

“Falling Interest Rates and Your Retirement”



As of August, 2019, the interest rate on the 30-year US Treasury Bond had fallen to an all-time low of just under 2%, and more than one-quarter of the world's sovereign debt had a negative yield. If interest rates in the United States continue to fall or even become negative, this will have a profound effect on everyone, especially those who are retired or nearing retirement.

A common asset allocation is 60% stocks and 40% fixed income; the former to generate real growth, and the latter to provide income and safety during bad times. It is also standard advice that when you are retired to have at least 3 years of living expenses in risk-free, cash equivalent investments such as a checking account, money market, Certificates of Deposit (CDs) and short-term Treasury Bills, so that you do not have to sell stocks or other assets when the market is down just to meet living expenses.

The older you are, the more you should have in fixed income, because you may not have the luxury of time to recoup losses in the stock market. The Dow Jones Industrial Average did not return to the 1929 high until the early 50s. When adjusted for inflation, the market did not return to the 1966 high until 1991. A common recommendation is to have 100 minus your age in stocks, the remainder in fixed income. Because people are living longer, some now recommend 110 minus your age in stocks. Thus a 70 year old should have at least 60% to 70% of their portfolio in fixed income, an 80 year old, at least 70%.

The average physician in the United States works about 25 years, and if they saved 20% to 30% of their salary, about \$50,000 to \$75,000 per year, they could easily retire with no debt and investable assets of \$3,750,000. Ten years ago, they could have put everything in risk-free investments that generated a 5% return, living on \$150,000 per year, and reinvesting 1% of the earnings to keep up with inflation.

Now, what if interest rates in the United States fall to zero? If you are 70 years old and retired with the asset allocation described above, you have zero return on the majority of your portfolio. Zero. The current bull market in stocks that began in March, 2009 will end sometime. There could be a time within the next several years where your fixed-income investments generates no income, and your stock investments are down 30% or even more. Unless you are independently wealthy, with a net worth of 8-figures, you will need to cut back significantly on your life style. Pray you are not forced to return to work.

Everyone will need to work longer, and if you are currently within 5 years of retirement, you may need to change your plans. Every extra year you work should generate

about 2 years of living expenses. You have that year covered, and further savings and/or a return from some other asset of your investment portfolio will (hopefully) generate another year's living expenses. If these low or negative interest rates last only a year or 2, it should not make much difference. But low to negative interest rates have been the case in Japan for the last 30 years since their stock market bust, so it could last long enough to force you to change your plans.

Most people feel that the low and negative interest rates are due, at least in part, to central bank manipulation. But what if the market is really saying that in 3 years 98 cents will be more valuable than \$1.00 now? It suggests Great Depression-like deflation, with the obvious implications. J. Wellington Wimpy of Popeye had it backwards “I’ll gladly pay you today for a hamburger on Tuesday.”

Whatever the cause, these low or negative interest rates are transferring wealth from the hard working savers to the profligate spenders, that is, the government.

Acknowledgment

Dr. Robert M. Doroghazi is a retired cardiologist who trained at the University of Chicago, the Massachusetts General Hospital, and Barnes Hospital. Warren Buffett said his book *The Physician's Guide to Investing: A Practical Approach to Building Wealth* should be “required reading at med schools”. To sign up for a free trial to *The Physician Investor Newsletter*, visit www.thephysicianinvestornewsletter.com

Dr. Doroghazi is not a registered financial advisor under federal or any state law. The advice provided is of a general nature, and should not be interpreted as personalized or individualized to your specific portfolio.

Disclosures

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