

Crafting Your Very Own Personal Pension

Professional pension managers got sidetracked in the great bull market of 1982 – 1999 that boomers grew up on. They were lured by seemingly endless double-digit stock returns and accounting tactics that comfortably overlooked the scientific fact, reversion to the mean. It seemed so easy to settle into the emotional hype of “This time it’s different.”

Simultaneously, financial advisors began calculating erudite-looking illustrations for individual clients. These were called, ironically, Monte Carlo Simulations. The illustrations were designed to prove the truth of the new paradigm, and came complete with – of course – disclaimers that a client’s own personal experience could, indeed, differ somewhat from the outcomes presented. Those cautionary notes paled in the climate that had forgotten risk was often a synonym for loss.

As a result, many suffered from performance expectations that even capitalist financial markets could not sustain in perpetuity. This time it was *not* different. Reversion to the mean inevitably occurred, and it was discovered suddenly that savings were inadequate.

Certain fundamentals may help *you* avoid the repetition of such experiences in your present or future, as you seek to establish your own personal pension. First, learn “Siegel’s constant*.” The term was coined by British money manager, Andrew Smithers, and Cambridge University professor, Stephen Wright, to describe the long-run equity return identified in the research of renowned Wharton Professor, Jeremy Siegel.

The most important statistic.....is the long-term average after-inflation rate of return on stocks. That return has ranged between 6.5 and 7 percent over all the long-term periods examined. No other asset – not bonds, not Treasury bills, not gold, and certainly not the dollar – displays anywhere near the constancy of the real return on stocks.

Smithers and Wright found it remarkable.....that this return has persisted through radical transformation of both the American economy and society over the past two centuries. (Note the absence of double digits.)

Secondly, don’t play the odds when formulating a ‘safe’ amount that may be withdrawn from your savings at retirement. If the financial markets happen to go south just as you retire (remember 2000, 2001, and 2002,) you probably don’t want your financial security messed with. William P. Bengen’s** research demonstrates:

*The withdrawal rate of 4.15 percent is the **safemax**, or maximum safe initial withdrawal rate, which has historically resulted in a 30-year portfolio longevity (37% fixed income, 63 % stocks,) regardless of the year of retirement.*

In plain English, this means \$4,150 can be withdrawn for every \$100,000 invested. Remember the pension managers who ignored the need for sufficient savings? This was an amateurish mistake because the math is simple arithmetic. For every \$1,000,000 in your nest egg, Bengen's data demonstrates you can hypothetically write yourself an annual check for \$41,500 as you begin retirement - irrespective of market volatility. His statistics assume you will continue your check writing for as long as 30 years. Taxes will diminish the actual spending power.

Thirdly, employer-sponsored pension plans - where the risk is taken by the employer - are on the decline. The trend is for employees to be fully responsible for funding their own retirement needs. Is the typical American worker on track? Sadly, no.

Analysts' estimates, based on contribution patterns during 2000 - 2005, project current 45-year olds will have an average household balance of (just) \$103,000 in their employer-sponsored retirement plan(s) upon reaching age 65.

I challenge every reader to apply the fundamentals of reasonable portfolio appreciation and realistic income generation to their projections of future need. Considering that retirement is almost certain to be the biggest bill of your life, professional guidance is recommended. In other words, don't try this at home!

E-mail me with your nest egg questions and concerns.

*Jeremy J. Siegel, *The Future for Investors*, p. 171.

**William P. Bengen, *Retirement Income Redesigned*, p. 220.

***Cynthia Saltzman, *Retirement Income Redesigned*, p.99

Joslyn G. Ewart is an educator, financial analyst, and business owner. E-mail her at joslyn@entrustfinancial.com. Her business column appears on a regular basis in Main Line Life.