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THE HIDDEN TAX ON SAVINGS

Frederic Bastiat, the great 19th century French liberal thinker, once said "In economics, there is what you see, and there is what you don't." Monsieur Bastiat had observed economists of his time focusing on the immediate benefits of policy, without considering the less obvious, long-term effects. In our time of unprecedented Central Bank policies, we "see" rising asset prices and lower interest rates. As for the less obvious long-term effects, well, let's just say that these potential effects, and the methods by which we return to traditional monetary policy, are hotly debated.

One such effect does play out when we meet with a potential client (and we love meeting potential clients!). Very often, prospects will seek our help meeting their retirement goals, and they are struggling to do so with CD rates at 1%. We suggest 10 year bonds at or around 3%, and they balk at 10 years. We ask about risk and most of the time, people tell us that they don't want to take on risk now that they are retired (or because they are too close to retirement). What's an investor to do?

To be sure, interest rates are historically low. Today's 10-year Treasury Bill rate stands at 1.88%. Other than for some time in 2012, when the rate bottomed out at 1.53%, current rates are lower than at any time in our history. The average 10-year Treasury Bill rate during the past 150 years was 4.62%. The mean rate was 3.90%.[1] Interest rates are at historical lows because of unprecedented policies enacted by the Federal Reserve. With the goal of boosting the economy, the Federal Reserve has pursued policies that have reduced interest rates and increased the money supply.

There have been winners and losers. For every subsidy paid to somebody (what you see), there is a tax on somebody else as a counterpart (what you don't see).[2] In this case, the subsidy is paid by the saver (in the form of less interest earned) to the borrower (in the form of less interest paid). Senator Patrick Toomey of Pennsylvania agrees, suggesting that the "extremely accommodative policy (of the Federal Reserve) is hurting savers' income because of the low rate environment."

Lower interest rates, combined with stock prices that are a bit high from a historical valuation perspective, make for tougher retirement planning and investment decisions. For many years, the "rule of thumb" was to retire at a typical retirement age (early to mid-60s), and to begin taking withdrawals at a rate of 4% of savings. This amount could be increased each year by the rate of inflation, and could be counted on to last the remaining lifetime. This rule of thumb worked well, when retirees could invest a sizable portion of their portfolio in bonds paying 5% - 7%. But that option is simply not available to today's retiree. Retiring clients are now faced with sobering statistics on amounts that can be withdrawn from portfolios during retirement – so-called "safe withdrawal rates."

Better to find out now than 10 years into retirement. Alan Lakein, a well-respected author on personal time management, once said that "Planning is bringing the future into the present so that you can do something about it." We help you "do something about it." And that "something" is as complex today as ever. Despite the complexity, proper planning combined with appropriate long-term investing is still the surest path to a secure retirement. Setting you on that path, and encouraging you to stay on that path, is what we do. Thank you for the opportunity to do so.

Sincerely,

Steven Criscuolo, CPA
Financial Advisor

1) http://www.multpl.com/interest-rate/
2) The Hidden Tax on Savings, Gavekal Dragonomics Global Research, February 24, 2015