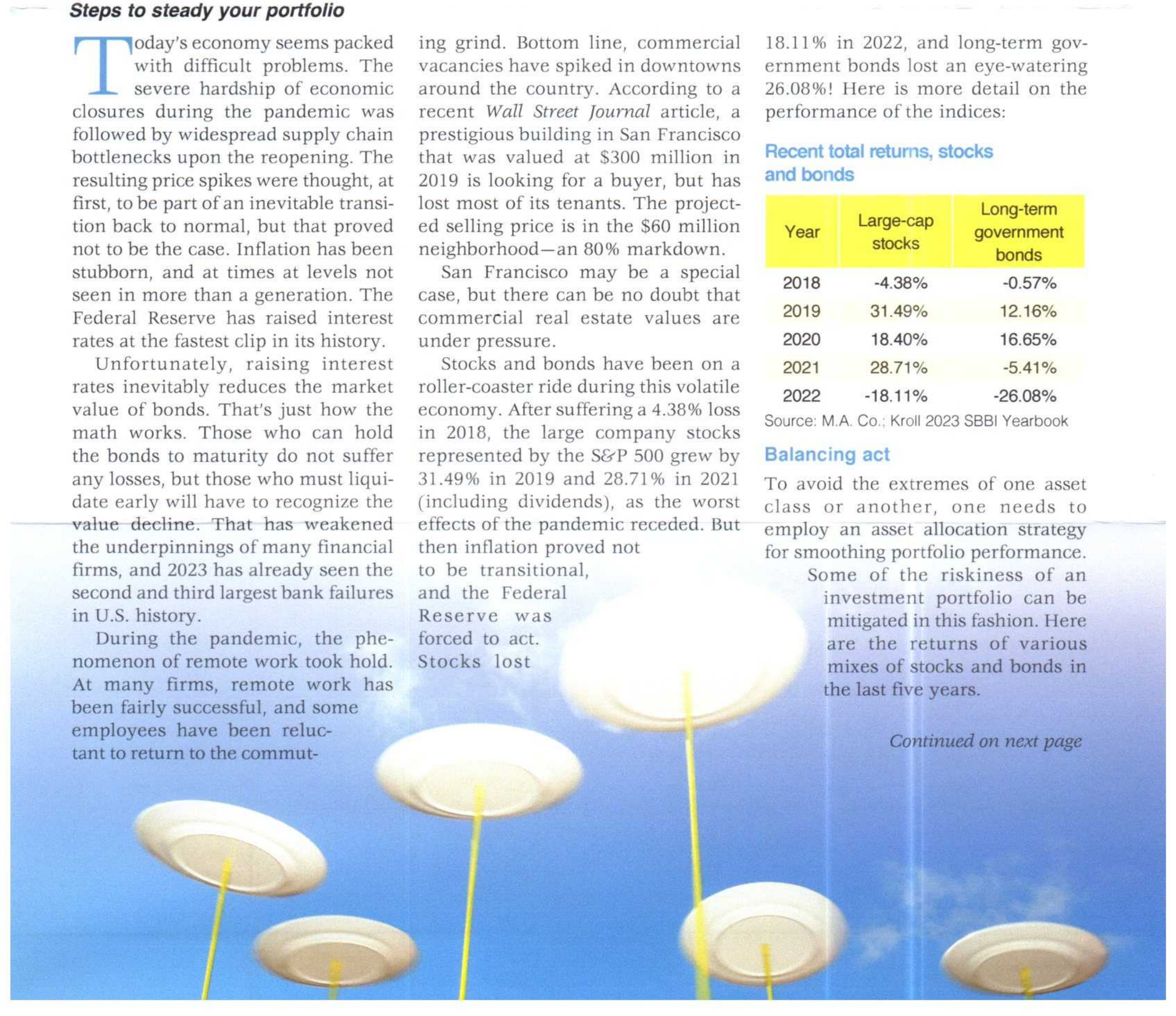

The question of balance

Year	70% stocks, 30% bonds	50% stocks, 50% bonds	30% stocks, 70% bonds
2018	-2.84%	-2.00%	-1.31%
2019	25.93%	22.09%	18.16%
2020	19.16%	19.04%	18.43%
2021	17.64%	10.67%	4.01%
2022	-20.27%	-21.83%	-23.47%

