Longevity 101

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I am going to start this commentary off with a personal story. I received a message recently from my second cousin on my mother's side. Her mother had recently passed away, and in going through her belongings, she came across numerous items related to my great-grandfather. She said she did not want to dispose of these items and offered to send them to me. I agreed and received a large, padded envelope earlier this month.

I received countless newspaper articles covering my great-grandfather's personal and professional life from the 1960s to the 1990s. I had previously seen some articles but missed most of them because I was too young or living elsewhere, and I did not see our area's local newspaper then.

My life began the year my great-grandfather turned 70 years old. At the time, he had retired from farming and was seventeen years into his eventual twenty-two-year stint as the mayor of our town. His hair was white when I was born, and he looked his age. As a small child, I always saw my great-grandfather as old, almost as someone from a different time. He was born in 1894; at fifteen, he took a train to Washington State from Pennsylvania to work as a cowboy on his sister and brother-in-law's ranch. He spent a little over a year on working on that ranch before returning home. Below is a photo of his sister and her husband on the ranch from that time:

When my great-grandfather returned from Washington State, he was almost seventeen years old, and the United States had entered the "War to end all wars," ironically, better known later in the 20th Century as World War I. Although too young to be drafted, my adventuresome great-grandfather lied about his age and enlisted in the U.S. Army. Shortly thereafter, he was navigating trench warfare. Fortunate to survive this treacherous combat, he was in France on Armistice Day, which he frequently talked about as one of the best days of his life. When he returned home, he was a young man, as can be seen in the photo below from around 1918:

He would soon be married to a young woman to whom he had promised marriage if he returned from the war alive.

They would have three daughters, one of whom would become my grandmother. By the time the Depression was over and World War II began, his daughters were young women starting their own families. Once the war ended in 1945, he gave up farming and moved to "town." This small town was just a couple miles from the farm on which my great-grandfather was born.

As he settled into "town life," he could not help himself from getting involved in local politics and the business of running the town. He joined the town council and was elected Mayor shortly after in 1948. His tenure as Mayor lasted until 1970 when he decided not to run again at age 75.

I was just five years old when he decided not to run for Mayor again. I walked to the elementary school named after my great-grandfather's brother-in-law. His brother-in-law was the first superintendent of the consolidated school district formed when the surrounding one-room schoolhouses were closed, and children began being bused to a central location. My great-grandfather was just one of many people in my life who lived full and active lives well into their late 80's and 90's.

I will now get to the point of this commentary. As I grew older, I began talking with my great-grandfather about everything from politics and history to one of his favorite subjects, finances. He was the only person I knew of in our small town with the Wall Street Journal delivered to his home. He would talk with me about the stock market, particularly dividend-paying stocks like electric utilities, his beloved Standard Oil company, and Bell Telephone spin-off companies like AT&T and Exxon Mobile. As he moved from farmer to local politician and finally to retired status, his investment strategy was always focused on safety and income. He figured that his retirement timeframe would be no more than twenty years. He could did not envision living much past

eighty-five years old, thus he felt secure with what he had accumulated and the income that he was receiving in stock dividends, as well as interest from his municipal bonds and bank CDs.

The 1970s was characterized by high inflation and stagnate economic growth. Not until the early 1980s were interest rates raised sufficiently above inflation to break the back of persistently high inflation. This was a very challenging environment for people such as my great-grandfather, who took a fixed-income approach to invest using bank deposits, dividends, and municipal bond income, as these investors essentially lost spending power for almost ten years. Had older, risk-averse investors, such as my great grandfather, with an assumed short investment time horizon locked in bond and CD rates during the early 1980s, they would have done very well because those rates did not stay abnormally high for very long. Many older investors assume they do not have a long-term investment time horizon, and intuitively, if that is one's assumption, investing long-term goes against being risk averse.

In 1980, my great-grandfather was eighty-five years old, and he more than occasionally said that he was not buying green bananas. Thus, locking in a five-year or longer CD seemed pointless.

This now brings me to an important lesson. I tell most retirement-age investors not to underestimate their potential life expectancy. Underestimating one's life expectancy can and will impose a very uncertain short-term horizon assumption upon significant investment strategy decisions.

Press-Enterprise/David J. Maialetti

BIRTHDAY BOY — Carl Fritz, Benton, sits in a rocking chair at his grandson's house in Waller on Sunday, his 101st birthday. Family, including Fritz's 1-week-old great-great-grandson, gathered for a small party.

