

# KEEN ON RETIREMENT



## Make Better Money Decisions by Learning This Market History Lesson

Welcome to Keen on Retirement  
With Bill Keen and Steve Sanduski

Steve Sanduski: Hello, everybody and welcome back to another episode of Keen on Retirement. I'm your host Steve Sanduski and through the magic of Skype I'm joined here with Bill Keen. Hey, Bill. Good to talk to you again.

Bill Keen: Hey, great to talk to you, Steve. Looking forward to our episode today.

Steve Sanduski: Yeah, me too. Today we want to talk about some of the historical returns in the financial markets. I think this is an important topic to talk about because as we talk here today, the stock market is near an all time high and we've been in a bull market basically since 2009. I think it's good to just talk about what some of the historical returns in different types of investments have been so that we can get some perspective on what we might expect going forward and just understanding that there is going to be some volatility here. We don't want people to freak out when things happen and they get volatile so we've got some good info here today and I'm excited to chat with you about all this.

Bill Keen: Me too. A keyword that you just said right there was perspective. I think that's very, very important to look back and say how have we gotten to where we are today, what have we been through and get some real wisdom on how things have played out. I really think this is important. Some people have this experience or they gain this from investing over the long term either on purpose or by chance. Others don't have the perspective that we might be talking about today and really, really need the information that we'll be talking about in order to make a rational and sound decision. I'm looking forward to it here, Steve.

Steve Sanduski: Yeah, let's talk about the really long term and some of the data that we have. One of our sources is a company called Ibbotson Associates, which is owned by Morningstar. They've been tracking the financial performance of several major what we'll call asset classes. These are just different types of investments. They go back to 1926 and they've been tracking the returns of some of these major

asset classes that we typically invest in. Bill, let's just talk about what are some of those longer-term returns here dating back to 1926? I fully understand that there's probably nobody listening to this podcast that was alive in 1926 but we just want some long-term perspective and then we'll talk about some shorter-term time frames as well.

Bill Keen:

The importance of going back to 1926 is it encompasses the era of the Great Depression and I do believe that it lends some credibility to going back farther. Understanding that, some folks might not relate to that and we know we don't have like you said an 88 or 90-year time frame of investing. It does still include that time period. That time period there was little regulation in the securities markets. There were things that were different certainly back then but we still include it in these numbers. In looking at the long-term numbers, these are average annual compounded returns since 1926 and through the end of 2014. Small company stocks have returned 12.2% annually.

Large company stocks have returned 10.1%. Government bonds have returned 5.7. Treasury bills have returned 3.5%. Inflation has been just under 3 where it's 2.9% or we can call it 3% here over that time frame. That gives us a baseline for these asset classes and these returns and one thing I wanted to do, Steve kind of up front here is in the financial the news that we get hit with all day every day. There are so much information coming at folks and it can feel really, really complicated. I always like to take a step back and just real quickly define what a stock and a bond is and even what cash is as the people ... We always say we have to choose the right asset allocation among those investments and we just got done looking at the long term returns here. Let's talk about what each one is just real quickly.

When you have money in the bank in a short term money market or money even in your pocket, cash money in your pocket that's money that we call spending money or money that is set aside for emergency reserve. We typically have folks recommend people keep six months or so in emergency reserve of their income needs. Once you have enough of that now you can invest for the future and the two ways to invest are you can be a owner or you can be a loaner. If you put money into a corporate bond or a government bond or another thing that's called a CD in a bank, in essence, all you've done is loaned your money to those institutions and you get a fix income stream back and your principal back when that investment matures.

If you want to be an owner of something and participate in the upside, now you can buy a stock or even a home let's say. When you buy something and you're an owner you hope that the price goes up in value. That's how you receive a good portion of your upside. Now, some things that you own pay dividends or interest while you wait or even income if it's a rental house, let's say but the majority of the upside would come from capital appreciation.