Source: M.A. Co.; Kroll 2023 SBBI Yearbook

As you can see, during this anomalous period, stocks and bonds have not counterbalanced each other, rather they have moved in parallel. But an asset allocation plan will employ many more than two asset classes. The historical performance of the asset classes is the starting point, then the degree to which the classes move in sync or not is determined mathematically. With these coefficients in hand, the portfolio may be optimized. That means expected performance may be maximized for a given level of acceptable investment risk. Alternatively, risk may be minimized for a target level of return.

We can help

Unbiased investment management is an integral part of our service as a trustee, but you don't need to fund a trust to be able to call upon our professional expertise. We manage investment portfolios for a fee for individuals and families in a wide variety of situations.

This month, why not schedule a meeting with us to learn more? □

Market volatility in retirement

As difficult as jumpy markets are for savers, they can be even more ominous for retirees. Imagine a soon-to-be retiree who has a $500,000 portfolio from which he or she will need to draw $25,000 annually. That's just 5%. How long will the money last? The answer depends on whether your retirement starts in a bull or bear market.

In a bull market, as the table below of hypothetical returns shows, the retirement money will continue to grow in the early years, despite the withdrawals. The fund is better cushioned for setbacks that occur later.

Retire in a bull market

Year	Return	Withdrawal	Value
			$500,000
1	25%	$25,000	$600,000
2	18%	$25,000	$683,000
3	8%	$25,000	$712,640
4	12%	$25,000	$773,157
5	10%	$25,000	$825,472
6	3%	$25,000	$825,237
7	8%	$25,000	$866,256
8	-2%	$25,000	$823,930
9	-4%	$25,000	$765,973
10	-28%	$25,000	$526,501

Source: M.A. Co.

Although that loss of 28% in the tenth year was severe, it did not bring the fund below where it was when retirement started.
But if we reverse the sequence of returns, the result is very different.

Retire in a bear market

Year	Return	Withdrawal	Value
			$500,000
1	-28%	$25,000	$335,000
2	-4%	$25,000	$296,600
3	-2%	$25,000	$265,668
4	8%	$25,000	$261,921
5	3%	$25,000	$244,779
6	10%	$25,000	$244,257
7	12%	$25,000	$248,568
8	8%	$25,000	$243,453
9	18%	$25,000	$262,275
10	25%	$25,000	$302,844

Source: M.A. Co.

The strong returns have a smaller base upon which to build. Accordingly, when markets are doing poorly, one may need to delay retirement or reduce spending—or work with an investment consultant who can smooth the bumps in portfolio returns.

This simplified example ignores the effects of taxes and inflation on spendable income.

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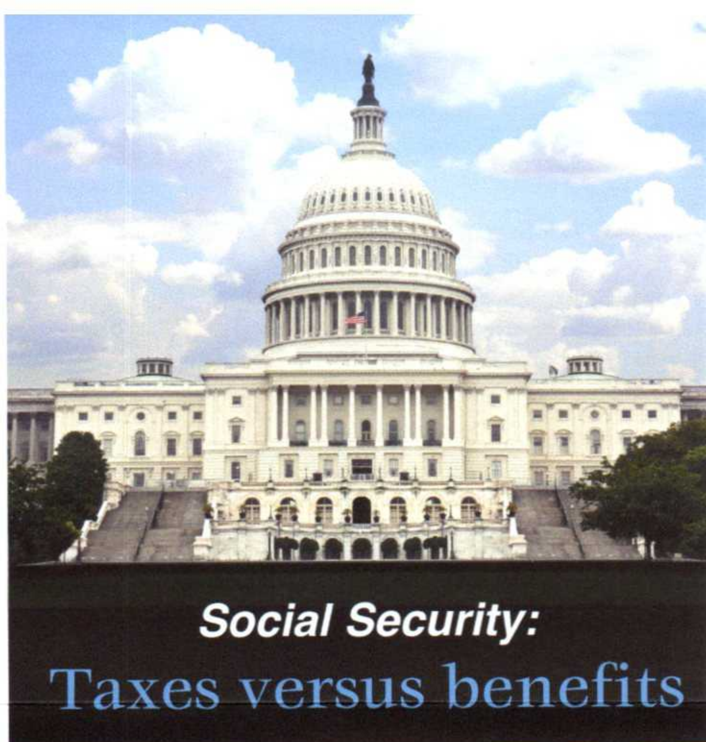

