CLIFFORD SWAN

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WISDOM *for* GENERATIONS

3 PILLARS FOR A HAPPY RETIREMENT

By Lloyd K. Wong
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Clifford Swan partner Lloyd Wong recently spoke on this topic as a guest on gerontologist Mary Winners' "Visionary Aging" podcast.

What do a fitness tracking device, a budget, and an appointment calendar have in common? They are all tools to motivate you and monitor your progress towards securing a successful retirement.

We believe it is best to approach retirement so that one is healthy enough to enjoy life, has sufficient funds to be free from financial worry, and can spend time in life-satisfying ways with cherished companions. The three distinct pillars to support these qualities in retirement are *health*, *money*, and *relationships*. Most people focus on *money* as the sole component to a rewarding retirement, largely ignoring the *health* and *relationships* pillars. However, all three are important and require upfront investments—sacrifices of energy, money, effort, and delayed gratification now for enjoyment later.

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HEALTH

To promote *health* in retirement, develop basic healthy habits. This includes eating right, sleeping enough, and getting adequate exercise. Since it's vital to visit medical professionals frequently enough for them to diagnose any diseases and make proper recommendations for health care, establish good relationships with knowledgeable medical professionals and remember to set up routine appointments. Daily habits and regularly scheduled medical appointments are simple ways to build up your *health* pillar.

Also consider how your health needs may change over time. Have conversations with loved ones, trustees or designated private fiduciaries so that they know your preferences regarding where you plan to age (for instance, at home or at a facility). Special health concerns such as dementia may also influence these preferences. Create or update your health directives and ensure your trusted contacts know where to find them. These proactive measures to solidify your *health* pillar will increase your peace of mind.

MONEY

Length of retirement can be long, perhaps longer than people anticipate. For the *money* pillar, the primary objective is to safeguard against outliving your money. Additionally, financial strength provides flexibility and autonomy to live comfortably during retirement—and hopefully also have funds available for what matters to you beyond the basics.

> "...it is essential to set appropriate asset allocations for your portfolio so that it is aggressive enough to grow when you are still working and is conservative enough to withstand withdrawals to meet living expenses during retirement."

There are numerous ways to build up the *money* pillar of retirement. Common practices include starting to save early to take advantage of the power of long-term compounding over time, maximizing contributions to tax-advantaged retirement vehicles during your working years, being disciplined in your spending in order to remain debt-free, and delaying claiming Social Security benefits until at least reaching Full Retirement Age. Additionally, it

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is essential to set appropriate asset allocations for your portfolio so that it is aggressive enough to grow when you are still working and is conservative enough to withstand withdrawals to meet living expenses during retirement.

Keep in mind that spending requirements often vary throughout retirement. The initial phase may require the same amount of spending or more than before retirement as retirees are still physically and mentally capable of living an active lifestyle, replete with hobbies and travel. As retirees age and physically adjust to lower energy levels, they may start to slow down, contributing to lower spending during this phase of retirement. In the final phase (typically ages 85+), choices become more limited due to a decline in activities resulting from diminishing abilities, whether physically, mentally, or financially. This phase may require an increase in spending or require additional support from family, government, or health care agencies.

Money can make you happy, but only up to a certain point. A Princeton study[1] published in 2010 found that $75,000 (approximately $97,300 in today's dollars) is a rough rule of thumb for how much annual income it takes to be happy. Researcher Michael Finke studied longitudinal data going back to 1994 on 20,000 retirees from the University of Michigan Health and Retirement Study to find that $4 million is the peak dollar amount above which money doesn't necessarily provide any additional positive psychic satisfaction[2]. Spending money on stuff doesn't necessarily make you happy; that sort of happiness can wear off after a while. Instead, social spending—the spending of money and leisure time with friends—creates meaningful memories and more lasting happiness.