With those definitions in place it's always about how do we look at these, do we have our emergency reserve taken care of, do we have enough set aside there to keep us sleeping at night, be able to handle that situation where the air conditioner goes out or we have an issue with the car, or lose our job and have to supplement our income for a few months. Then, once we have that in place how much money do we have in stocks, how much money do we have in bonds and does it make sense and do we understand it.

Steve Sanduski: Thinking about that and looking at the numbers that you shared here a minute ago, people might ask, "Gosh if the small company stocks have returned on average about 12% per year and large company stocks about 10%, why the heck don't I just put all my money in those particular types of assets?"

Bill Keen: Exactly, exactly. When they show you these charts I know I saw this in finance class in college and you look at these numbers and you start to look at what things are worth and how things compound over time you would think, "Yes, why don't I have everything there?" I might say this would work if you are Rip Van Winkle and you went to sleep and you invested all your money. You chose the small cap stocks here and you woke up 40 years later based on this information we're looking at you would have more than had you put in in anything else. The problem is we're not Rip Van Winkle. We have to go through the emotion of seeing what these investments are doing every day. We have to watch the ups and downs and we may even need some of the money back at some point along the journey as well which also creates issues around the timing of needing money back. Not being Rip Van Winkle sleeping for 30 or 40 years we have to have some different asset allocation to get us through those issues.

Steve Sanduski: I think it was Warren Buffett who said something along the lines of when he makes an investment he makes it with the idea that if the stock market was closed for the next ten years he'd still be okay holding this investment knowing that he couldn't do anything with it over that ten year period.

Bill Keen: That's right. That's exactly right. I was thinking of something along those lines I believe I heard him say that in his mind he would be happy if the market was just open one day a year. Everybody would posture, they would do the research, they would find out what they think the stocks are worth. On that one day everybody would trade securities and then it would be closed again for the year and he said, "Everything in the middle is noise." Unfortunately we don't have that. We have to look at the markets five days a week and we have to hear all the commentary and see all the volatility. I work quite a bit with a couple of firms here in Kansas City that are private and they are I would say blessed by only having their stock prices valued in one case annually and then in other case quarterly. They've got a version of what Buffett talks about. They don't have to see their price or know what it is between those privately held evaluations.

Steve Sanduski: Yeah, that is definitely one advantage of privately held companies is that you're not so focused on your stock price because you're not seeing it every day, every second when it's trading during the open market phase. All right, Bill let's talk about some of the volatility. We said that if you look at these long term returns it's like, "Great, let's just invest in the stock market because that's where all the great returns are." The reason why we have those high returns is because there's risk there and there's volatility meaning they go up and they go down. Let's look at some of the historical numbers and of course we always have to say that past performance is no guarantee of future results. With that, let's take a look at what's happened in the past and what I want to talk about here with you Bill is looking at how frequently the market has dropped. When I say the market I'm talking about just the general stock market here. How frequently it had different types of decline. For example, how frequently has the market declined 2%. Let's say a market index was at a 100 and that means that that index would drop to 98 so that's a 2% decline. How frequently does the stock market experience a 2% decline?

Bill Keen: Are you putting me on the spot again...

Steve Sanduski: I am.

Bill Keen: This is three episodes in a row.

Steve Sanduski: I'd call that a trend.

Bill Keen: All right, yes. I'm noticing this now. I'll tell you in the last nearly two and a half decades I've been paying attention to these things. I would say I don't have the numbers in front of me written down but I would say that 2% probably happens gosh six times a year.

Steve Sanduski: Actually it's eighteen times a year.

Bill Keen: Eighteen, okay.

Steve Sanduski: Eighteen. It's quite a bit there.

Bill Keen: I've been lulled into this false sense with this lack of volatility we've had up until August the last five years it's just been this I don't know ... If your data would look at the last five years it probably is the last. You know what?