Social Security: Taxes versus benefits

Are Social Security and Medicare really fair for most taxpayers? That is, how do the benefits reaped by retirees compare to the taxes they paid throughout their careers to secure those benefits?

An updated February research report from the Urban Institute explored the data from the Social Security Administration to address those questions. Researchers compared the total career FICA taxes paid to the discounted present value of Social Security and Medicare benefits for an average retirement. Their tables show how this relationship has changed over time and project how it will change in the future.

For example, a male who turned 65 in 2020 and who earned an average wage throughout his career, $62,600 in 2022 dollars, will have paid $344,000 in total Social Security taxes (adjusted for inflation). His first year Social Security benefit was $23,100, and the total retirement benefit for an average retiree in this situation will come to $358,000. Taxes paid represent about 96% of the value of the benefits.

For those who reached age 65 in 1980, the ratio was quite different. The average wage earner paid $111,000 in lifetime taxes for a benefit worth $262,000—taxes covered only 42% of the benefit. That ratio was not sustainable, and thus the necessity of the changes to Social Security taxes and benefits recommended by the Greenspan Commission (higher taxes and later ages for full retirement).

Medicare is another story entirely. The average wage earner who was 65 in 2020 had lifetime Medicare taxes of $91,000, while the actuarial value of his Medicare benefits net of premiums was $250,000! Cumulative taxes covered only 36% of the projected benefit.

The picture for top taxpayers

For the highest income taxpayers, the picture is not quite so rosy. Someone who had maximum taxable earnings throughout a career would have paid, according to the report, $815,000 in taxes for a total retirement benefit worth $576,000. The first year benefit would have been $37,300. He would have paid well over double the total taxes for a roughly 50% increase in benefits, with his taxes at 141% of the benefits. His Medicare net benefit is the same $250,000, but he paid $218,000 in lifetime Medicare taxes.

The table below shows the total taxes and benefits for a married couple with two average incomes, reaching age 65 at various years. The table includes the ratio of benefits to taxes, which has held fairly steady over the years. Average couples receive benefits worth about 150% of their total tax payments.

However, the better the deal looks for retirees, the sooner the trust funds will run out of money. According to the 2023 annual report of the Social Security Board of Trustees, the surplus in the Social Security trust fund will be depleted by 2034. Medicare's trust fund could go dry even earlier. □

Projected Present Value of Lifetime Social Security and Medicare Benefits and Taxes

For married couples with two average earners ($125,200 in 2022 dollars)

Year reaching age 65	Lifetime BENEFITS			Lifetime TAXES			Ratio of benefits to taxes
	Social Security	Medicare	Total	Social Security	Medicare	Total	
2000	$621,000	$352,000	$973,000	$487,000	$93,000	$580,000	1.68
2010	$715,000	$431,000	$1,146,000	$611,000	$147,000	$758,000	1.51
2020	$757,000	$536,000	$1,293,000	$688,000	$183,000	$871,000	1.48
2030	$843,000	$703,000	$1,546,000	$778,000	$212,000	$990,000	1.56

Source: Urban Institute, "Social Security & Medicare Lifetime Benefits and Taxes: 2022" (February 2023); M.A. Co.