Anti-Depression Advice for Retirees

- Is cash the safest strategy for troubled times?
- How does this economic crisis differ from the Great Depression?
- What opportunities might exist despite the downturn?

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Anti-Depression Advice for Retirees

With the fear of an economic depression weighing on many Americans, the calls for retirees to abandon stocks are growing louder. But history shows that a blend of stocks and bonds is a better investment approach—even in the most difficult times.

According to a recent poll, six out of 10 Americans now believe a depression is somewhat or very likely, with unemployment rates reaching 25%, millions of homeless families and extended market declines similar to the Great Depression of the 1930s.[1]

We don't believe that a depression is on the way, but the fear is palpable. Some commentators are recommending that savers—especially retirees—replace the stocks in their portfolios with cash or bonds. Even if we do enter a depression, is this really the best advice for making your savings last through retirement?

Recreating the Retirement Experience

We decided to find out by using historical data to model the experiences of people who retired in every period starting from 1926. We wanted to answer two key questions: First, would people retiring in previous periods have run out of money? And second, which asset allocation would have been the best strategy to fund retirement?

To create this hypothetical withdrawal of money to fund retirement spending needs, we assumed that our retirees took out 5% per year (so a person with $100,000 in savings at retirement would withdraw $5,000 yearly). We also assumed that retirees' goals were to make their money last for 30 years. During the 1930s, life expectancy was much shorter than it is today. But today's retirees should budget for their money to last 30 years or more, as we'll discuss later.

Of course, we could only model the asset classes that have existed continuously since 1926: US stocks, US bonds and cash.[2] We compared the classic portfolio of 60% stocks and 40% bonds with a 100% cash strategy, for 30-year periods starting every year from 1926 through 1978. There were 53 such 30-year periods, with the earlier periods (1926–1940) crossing through the Great Depression. How did the 60/40 portfolio fare when compared to cash?

[1] CNN/Opinion Research Corp. poll released on October 6, 2008, which surveyed more than 1,000 participants

[2] US stock returns are represented by the S&P 500 sourced from Ibbotson until 1969, Compustat from 1970–2006 and S&P thereafter; US bond returns by five-year Treasuries are sourced from Ibbotson through January 1962, the Federal Reserve from February 1962–December 1969, CRSP/TPA from 1970–1972, Lehman Intermediate Gov/.Corp. Index from 1973–1975 sourced from Lehman Brothers, and Lehman Aggregate sourced from Lehman Brothers thereafter; and cash returns are three-month Treasuries sourced from Ibbotson through 1962, the Federal Reserve from 1963–1969, CRSP/TPA from January 1970–August 2007, and Citigroup thereafter. Inflation is represented by the Consumer Price Index sourced from Ibbotson from 1926–1947 and the US Bureau of Labor Statistics thereafter. Past performance does not guarantee future results. Investors cannot invest directly in an index, and its results are not indicative of any AllianceBernstein product.

No Contest—A 60/40 Portfolio Historically Has Been the Best Approach

The results were stunning. In fact, it was no contest—the 60/40 portfolio won every time, as illustrated in *Display 1*. The 60/40 portfolio never ran out of money in any of the 30-year periods; the cash strategy failed in 49% of the periods (26 out of 53).

In fact, cash failed consistently during the years affected by the Great Depression, because cash returns in the 1930s were so low that a 5% withdrawal rate wiped out our retirees' savings within 30 years (*Display 1 Detail, page 4*). And in the periods when the all-cash strategy did fund 30 years of withdrawals, it never beat the 60/40 portfolio… not once. So much for the idea that cash is a safe haven for retirees!

These results are extremely compelling, but we wanted to add an extra dose of reality by accounting for the impact of inflation on the retirement experience.

Display 1

A portfolio of 60% stocks and 40% bonds dominated cash

	Lasted the Entire Period	Ran Out of Money
60/40 Strategy	100%	0%
Cash Strategy	51%	49%

60/40 ended with more money than cash in all of these periods

This is based on a hypothetical portfolio; actual fund performance may differ.