Steve Sanduski: Yeah, I think you're right exactly that in the last few years things have just not been as volatile so it probably is closer to six a year over the past few years. Then, just I want to quickly go through some of these other numbers here. A 3% decline happens on average about once a month. A 5% decline happens about once every three months. A 10% decline happens about once a year. Then, a 20% decline happens once per market cycle. That could be two, three year-ish type period. Just I want to give our listeners a sense for how frequently they can

expect this type of volatility. 5% decline, that should happen every three months. Then a 10% once a year we just had a 10% decline here back in what the August to early October time frame.

Bill Keen: That's right. We sure did.

Steve Sanduski: Bill, I think you were quoted. You're quoted in US News in World Report Magazine talking about what was going on there back in August.

Bill Keen: I was, it was interesting. I was contacted over the weekend that we had a big volatility and I gave a quote and wasn't sure if it would be published because my quotes when I do speak to the media. I don't participate in the sensationalism. I simply said that these opportunities or these types of volatile situations can create opportunities to rebalance portfolios for long-term investors. One thing I also mentioned was that if you have a plan in place and that you're following the plan again it's opportunistic. Secondly, if you do not have a plan in place and the discipline for what you're doing there should be a call to action. That was my message and I printed and it came out well.

Steve Sanduski: Bill, what are some other numbers that you have that you think would be important to share with our listeners.

Bill Keen: One of the things that I see is the biggest risk, we're talking about volatility and that's volatility of something around the trend line. I look at the long-term numbers and I see the stocks have returned somewhere between 10 and 12% over time. That's been the trend line but as you've mentioned if you've done a great job articulating how often we can expect the downside volatility so it doesn't come as a surprise. Prior episodes I've always said let's eliminate the surprises, control the controllable, understand what we're doing and this is a great, great way to understand this and get clarity on it. By the way, Steve no one complains about upside volatility. Have you ever thought about that?

Steve Sanduski: That's right. We love it on the upside when things are going up that's great.

Bill Keen: The real risk that I see we could talk about volatility and it is how our industry defines risk is how much something varies around it's trend line or not to be too technical but it's mean. The real risk that I see to individuals they are investing for a 30 plus year retirement when I really look at risk I say the real risk is outliving their money and making sure that they have a dignified retirement out until the very end of their lives. If we define volatility yes it's a risk because I believed that volatility if somebody doesn't understand it can shake them off their plan and cause them to make an emotional decision. Hey, I've got a question for you now. I want to give you put you on the stand.

Steve Sanduski: Okay, great. Turn about is fair play. Right?

Bill Keen: Yes because the reality is risk in my mind it's the possibility of permanent loss. That's the definition of risk volatility as long as it's not acted on because we either panic or we needed our money back in essence then maybe is it risk? Is it not? It's just what it is. It's volatility. That's what it is. Let me ask you this, Warren Buffett you mentioned earlier, do you know how much that his portfolio was down in 2009? I know I'm putting you on the spot, do you have an idea?

Steve Sanduski: In 2009, okay, I know the market ...

Bill Keen: 2008 and then bottomed in March.

Steve Sanduski: We're talking Berkshire Hathaway stock here. I would say that was down I'm going to say 20%.

Bill Keen: I'm going to give you a dollar value because I think it's more ...

Steve Sanduski: Okay.

Bill Keen: Off his net worth was down it's been estimated at 25 billion dollars at the bottom in '09 in that something.

Steve Sanduski: That he was down 25 billion?

Bill Keen: 25 billion dollars off his net worth at the bottom in '09. Now, here's my question for you, what was his total loss in 2009 going forward?

Steve Sanduski: Zero.

Bill Keen: Man.

Steve Sanduski: Because he didn't sell.

Bill Keen: Darn it, Steve. I thought I would stump you for at least a moment there but I might have forgotten now you're from Omaha.

Steve Sanduski: That's right. Yeah, I'm from Omaha where Buffett is from. Someday I'll have to tell you a couple of stories about when I got a chance to meet Mr. Buffett. Just some fun stories there that we'll save for another episode. Bill, you're going to have to try harder to stump me.

