

The Outer Limits

“There is nothing wrong with your television set. Do not attempt to adjust the picture. We are controlling transmission.” So began *The Outer Limits*, an iconic TV show of the 1960s. This introduction gripped the attention of young baby boomers, for whom nothing is scarier than not being in charge. We all want to command our destiny, and the boomers (combining attitude, education, technology) have more control freaks per capita than any generation in history.

Marketers of financial products know this and craft their ads to emphasize that you are running the show. In the ads, either you are micro-managing your own investments or the firm’s know-it-all experts are able to see clearly into the future and fine tune your portfolio performance. Many brokers, financial planners and insurance salespeople love to pretend that they can predict your portfolio value to the penny ten years, two months and three days from now, and you love to believe them. But they cannot successfully predict, and you should not credulously believe. In investing, the markets control the “transmission,” not you.

Most people make many investing mistakes. Even if you do everything right, though, you cannot avoid randomness. Imagine two brothers, three years apart, who each retired at age 62 in the early 1960s when the TV show aired. Each had a \$1 million portfolio, and each lived 30 years in retirement. They withdrew only five percent (\$50,000) in the first year of their retirement, and took out the same dollar amount in subsequent years, adjusted for the cost of living.

Both brothers did everything right from an investment standpoint. They had an optimal asset allocation to make their money last (and if you want to know what “optimal” asset allocation is, you will have to call us). They both diversified and periodically rebalanced their portfolios. Neither selected a bad manager, was duped by the latest investment fad or otherwise did anything stupid. Brother #1, who retired in 1962, died 30 years later with a large estate. Brother #2, who retired in 1965, ran completely out of money 22 years later at age 84. Brother #2’s withdrawals during the sub-par market returns in the late 1970’s pushed his portfolio past the tipping point beyond which it could not recover. Brother #1 enjoyed three years of a bull market before Brother #2 retired, so his portfolio reached the critical mass necessary to survive.

Brother #1 probably attributed his success to hard work and smart investing – his younger brother must have made a stupid mistake, must not have been as smart at managing his money, must have been profligate in his spending. We all tend to attribute our good fortune to virtue and intelligence. If somebody fails when we succeed, well, they just were not as upright, careful and smart as we are.

But consider the somewhat heroic assumptions we made in our hypothetical. We assumed both brothers had an appropriate portfolio allocation – but most investors do not. We assumed neither brother made investing mistakes – but most investors do. We assumed they lived on only five percent of their starting retirement portfolio – but how many millionaires do you know who want to live on \$50,000 a year? We assumed they both sought to have their money last a full 30 years – but most investors tend to assume, based upon average life expectancy, they will die in less time. Many will live longer.

Nobody controls the future. As much as we would like everything to be orderly and according to plan, wildness lies in wait.

Despite Brother #1's smug attitude towards his sibling, there is no virtue or intelligence gap – both brothers behaved identically. Both lived with the same Presidents, Congress and Federal Reserve (we also want to believe that our political leaders “control” the economy and financial markets). Both were equally

savvy investors – the only difference is the three years between their retirement dates. Yet one winds up wealthy and the other penniless. Neither could have foreseen in the early 1960s what was to befall their portfolios. Even scarier, small changes in our assumptions could lead to much more severe adverse results – even for Brother #1.

In retirement investing, the sequencing of returns is absolutely critical. You cannot eat “average” rates of return – all that matters to you is the period you actually live through. All time periods are not the same, even if they have identical “average” rates of market returns. If you are unlucky enough to experience below average returns in the early years, you will be out of money before high returns in later years bring the average back up to snuff. You will not have enough of a portfolio left to enjoy the good returns.

Few are good at predicting returns in the future, much less the critical timing of when the years will be good or bad. What if you thought bad returns were likely – would you really put off retiring because of a guess about the future? There is a great tendency to assume that everything will work out. After all, the parents of the boomers are doing OK even though they had less than the hypothetical brothers. But boomer parents were lucky in retiring during the biggest bull market in U.S. history, driven in large part by the coming of age of the baby boom generation. Will the boomers be similarly lucky when they retire?

You are not “controlling the transmission;” neither are we. Nobody controls the future. As much as we would like everything to be orderly and according to plan, wildness lies in wait. *“You are about to participate in a great adventure. You are about to experience the awe and mystery which reaches from the inner mind to the outer limits.”* Great adventure, indeed. It is not our intent to depress the keys on our computer and the spirits of our readers, but to ensure a comfortable retirement, you have to be both good at investing *and* cognizant of historical randomness. If you are, you can position yourself correctly. We could have helped Brother #2 by adding a margin of safety in his plan so his portfolio could survive. If you would like this kind of help to reach the outer limits of your retirement years with experienced, realistic advisers, call us at 503-419-3938.