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## I. Can You Retire Early and How

If your retirement assets are invested in a mix of stock and bond investments, then you ought to be able to withdraw 4% of that amount per year. If inflation drives the price of bread up 10% in a year, then, if your investments earn it, you ought to be able to withdraw 10% more the next year. So the withdrawal standard, which is projected (but not guaranteed) to preserve the earning value of your investments long term is: withdraw 4% plus inflation if earned.

The 10% tax penalty for withdrawing from IRAs before age 59 ½ is a significant stumbling block to early retirement, but it can be overcome. Here are some of the elements of early retirement.

A. SEPP, Substantially Equal Periodic Payments.

This is the IRS's method of withdrawing from IRAs without the early withdrawal penalty before age 59 ½. (I used it at age 48 after leaving my last full time employment.) Warning departure from the required formula may impose heavy tax penalties. The formula is based on ones age and a very conservative earning rate (derived from medium term US federal bond interest rates). If the investments earn only this minimal amount they will last over the projected years of life as of the early retirement date. Since, currently, the interest rate is very low (0.62% per year in January, 2021) this allows only relatively small withdrawals (Investments will generally earn a significantly higher rate of return). The SEPP system must be set up properly and it must continue to the later of five years or age 59 ½.

B. Withdraw from regular, currently taxed investment account.

Withdrawals from this portion of retirement savings can occur at any age and are tax advantaged in that each sale of securities to finance the withdrawal is only taxed on the gain imbedded and not on the entire amount realized. And most of the gain, generally, is long term gain (security owned for more than one year) so the gain is taxed at less than one's marginal tax rate.

C. Social Security

Benefits can begin as early as age 62. Before claiming I urge each of my clients to consult their doctor asking the question: "Will I live to age 85 or 86?" If the answer is yes, and one can afford to wait, then for every year that one waits (there is no payment from SSA that year), then the annual benefit is increased by 8% and one gets the annual cost of living increase. So, if you are going to be long lived, the strategy is to try to wait until age 70 to begin taking Social Security. (I began benefits at age 67 and invested them, 50% in my

one person 401(k) and 50% in a Roth 401(k). In 2011 we were still coming out of the worst recession since the Great Depression and I thought stock was a great investment, turned out I was right).

D. Two Aces in the Hole

The first ace is an immediate annuity. Annuities are poor ways to save for retirement but an immediate annuity is the guaranteed payment for life (and, if requested, the life of another, e.g. one's spouse). I urge my few clients who have availed themselves of this option to take a lower initial payment in return for an annual cost of living adjustments. This is not a great option now because interest rates are so very low. When your give your immediate annuity purchase money to the life insurance company they buy bonds with it, so the offers of payment for the owner of the annuity are very low at present.

The second ace is a reverse mortgage. I have no clients who have availed themselves of this one. The product has improved over the last decade but there is a start up fee which is, in effect an insurance policy payable to the issuing financial institution which protects them if the value of your home goes down, not up. This fee is off putting. (At one point my dad wished to move and my mother would not so I suggested that he obtain more investment capital by obtaining a reverse mortgage on the home in which we were raised. He resisted and three years later they moved to independent living in a senior complex.)

So, that's the picture as I see it. Can you live on 4% of the value of your investments? Remember the budget needs to include the payment of income taxes, medical insurance, periodic auto repayment (or Uber fees!) and perhaps should have a cushion currently because the values of both stocks and bonds are close to historic highs. If you have an interest I'd be pleased to discuss further.

## II. What Are YOUR and MY Asset Allocations?

Each of us has a different ability to live with uncertainty (risk) and so our investments will be different:

| As of December 31, 2020 | Clients | John Smartt |
|---|---|---|
| **Money Market Funds** | 1.0 | 4.2% |
| **Bond Funds** | 27.2 | 20.6% |
| **Stock Funds** | 71.8 | 75.4% |
| **Totals** | 100.0% | 100.0% |

Remember each of us has different goals and needs and our asset allocation should fit us and our family. If you have questions about your asset allocation, or your retirement plan investments, I'd be pleased to assist.

If you have questions, don't hesitate to contact me.

## III. Vanguard Rates of Return (through Latest Quarter End)

Performance percentages are per ***Morningstar.*** Amounts in parentheses are percentile rankings (1= best and 100= worst) within category.

| Periods ended December 31, 2020 | Yr.-to-date | | 5 Years | | 10 Years | |
|---|---|---|---|---|---|---|
| **Total Stock Market Index Admiral** | **21.0%** | (17) | **15.4%** | (14) | **13.8%** | (15) |
| **Tax-Managed Capital Appreciation Admiral** | **21.1%** | (17) | **15.7%** | (9) | **14.1%** | (7) |
| **Tax-Managed Small Capitalization** | **11.1%** | (52) | **12.2%** | (26) | **11.9%** | (7) |
| **REIT Index Admiral** | **-4.7%** | (44) | **5.7%** | (38) | **8.7%** | (31) |
| **Total Int'l Stock Index Admiral** | **11.3%** | (30) | **9.1%** | (18) | **5.1%** | (57) |
| **Balanced Index Admiral** | **16.4%** | (17) | **11.3%** | (11) | **10.0%** | (9) |
| **Total Bond Market Index Admiral** | **7.7%** | (45) | **4.5%** | (38) | **3.8%** | (47) |
| **Interim-Term Investment-Grade Bond** | **10.3%** | (38) | **5.5%** | (80) | **5.0%** | (75) |
| **High–Yield Corporate Bond** | **5.3%** | (50) | **7.1%** | (48) | **6.4%** | (14) |