$4 Million

Peak dollar amount above which money provides no additional positive psychic satisfaction

RELATIONSHIPS

The Harvard Study on Adult Development[3] shows that "Close relationships, more than money or fame, are what keep people happy throughout their lives." A meta-study[4] by Brigham Young University reveals that adults get a 50 percent boost in longevity if they have a solid social network. Social relationships are thought to help improve health either by buffering individuals from stressful situations or creating a norm of healthful behaviors.

The results of these studies are not surprising. It is imperative to create and maintain relationships to extend the possibility of a long and rewarding retirement. Your spouse can often be the greatest source of the *relationships* pillar. However, if your marriage isn't strong, those weaknesses will exhibit themselves during retirement; if it is strong, that relationship can enhance other relationships as well. Surprisingly, spouses and friends can be more of a source of psychological wellbeing than your own children (and unlaunched adult children can be a headwind).

Beyond family, relationships often develop by happenstance through your social interactions through your spiritual community, neighborhood, job, volunteer work, hobbies, and creative pursuits. Maintaining social relationships and connection is necessary for a gratifying retirement. Volunteering can enhance your ties to the community.

Having as few as just three to five close friends[5] can provide the infrastructure of a robust support network. The quality of friendships matters just as much as the quantity of friendships you have. Frequency of contact can help deepen and strengthen relationships. These relationships need to be nurtured and maintained so that they remain intact. However, these are the very relationships that can often be neglected or ignored during your working phase of life. If you find you no longer have the social network you once had from work you may need to develop new relationships and create a new social network from scratch during retirement. One of the things that the Covid-19 pandemic taught us is that Zoom and Facetime are useful tools in helping us maintain relationships and points of commonality. Developing and maintaining relationships require investments in time and intentionality prior to retirement.

50%

Boost in longevity if a solid social network exists

All three pillars require time to build, which is why it is important to start investing in them well before retiring. We here at Clifford Swan are dedicated to helping fortify your *money* pillar. However, we also encourage you to continue building your *health* and *relationships* pillars so that your "golden years" can be truly "golden." ◆

Source: Michael Finke, Professor and Chief Academic Officer at the American College of Financial Services, spoke on life satisfaction in retirement at the 2021 Morningstar Investment Conference in Chicago.

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3 Mineo, Liz. "Good genes are nice, but joy is better." https://news.harvard.edu/gazette/story/2017/04/over-nearly-80-years-harvard-study-has-been-showing-how-to-live-a-healthy-and-happy-life/. 11 April 2017.

4 Holt-Lunstad, Julianne, Timothy B. Smith and J. Bradley Layton."Social Relationships and Mortality Risk: A Meta-analytic Review." https://journals.plos.org/plosmedicine/article?id=10.1371/journal.pmed.1000316. 27 July 2010.

5 Degges-White, Suzanne. "How Many Friends Do You Really Need in Adulthood?"https://www.psychologytoday.com/au/blog/lifetime-connections/201908/how-many-friends-do-you-really-need-in-adulthood. 9 August 2019.

U.S. MONETARY POLICY: MASSIVE AND DOMINANT

By Randall L. Zaharia
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U.S. monetary policy is more active than ever, with the Federal Reserve exerting considerable influence on the global financial and economic environment. We believe that the current landscape may warrant asset allocation shifts in investment portfolios.

BACKGROUND – THE RISING INFLUENCE OF THE FEDERAL RESERVE:

The Federal Reserve was established by Congress in 1913 as a decentralized organization of twelve Federal Reserve banks spread across the county. Congress created a central bank to provide the nation a safer, more flexible, and more stable monetary and financial system. The Fed was relatively obscure until the 1970s when it dramatically increased the economy's money supply (this primarily consists of U.S. bank deposits and money market funds) in the early part of that decade to quickly boost the economy. This partially fueled very high inflation in the later part of the 1970s and into the early 1980s.

President Carter made the first meaningful attempt to control inflation by nominating Paul Volcker as Fed Chair in 1979. To combat rampant inflation, Volcker took decisive action, increasing interest rates well into the double-digits by the early 1980s. This induced a substantial recession in 1982/1983. This painful process gradually reduced inflation, culminating in inflation rates between 1% and 2% in the most recent decade. This downshift in inflation was concurrent with interest rates declining from double-digit levels in the 1980s to under 1% in 2020.