Bill Keen: Okay. You better watch out. You mentioned numbers. Let's talk about another number that I think is important. I talk about a dignified retirement lifestyle. I had a client in recently and she said, "Bill," she's in her 70's and she say, "I have a stock in bond portfolio." She understands the concepts of it and understands what we're doing. She says, "I just don't want to be a burden on my kids. I want to make sure that my kids know that I've taken care of my business so they don't have to worry about taking care of me when I get older." That really struck

a chord with me. We talk about inflation in there because some people might say, "You all given us mix signals here." You're telling us that we can make this, these are returns on the equity side of things. Nice returns, 10% plus. That's what history has shown us here. Again like you said it's not guaranteeing anything going forward but why participate at all in those environments? Why subject ourselves to any of that volatility? Why do we do that? The reality of it is let me ask you this, Steve what did you pay for your first car?

Steve Sanduski: I actually remember that. It was 1984. It's the summer of '84 just graduated from college. I had my first job working for at the time it was called Caterpillar tractor company. Today it's just called Caterpillar Inc. I was sitting at a McDonalds. I hate to admit this. I was sitting down at McDonalds I was a bachelor. Eating breakfast looked out the window and right across the parking lot was a car dealership and I saw this really shiny red car. I thought that's cool. I walked out, took a look and say, "I'm going to have to stop by after work," so stopped by after work and ended up buying my first car it was a Chevy Cavalier three door hatchback which at the time was cool. I mean that sound cool today. I paid like \$8,700 for it.

Bill Keen: Wow. Now, that was brand new, right?

Steve Sanduski: That was brand new.

Bill Keen: Okay, All right. There you go. Now, I wonder what that would cost today I'm thinking somewhere around in the 30's, wouldn't you?

Steve Sanduski: You know? I don't know. I'm not sure I don't think they make the Cavalier anymore. I think that's been long since discontinued.

Bill Keen: You're not still driving that one, are you Steve?

Steve Sanduski: No, no but my philosophy is I typically hold on to a car for ten years. Then, did a new one so I definitely held that one on ... Held on to that one for ten years.

Bill Keen: Very nice. Very nice. That's a great example of what I'm talking about. One of the thought experiments I ask our clients to go through when they come in is what was your first year salary. We're talking to people that are in most cases at a near retirement. They are looking back literally 40 years and almost across the board folks look at it and they think, "My goodness. My first year salary was about a 10th of what my final year salary was. What did I pay for our first home? Where are the home is now?" I mean, do you look at the differences?

It's five to ten times. In most cases it's closer to ten times. When you think about that thought experiment I always ask people just look at your own lives. I'll quote data and I'll quote research but look at your own lives and learn from your own experience about how things work for you. What inflation has been like? Then you think ahead and you say now, what's going to happen going

forward and would A, this is the question, would A 1% return from bank CDs today or 2% return or right now the ten year treasury is somewhere little over 2%. Would a 2% return get you to your destination in this 30 plus years of arising cost world? You work backwards and in most cases people realize, "Wow, we need some of our assets to be in these asset class stocks or equities that will provide a portion of our account with some nice growth even though it was going to be volatile.

Steve Sanduski: Bill, you remember back to the late 1970's early 80''s when we had really high inflation maybe today we've had low inflation for quite a few years now and maybe inflation is not on people's radar as much but guys you and I can certainly remember back to the late 70's early 80's when inflation was so high. Just trying to look up some numbers here to see ... Do you remember how high inflation got back in those days?

Bill Keen: I think short term it was in the 12, 14, 15%. If you look at the numbers it was a pretty short term period based on history. It was anomalous. I can tell you it did happen and remember back that point too you can get money markets and bonds and CDs that paid 12, 13, 14, 15% as well.