Assumed 5% withdrawal for 30 years. Not inflation adjusted.

Accounting for Inflation

Purchasing power can shrink dramatically over 30 years. For someone who retired in 1970, the purchasing power of a $5,000 fixed payment would have shrunk to just $1,120 by 2000. We decided to increase spending over time to keep pace with inflation and keep our retirees' standard of living equivalent to the original $5,000.

As is clear in *Display 2*, increasing the yearly withdrawal amounts by the inflation rate makes it much more difficult to sustain these withdrawals for 30 years. In fact, the cash strategy ran out of money in every 30-year period. This isn't surprising—investing in cash essentially ensures that assets will be eroded by inflation.

In contrast, we found that the 60/40 strategy supported 30 years of inflation-adjusted withdrawals—in 74% of the periods (39 out of 53)—including all but one of the retirement periods that were affected by the Great Depression years. Even in periods when the money ran out in the 60/40 strategy, the 60/40 strategy allowed withdrawals to last longer 64% of the time.

The exceptions were the 30-year periods marked in gray beginning in 1965, 1966, 1968, 1969 and 1973 (*Display 2 Detail, page 4*). However, these periods were characterized not by depression but rather by stagflation.[3]

Display 2

The 60/40 portfolio was far better than cash in supporting inflation-adjusted withdrawals

	Lasted the Entire Period	Ran Out of Money
60/40 Strategy	74%	26%
Cash Strategy	0%	100%

60/40 lasted longer in 64% of these periods

This is based on a hypothetical portfolio; actual fund performance may differ.

Assumed 5% withdrawal for 30 years. Inflation adjusted.

[3] Stagflation is a period of stagnant economic growth combined with high inflation.

What About Bonds?

Moving retirees' assets to cash clearly didn't protect them from a depression. But what about holding 100% bonds—could that be a better strategy? After all, bonds are more stable than stocks and yield more than cash.

Our research said no (*Display 3*).

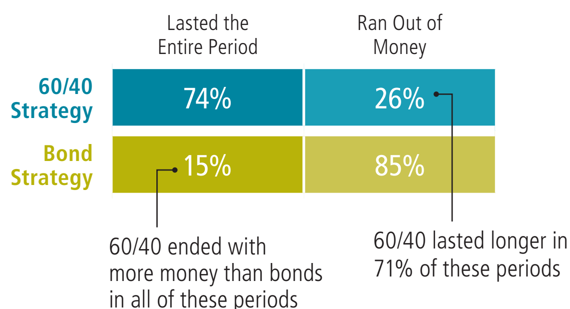
The 100% bond portfolio ran out of money in 85% of the periods (45 out of 53). By comparison, the 60/40 stock/bond strategy only ran out of money in 26% of the periods (14 out of 53).

Even in periods when bonds didn't run out of money, the 60/40 stock/bond allocation always provided a better outcome than 100% bonds. The only times when bonds worked better were in the 30-year periods beginning in 1966, 1968, 1969 and 1973—stagflationary periods when both strategies ran out of money, but the all-bond strategy lasted longer (*Display 3 Detail, page 4*).

Why was the 60/40 stock/bond strategy consistently a better retirement portfolio than cash or bonds? It's because retirees face the risk of running out of money—a risk that's not one-dimensional. Market losses are just one reason that retirees may run out of money. Inflation risk also increases the likelihood of running out of money, and so does rising longevity. For a 65-year-old couple, there's a 50% chance that one of them will live past 92 and a 25% chance that one of them will live past 97.[4]

Display 3

The 60/40 portfolio also delivered better real outcomes than bonds



This is based on a hypothetical portfolio; actual fund performance may differ.

Assumed 5% withdrawal for 30 years. Inflation adjusted.

Being able to fund 30 years of inflation-adjusted spending is becoming a must for retirees today, and we believe that utilizing meaningful exposure to stocks is the best way for most retirees to reach this goal.