THE GREAT FINANCIAL CRISIS AND THE COVID-19 PANDEMIC:

The financial and economic environment has been shifting in many ways since the Great Financial Crisis in 2008/2009, but especially so over the last two years in response to the Covid-19 pandemic lockdowns.

The presence of the Fed in financial markets grew immensely from 2008 on. The Fed's balance sheet, which underpins the money supply, was below $1 trillion in 2007, then ballooned to nearly $4.5 trillion in 2019 as the Fed bought massive amounts of U.S. government bonds (quantitative easing). In early 2020, the balance sheet ballooned again during the Covid-19 pandemic; by January 2022, the Fed balance sheet reached nearly $9 trillion. Concurrent with the growth of the Fed's balance sheet was the dramatic increase in the money supply. From $15.4 trillion in March 2020, M2 (one measure of money supply) grew to nearly $22 trillion—an increase of over 40% in less than two years, compared to approximately 5% annual growth in the money supply in the previous 40 years. To put the scale of these values in perspective, U.S. real GDP (the country's economic output) stands at about $20 trillion as of year-end 2021.

The dramatic increase in the money supply has helped create price inflation. From 2019 through 2021, inflation, as measured by the personal consumption expenditure (PCE) price index, increased by about 3.3% and reached 6% in the last quarter of 2021. Specifically, the substantial amount of liquid funds helped fuel purchases of financial assets, real estate, and other investment options, inflating asset values as well as pushing inflation of goods and services up to the high single digit levels. By comparison, from 1929 through 2019, overall U.S. inflation was a moderate annual rate of 2.7%, including a modest 1.6% from 2008 through 2019.

The Covid-19 pandemic response by the Fed and the U.S. government was unprecedented in its pace and scope. The Fed reduced short-term rates to nearly 0%, coupled with the massive buying of U.S. Treasury and U.S. agency securities, as well as corporate bonds via controversial special purpose vehicles. At the same time, the Trump and Biden administrations flooded the U.S. economy with massive amounts of funds and stimulus,

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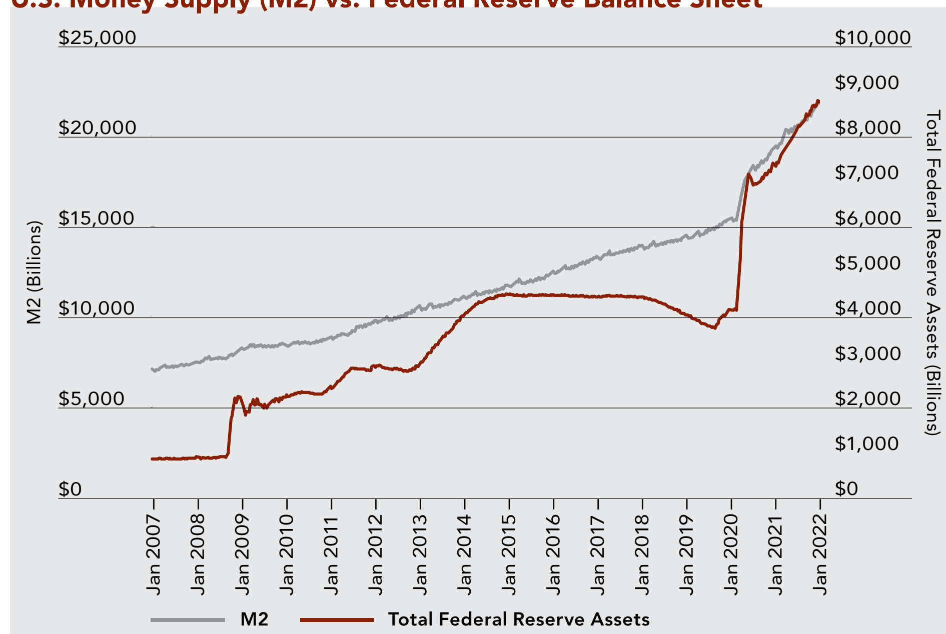
U.S. Money Supply (M2) vs. Federal Reserve Balance Sheet