For comparison, here are several stock and bond benchmarks:

| Periods ended December 31, 2020 | Yr.-to-date | 5 Years | 10 Years |
|---|---|---|---|
| **S & P 500 (large stocks)** | **18.4%** | **15.2%** | **13.9%** |
| **Russell 2000 (small stocks)** | **20.0%** | **13.3%** | **11.2%** |
| **MSCI World Index** | **15.9%** | **12.2%** | **9.9%** |
| **BBgBarc US Aggregate Bond Index** | **7.5%** | **4.4%** | **3.8%** |
| **ICE BofAML US High Yield Master II TR (bond index)** | **6.2%** | **8.4%** | **6.6%** |

Vanguard mutual funds and ETFs (exchange-traded funds) continue to perform as expected. I expect each Vanguard fund or ETF, for each ten-year period to be in the <u>top 1/3 before taxes based on low cost</u>, and they <u>ought to be in the top 1/4 (stock funds) after income taxes</u>.

The Vanguard High Yield Corporate Bond fund takes significantly less risk that the average "high yield" (also known as "junk bond") fund. The Vanguard fund, which takes less risk, continues to rank reasonably highly in the rankings over the last ten year period. When the more risky portions of the "junk bond" investment sector are under stress (as they have been recently), the Vanguard fund shines and it is doing so at present. Over the last ten years the Vanguard fund has captured almost all of the excess of junk bond returns over good quality bond returns—exceeding my expectation. I continue to believe that, for tax deferred accounts, this fund is a reasonable, additional diversification and comprises some of my personal bond holdings.

If you have questions about your investment asset allocation, please contact me.

## IV. <u>Other items Briefly noted</u>

As noted in the *Morningstar FundInvestor*, January, 2021 edition re: Vanguard's Primecap fund:

> "Primecap has beaten its peer group handily for much of the past decade and all the way back to when its first funds launched in 1984…there have been off years, but not many like 2020, when the fund's 16% gain massively lagged the 37% gain of the average large-growth fund and 39% for the

Russell 1000 Growth Index. It was so bad that the fund's three-, five- and 10year returns are now pedestrian relative to peers as well.

Smartt comment: Indirectly, this is also an indictment of indexed annuities (which promise to deliver most of the stock market's return with a guarantee of little or no loss). Shaving the top off of a great stock market year means that the long term returns of the investment (especially after the annuity's high costs) are ordinary, at best.

From the April 18, 2020 edition of *The Economist*: "Corporate Fraud, Who Lost Their Trunks.

> "The crisis will expose a decade's worth of swindling and aggressive accounting.
>
> When Bernie Madoff owned up to a $65bn Ponzi scheme in December, 2008, it was not out of guilt. He knew the game was up. Three months earlier Lehman Brothers had imploded. The market meltdown sent clients clamouring to withdraw from his funds, leaving them depleted with many investors still unpaid. American regulators had not spotted the fraud despite a tip-off years earlier. It was not them that did for Mr. Madoff, but recession.
>
> Booms help fraudsters paper over cracks in their accounts, from fictitious investment returns to exaggerated sales. [e.g Enron and WorldCom] As Warren Buffett…once put it, 'You only find out who is swimming naked when the tide goes out.' This time, thanks to a pandemic, the water has whooshed away at record speed."

From the November 14, 2020 edition of *The Economist*: "The Money Doctors; The asset management industry is at last sorting the quacks from the true specialists…

> In March, 1868, a prospectus appeared for a new kind of money-market scheme. The Foreign & Colonial Government Trust would invest 1million British pounds [Lb]… in a selection of bonds. For 85 Lb an investor could buy one of the 11,765 certificates giving an equal share. The trust promised a 7% return…The trust was the brainchild of Phillip Rose, a lawyer and financial advisor to Benjamin Disraeli…Rose's trust survives to this day, but asset management is now a far bigger business. Over $100 trillion is held in pooled investments managed by professionals who charge a fee.
>
> It is a business unlike any other. Managers charge a fixed fee on the assets they manage, but customers ultimately bear the full costs of investments that sour. Profit margins in the…business are high by the standards of other industries. For all the talk of pressure on fees, typical operating margins are well over 30%.
>
> In many industries, firms avoid price competition by offering a product distinct from rivals—or, at least, that appears distinctive. Breakfast cereal is mostly grain and sugar, but makers offer a proliferation of brand names, with subtle variations on a theme. Asset management is not so different. Firms compete in marketing, in dreaming up new products and, above all, on their skill in selecting securities that will rise in value."

Smartt comment: As always, past results are no guarantee of future performance. The long term winning strategy is to diversify widely and use very low cost mutual funds.


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