

## The Great Experiment: Regis or Groucho?

As the political locusts descend on us this election year, Social Security has become an election issue. This interests us, since the primary investment goal of most of our clients is to assure retirement security. Unfortunately, debates over Social Security tend to fall into two categories: (1) the non-substantive appeals to fear and (2) the soporific. Politicians and policy analysts can appear on the same stage with one claiming that Social Security "has enough money" to last forever, while the other claims that the system is on a rapid road to bankruptcy. The differences appear to depend upon your interpretation of federal government accounting. Unfortunately, having an interpretation seems to require understanding it. We're really interested, but we have to admit our eyes start to glaze over once the discussion descends into the minutiae of the system's bookkeeping.

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While we're excited about the topic being front and center in the political debate, we're skeptical of the chances that the electorate's understanding of the issue will be enhanced. One side assures us that

Social Security is in great shape, so we need to dedicate the budget surplus (another result of dubious government accounting) to save it. The other side assures us that the system is defunct, so we should fix it by starving it of additional funds. A third group in the debate argues that privatization is a good idea, but this is a bad time to implement it because stock prices are so high relative to underlying business fundamentals. As any reader of these newsletters knows, we agree with that notion about values. Anyone who thinks the political will to privatize will exist after a severe bear market, however, needs to review their college psychology textbooks. These paradoxes remind us of H.L. Mencken's observation that folks who complain about taxes haven't factored in the entertainment value of politics. In Mencken's time, the tax burden was much lower than it is today. Current politicians, however, probably provide better entertainment than Woodrow Wilson and Calvin Coolidge.

We admit to having mixed feelings about the Social Security privatization proposals. On the one hand, the "return" received on the payroll taxes for a typical worker would be exceeded by actually investing money in just about any asset, including Treasury bills. It would also be nice to have actual investments in the system, as opposed to mere transfer payments from the young to the old in the guise of a "trust fund." On the other hand, expanding choices can go too far. As with 401(k) plans, allowing participants to short the yen at 2 a.m. on their touch-tone phone does more harm than good. Studies of investor behavior demonstrate that investors, given a chance, will chase past returns. The more "active" the investor, the lower the returns.

Whatever your views on current proposals, the debate provides an opportunity to think about the unprecedented social experiment underway with respect to retirement security. The baby-boom generation, a huge demographic group, paid Social Security taxes to support their parents in retirement. When the boomers retire, the number of workers relative to retirees will be much smaller. Almost everyone in the current debate acknowledges that Social Security payments, in real terms, are likely to be smaller than those received by current retirees. The boomers are also less likely to retire with a traditional pension than their parents. The times when dad worked his whole life for IBM and received a fat pension upon retirement have gone the way of avocado-colored kitchen appliances and double-knit pants. Finally, healthy lifestyles and advances in medicine mean the boomers are more likely to require retirement incomes for a longer period than their parents.

***Allowing citizens to short the yen at 2 a.m. on their touch-tone phones with Social Security money is likely to do more harm than good.***

The replacements for the traditional pension and, to a lesser extent, meaningful Social Security payments are the 401(k), similar defined contribution plans and the IRA. In other words, you have been delegated the responsibility for your own retirement income. This has seemed like a tremendous boon in the long bull market we have enjoyed since the Dow Jones Industrial Average was below 800 in 1982. The bull market has had a touch of circularity, though, since the money invested in the new investment programs has helped elevate stock prices. One result of the longest bull market in U.S. history is that most investors have never endured a protracted bear market. Investors in 1982, with the market 20 percent lower than its level 16 years previous, thought about the world differently than investors today. Over the past several years, investors have significantly increased the aggressiveness of their retirement portfolios. Is this due to increased investor education or just chasing past returns?

How investors react during the next extended bear market is an open question, to which nobody knows the answer. How the question is answered will have monumental impacts upon politics, social policy and inter-generation relations. An oft-commented upon metaphor for investor sentiment these days is the popular TV show "Who Wants To Be a Millionaire?" which, if nothing else, is teaching the young the definition of a rhetorical question. We think a better metaphor for our current situation is another game show we are depressed to admit that we are old enough to remember, hosted by Groucho Marx, titled "You Bet Your Life!" If you would like help to avoid being a lab rat in a massive social experiment, contact us. And kiss your children tonight when you put them to bed - you might need them.