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Between 1980 and 1999, I had many discussions with my great-grandfather that inevitably led to him complaining about how expensive a loaf of bread was and how little interest bonds and CDs paid. Yes, I said 1999! My great-grandfather passed away, living in his own home, when I was 35 years old, just a month short of his 105th birthday.

I was the Executor of my great-grandfather's estate. What I learned from many years of discussions with him, as well as getting an in-depth look at his assets at the end of his life, was that no matter how financially secure you feel at retirement, if you under-estimate your longevity, do not invest for real inflation adjusted capital appreciation over and above your withdrawal rate, you can start to experience very real financial anxiety in the latter years of your retirement. A good rule of thumb is that a person's retirement nest egg will lose approximately fifty percent of its spending power over twenty-five years, even when inflation averages just 3%. In my great grandfather's case, his longevity and health were a true blessing, but because he greatly underestimated his longevity, he invested too cautiously. He retired at 75 with a nest egg that was quite significant in today's dollars. When he passed away, the inflation-adjusted value of his preservation and income-managed nest egg dropped in "real" value by over 75%.

We take these longevity lessons to heart, both from my great grandfather's experience and the experiences of relatives and clients who have lived well past their "life expectancy." Retirement should not be viewed as the finish line from an investment standpoint; instead, retirement is just an important pitstop in a long endurance race where we are not told when the checkered flag will wave.

Clients who are fortunate enough to be very financially secure at the time of retirement are several laps ahead and can afford to stop pushing so hard to find more speed. These clients require a strategy that helps ensure they do not give up their several-lap lead but protects them from unnecessary risks that could set them back. But they also cannot afford to coast because they have no idea how long the race will last.

However, for those clients who do not have a substantial lead in this indefinite endurance race called retirement, these clients cannot afford to get too conservative, otherwise they run the risk of moving falling further behind. We remind these clients that they need to plan for a long race, but it is imperative that they guard against crashes or running out of fuel. So, the name of the game for these clients is to be aggressive enough to stay ahead of inflation, which is always a persistent threat to one's spending power, and manage those risks that can throw them off the course and set them back significantly.

Fortunately, as technology advances and many sophisticated investment strategies, previously out of reach for most investors, become more widely available, managing risks without overly sacrificing long-term inflation-adjusted growth can be more easily accomplished. With the recent introduction of new, fully liquid hedged ETFs and mutual fund investments, access to risk-hedged strategies can now be introduced into growth-oriented portfolios. Given the highly uncertain variable known as longevity, it is feasible to build and manage investment portfolios to suit most affluent or high net-worth clients' retirement situations.

Retirement is a transition for a person's investments, not the end. Surprisingly, old conventions such as one should have their retirement portfolio's bond allocation equal to their age have survived over 50+ years. According to the University of California, Berkeley, in 1900, when my great-grandfather was just six years old, the life expectancy for a male in the U.S. was just 46 years old. Fifty years later, the average life expectancy for a male born in 1950 had risen to 65 years old in the U.S. Today, the U.S. CDC's most recent life expectancy estimate for a male in the U.S. is 74.8 years. From my personal and professional experience, average life expectancy statistics are helpful data for a life insurance company actuary looking at vast numbers of lives. However, for individuals, these average data are meaningless and detrimental when weighing investment decisions, from asset allocation decisions to when to begin taking Social Security. Generally, our advice to our clients is to plan for a very long life and invest appropriately so that outliving the averages is not considered a risk but a blessing.

Do not be afraid to talk with us about mitigating longevity risk and ensure that longevity can be a blessing for you and your family if you are so fortunate. Time is finite, and as such, time is the most precious gift given to us. We strive to help our clients be prepared should they be blessed with the gift of time well into their 90's or longer. My general advice for retirement-age clients is not to underestimate your longevity and not to overestimate your mobility. In other words, plan for a very long life; if you dream about travel, travel early and often.

Disclosure:

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- The Standard & Poor's 500, or simply the S&P 500, is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the United States. It represents the stock market's performance by reporting the risks and returns of the biggest companies. Investors use it as the benchmark of the overall market, to which all other investments are compared.
- The NASDAQ Composite Index is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others. Along with the Dow Jones Average and S&P 500, it is one of the three most-followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.
- The Dow Jones Industrial Average (DJIA), also known as the Dow 30, is a stock market index that tracks 30 large, publicly owned blue-chip companies trading on the New York Stock Exchange (NYSE) and the Nasdaq.
- The Russell 2000 index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest US stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.
- The Russell 2500 Index measures the performance of the 2,500 smallest companies in the Russell 3000 Index, with a weighted average market capitalization of approximately $4.3 billion, median capitalization of $1.2 billion and market capitalization of the largest company of $18.7 billion.