Steve Sanduski: Right, there were some 30 year US treasury bonds I think where up in the 14, maybe 15-ish percent range for 30 years just imagine that. I mean, if someone told you today that you could buy a government bond that would pay 14, 15% interest for 30 years would you take that deal?

Bill Keen: I think we would take the deal and we probably wouldn't have to own any stocks anymore, would we Steve?

Steve Sanduski: Yeah, things have certainly changed quite a bit since those days.

Bill Keen: Remember too that back in those days that short term interest rates money markets actually paid more. There was a time period that money market accounts paid more interest than a five and ten year or 30 year instruments but people say, "Why would I tie my money up for 20 or 30 years at this rate when I can get even more on a money market account?" Again, to your point boy if we would have known.

Steve Sanduski: Yeah, if we only knew then what we know now we could certainly made a lot of money on that.

Bill Keen: That's right. That's right.

Steve Sanduski: All right, Bill I want to talk some more here about some of these historical returns and look at it. I know we talked about the 88, 89 year period going back to 1926 but looking at more of a decade by decade basis. Let's put it on a ten year period. If we look at the decade of the 1930's so this would include the Great Depression and then coming out of the Great Depression and leading up



to world war two the average compound return of the SNP 500 index and we cannot invest directly into an index but based on that index the average compound return for the year was negative .1%. Essentially you got nothing over that ten year period.

Bill Keen: Okay. All right. That was the decade of the 30's.

Steve Sanduski: That was the 30's so that was the Great Depression and then we move into the 40's. The first half of that we had world war two and then coming out it averaged 9.2%. Not bad. Then in the 50's was a glorious period for the financial market so the stock market index. The S&P 500 index had a compound average annual return of 19.4%. The turbulent 60's we dropped down to 7.8%. The 70's with the high inflation and oil embargoes and lots of unrest in the US it was 5.9. then the 80's and 90's were really phenomenal. We had 17.5% average annual return in the 80's an 18.2% in the 90's and I think we were all very, very spoiled. Because then in the 2000's from 2000 to 2009 the average annual return was a negative .9%. Even looking at it on a decade by decade basis you can see there's quite a bit of volatility in those numbers.

Bill Keen: There really is and to look at that and try to identify the timing of where you might be I think it's just super important to look at now you're own situation and come up with the numbers that you are going to need back from your investments. This speaks to the time horizon of your investment. One mistake that I see people make is they think that if they are retiring in two years that their investment time horizon is just two years.

The reality is for some of their money yes they will need some money back beginning in two years when they retire to live on but they certainly won't need all of their money back at that point. It's really being sensitive to what's the time frame for this resource and the investments that are being made. Understanding that I like the way you broke it down here per decade because we gave some long term averages but you've now even articulated a little bit clearer what happens in this different ten year period as well.

Steve Sanduski: Here's something else Bill that I think is important to talk about. It's one thing to say historically this is what the financial markets have done. Also we have to understand what causes the different asset classes, the different types of investments to behave the way that they do and of course if we look at stocks. I think we could certainly say that over a long period of time the returns on stocks are generally driven by the profits that those companies are generating. Also I think we have to take into consideration the economic environment that is in place and how that can affect some of these different investments.

I know there's a number of charts and studies out there that talk about how some of these different investments behave if we're in a deflationary type of environment where prices are actually negative. They are declining or we have a growth environment where the economy is expanding. We have an inflationary

environment where prices are rising for the goods and services that we buy. Depending on the type of economic environment we're in we'll also have an important impact on how some of these different outside classes perform.

Bill Keen: Absolutely. Again, that speaks to diversification. It's one of the things that we talk about is we've outlined four asset classes and inflation in our long-term look today. There's the reality there's a lot of different asset classes that folks can be invested in in both fixed income and equities and they key to all these is having a very diversified portfolio and not just being aesthetic but actually rebalancing things over time. Identifying what make sense, what's appropriate.