The Bottom Line: Stick with Stocks

Of course, our view isn't universal. Consider the recent recommendation from Jim Cramer, the host of CNBC's *Mad Money:*

"Whatever money you may need for the next five years, please take it out of the stock market right now, this week. I do not believe that you should risk those assets in the stock market right now."[5]

Contrast that opinion with the thoughts of Warren Buffett, an investing icon:

"I haven't the faintest idea as to whether stocks will be higher or lower a month—or a year—from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up… Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value… I've been buying American stocks."[6]

We understand why people feel the anti-equity emotions expressed by Jim Cramer. But we think Warren Buffett provides better advice. Cash may appear "safe" compared with the recent wild volatility of stocks, but history shows that a balanced mix of stocks and bonds provides far better protection over the long run, even in difficult times.

We don't believe that the US is heading into a depression. American companies are better positioned than they were in the 1930s, and the US government's policy response has been far swifter and more expansive.[7] But even in the event that we enter a depression, our research indicates that holding some stocks is the best strategy to fund retirement.

[4] Society of Actuaries, Annuity 2000 Mortality Table

[5] Michael Inbar, "Jim Cramer: Time to Get Out of the Stock Market," MSNBC.com, October 2, 2008, http://www.msnbc.msn.com/id/27045699

[6] Warren Buffett, Op-Ed Contributor, "Buy American. I Am,." *New York Times*, October 16, 2008

[7] "Global Markets Review," *Research Insights*, AllianceBernstein

Detailed Findings

Display 1 Detail

A portfolio of 60% stocks and 40% bonds dominated cash

60/40 Stock/Bond Strategy vs. 100% Cash*
(No Inflation Adjustment)

Great Depression Years

					1926	1927	1928	1929	1930
1931	1932	1933	1934	1935	1936	1937	1938	1939	1940
1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
1971	1972	1973	1974	1975	1976	1977	1978		

26 Periods
- The 60/40 portfolio lasted for the entire 30-year period.
- The cash strategy ran out of money before the end of the 30-year period.

27 Periods
- Neither strategy ran out of money.
- The 60/40 portfolio was the one with the most money left at the end of the 30-year period.

Display 2 Detail

The 60/40 portfolio was far better than cash in supporting inflation-adjusted withdrawals

60/40 Stock/Bond Strategy vs. 100% Cash*
(Inflation Adjusted)

Great Depression Years

					1926	1927	1928	1929	1930
1931	1932	1933	1934	1935	1936	1937	1938	1939	1940
1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
1971	1972	1973	1974	1975	1976	1977	1978		

39 Periods
- The 60/40 portfolio lasted for the entire 30-year period.
- The cash strategy ran out of money before the end of the 30-year period.

9 Periods
- Both strategies ran out of money.
- The 60/40 portfolio lasted the longest.

5 Periods
- Both strategies ran out of money.
- The cash strategy lasted the longest.

Display 3 Detail

The 60/40 portfolio also delivered better real outcomes than bonds

60/40 Stock/Bond Strategy vs. 100% Bonds*
(Inflation Adjusted)

Great Depression Years

					1926	1927	1928	1929	1930
1931	1932	1933	1934	1935	1936	1937	1938	1939	1940
1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
1971	1972	1973	1974	1975	1976	1977	1978		

31 Periods
- The 60/40 portfolio lasted for the entire 30-year period.
- The bond strategy ran out of money before the end of the 30-year period.

10 Periods
- Both strategies ran out of money.
- The 60/40 portfolio lasted the longest.

8 Periods
- Neither strategy ran out of money.
- The 60/40 portfolio was the one with the most money left at the end of the 30-year period.

4 Periods
- Both strategies ran out of money.
- The bond strategy lasted the longest.

The above data are based on hypothetical portfolios; actual fund performance may differ.
*5% withdrawal for 30 years. The year listed in each box above indicates the beginning of a 30-year period.

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