Source: Federal Reserve Bank of St. Louis

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attempting to minimize the economic fallout from the pandemic shutdown. As a result of federal deficit government spending, the U.S. debt level expanded by roughly $7 trillion since the end of 2019 to its current $30 trillion level.

LOOKING AHEAD:

With U.S. debt at $30 trillion and a Fed balance sheet near $9 trillion, it is difficult to estimate with confidence what might happen next. Nonetheless, we expect economic growth in the U.S. to slow from the high pandemic recovery rates of roughly 6% in 2021 to 2-3% in 2022. We believe much of the GDP increase in 2021 included inventory build ups as well as a post-pandemic consumer spending surge. Both trends are likely temporary; consumer spending should moderate, and companies will likely slow down production and purchases to maintain more manageable inventory levels.

Ultimately, the Fed is threading a very narrow needle to maintain full employment (and a healthy economy), a steady inflation rate, and financial market stability. Lowering inflation without destabilizing markets is extremely difficult. Alan Blinder, a former Vice Chair of the Fed, recently shared his viewpoint[1] on the challenge: "By late 2022, economic growth could be sluggish, the unemployment rate could be stable or inching up, and the inflation rate could be nearly back to 2%. If that's what the future holds, the Fed will want to be cautious about how fast and how far it hikes interest rates during the first half of 2022." We agree with Dr. Blinder's evaluation. The Fed is juggling priorities, potentially limiting their effectiveness. Therefore, our expectation is that interest rates will increase much more modestly than markets are anticipating.

> "Ultimately, the Fed is threading a very narrow needle..."

We are paying careful attention to the strength of the economy as economic tailwinds may dissipate by 2023, especially with respect to consumer spending. In addition, higher interest rates may cause financial leverage issues to surface as the cost of borrowing becomes more expensive, as well as crimp the robust real estate market by significantly increasing mortgage rates.

What will happen to inflation? The answer largely depends on how transitory contributors to inflation prove to be. That is, how much of a role did supply chain disruptions play? How much did loans and stimulus checks boost demand? While the answers matter, we believe the flywheel of inflation has been started by the huge increase in the money supply. As a result, we would not be surprised to experience 3-4% inflation over the next several years—roughly double pre-pandemic levels. While our outlook is somewhat moderate, significant differences of opinion amongst economists and analysts on inflation trends over the next few years underscores the uncertainty that lies ahead.

STRATEGY AND TACTICS:

Given the prominence of the Fed and the U.S. government, we believe that the 2020s will be a less predictable period, where maintaining real (post-inflation) purchasing power and wealth will be an important goal for many clients. Following the huge double-digit run of stocks in the 2010s and into the early 2020s, it now appears that investors are looking toward more fundamentally strong and reasonably priced stocks—the type of solid, high-quality stocks in which Clifford Swan invests. We believe ownership in strong companies should provide good total returns.

In addition, we are considering a broad range of diversified assets that are not strongly correlated to each other over a longer horizon. Depending on risk tolerances and appropriateness for each individual client, international stocks, real estate, precious metals, as well as other potential alternative options—including cash itself—might be compelling.

The presence of the U.S. government and the Federal Reserve has become massive, with both reshaping the investment environment. Our challenge is to gauge the direction and crosscurrents that their recent actions will create, and to translate our perception into appropriate portfolio management decisions. ◆

1 Blinder, Alan S. "The Fed Should Raise Interest Rates, but Gently." https://www.wsj.com/articles/the-fed-should-raise-interest-rates-but-gently-inflation-transitory-fomc-stock-market-supply-chain-prices-11644175236. 7 February 2022.

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