What will get the job done for a family and what they are comfortable with and what they understand very important but then keeping things balance because if you just look at these numbers to your point things do different things at different times. If you start out with a portfolio of 50% equities or stocks and 50% fixed income most likely it won't be too long before the stocks are more than 50% because they have done better and things have to be systematically rebalanced whether it's on a certain date each year or based on volatility, keeping things balanced is really important among all the asset classes that someone might own. So that it really helps to smooth that ride out over time.

Steve Sanduski: Bill, what do you mean rebalanced? Explain that.

Bill Keen: I always explain it like this. If you had two things that you wanted to invest in you had equal amounts of two things and one went up and one went down and now you want to bring them back to even or rebalance them by definition you will have to sell some of what went up and put it over into the item that went down to balance them back out again.

What we see though is people looking at their in this case many case it's 401K statements or investment statements where it doesn't have to be 401K and they look at what their investments have just recently returned in the prior period. Whether it's one year, two years or three years and in most cases people really do. They key on what's just happened maybe on year to date or the prior 12 months and they experienced that as if that's what that investment is paying as in it's paying going forward. Now, its reports of what just happened but as you know as market cycles happen and its things rotating and out of favor what just happen in an asset class has really nothing to do with what's about going to happen in the next time period.

One of the biggest mistakes investors make when they look at their account statement is they chase what just did best in a prior period. They move their money into what just the best and prior period thinking that they've done the research and that that's going to be what it does best going forward when in reality they should have been rebalancing and actually taking money out of the things that had done well. As long as it was within their asset allocation if they had one that was thought through and reallocating assets into the things that

haven't done as well. That is exactly backwards to our human nature. That's what makes this whole investment and long-term retirement and financial planning thing so difficult to navigate on your own because these things go against human nature.

This is why I always talk about having a financial plan in place. They articulate exactly what the purpose of someone's investment assets are. What's the purpose of the money? I believe you can't invest long-term serious wealth without a purpose without it being in a context of what those resources are going to provide for you and your family. Really have it thought through with time lines in place and our understanding of the difference between a stock, a bond, inflation and why you're doing what you're doing. If you go into these things like right now Steve, I have my TV off. You probably do too.

There could be something happening right now as we speak that could close the markets down temporarily like we had in 2001 or something God forbid like that happens. My point always is you have to have your portfolio set up and your financial plan in place so that no matter what happens the next day you can weather it. You can get through it. That's why I think this episode was so important. We at least we scratched the surface on it. There's a lot more we can cover and get into this over time and we will. Just understanding why you're doing what you're doing, what to expect, we can actually turn this volatility we talked about into opportunity.

Steve Sanduski:

Yeah, I think that's great Bill. Good way to wrap up this episode as we talked about some of the long term historical rates of return for different asset classes. We discussed some of the volatility that we might expect. Some of these different assets to experience and having that perspective as you were saying I think is just critical because when things do get a little squarely in the financial markets if we have some understanding of how this fits within historical context I think that's helpful.

Also, you were talking about how by having that financial plan and by being diversified will help you be able to sleep a little better at night. I always like to say to people that the allocation that you have in your investments, the diversification that you have should be structured so that you can go to bed at night and no worry about what's going to happen over night in the financial market because you know that you're diversified and that yes things will fluctuate, things can go down but if you've got a good plan in place and you feel comfortable that you're not taking more risk than you should. Any final comment here, Bill as we wrap up?

Bill Keen:

Steve, the thing that I wanted to close with was simply have a plan and understand why you're doing what you're doing when it comes to the investments. Always be a learner just be willing to go out and continue to learn and add to your knowledge base and that is what will help people get to their destination long term. Reduce anxiety and really help people get focused.

Steve Sanduski: I think that's a great way to wrap up this episode, Bill. I appreciate your time as always. I look forward to our next time together to help share some of this insight and wisdom with our listeners.

Bill Keen: Me too, Steve. Thank you very much.