The Optimistic Investor®

Focus on What Really Matters

Illusion of "Safety" – The Hidden Risk of a Fixed Income Retirement Strategy

We all know that being a good investor is difficult. Many people think the key is keen intellect or profound insightfulness. But the traits that define great investors are patience, discipline, and humility. Those are the virtues that allow us to temper our emotions and keep the balanced perspective we need to succeed. Unfortunately, those virtues are hard to maintain in a world that's hyper-focused on the here and now; our culture of social media and 24-hour news emphasizes immediate gratification rather than long-term thinking.

To be sure, we should all be aware of short-term considerations. In our non-financial lives, we want to make the most of today because none of us are guaranteed tomorrow; being "present" enhances the time we spend with loved ones, makes us better people, and increases our enjoyment of daily life. And the short term is an important part of our financial lives as well, because understanding current needs and cash flows is a critical piece of comprehensive planning and prudent risk management.

At the same time, if we only focus on the short term, we quickly lose the balanced perspective we need to establish and maintain financial independence. A good example of this is saving for retirement. We all want to enjoy life and seek out great experiences with family and friends. But, if we only focus on the present and don't save enough for the future, retirement will be disappointing and difficult. We can't let our desire for short-term comfort blind us to the long-term reality that life will (hopefully) last a long time and we need to plan for that.

This conflict between short-term comfort and long-term reality often comes up in conversations with new clients about risk. The investing world and financial media relentlessly focus on the short term because that's how they make money. Negative and fearful stories generate more reader interest and thus more ad revenue. So, we're all bombarded with headlines about potential recessions and stock market declines and what we can do to avoid such "threats." That messaging conditions people to focus on the immediate future, and it blinds them to the true nature of risk as lifetime investors.

The most dangerous manifestation of this mindset is the idea that bonds are "safe" and stocks are "risky." We hear this all the time from new clients, and it's troubling because it reflects a lack of perspective that can lead to bad decisions and failed retirements. Thus, our goal for this edition is to look at "risk" and "safety" in the broader context of retirement, so we can highlight the fact that the biggest concern for lifetime investors is not "losing" their money, but running out of it.

The Lurking Menace: Inflation

To begin, let's acknowledge that bonds (at least quality bonds of short to medium maturities) offer greater relative stability than stocks. There's a saying that a bad year in the bond market is like a bad day in the stock market; and it's true that short-term price fluctuations in bonds are generally much smaller than those of stocks. Sadly, many people wrongly believe this short-term price stability means bonds are always the "safe" option.

We agree that the relative stability of quality bonds makes them useful in managing the "timing" risk of diversified equity portfolios over shorter periods of time. But that doesn't make them "safe" long-term investments. To the contrary, short-term price stability (and the lower expected returns it brings) can introduce substantial uncertainty in the form of longevity risk – i.e., the risk of running out of money in the future.

To appreciate this long-term risk, we need to understand the corrosive effect of inflation, which is simply the rate at which the prices of goods and services increase over time. Most people know that high inflation means prices are going up. But there's a common misperception that lower inflation means prices are coming down. That is not the case – low inflation just means prices are rising at a slower pace. Price levels very rarely decrease, and the reality is that ***inflation relentlessly chips away at wealth as time goes by***.

The most popular measure of inflation is called the US Consumer Price Index (or CPI). And the CPI has averaged 2.6% over the last 20 years (from 2005 through 2024).[1] Table 1 shows how that level of inflation impacts baseline annual expenses of$100,000 over a 20-year period.

Table 1

Year	Expenses	Year	Expenses
1	100,000	11	129,263
2	102,600	12	132,624
3	105,268	13	136,072
4	108,005	14	139,610
5	110,813	15	143,240
6	113,694	16	146,964
7	116,650	17	150,785
8	119,683	18	154,705
9	122,794	19	158,728
10	125,987	20	162,855

Think about these figures in terms of retirement expenses. If it will cost you $100,000 to live comfortably this year, with inflation at 2.6% you'll need $102,600 to maintain your lifestyle next year, and $105,268 the year after that. By the time you get to year 20, you'll have to spend $162,855 to buy the things that cost you $100,000 today – a nearly 63% increase!

The upshot of expenses grinding steadily higher like this is that ***your investment portfolio must be able to generate an income that increases throughout your retirement***. If it can't do that, the portfolio will eventually enter a downward spiral and you risk running out of money. Of course, no one wants to end up in that situation.

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[1] *Source: Dimensional Fund Advisors, Matrix Book 2025, pg. 9.*

The (Not-So?) "Safe" Option

Let's look at this in the context of a bond portfolio. Most people view the Bloomberg US Aggregate Bond Index (or US Agg) as reflective of the broad market for quality bonds in the United States. Over the last 20 years (again 2005-2024), that index has averaged a 3.0% annual return.[2]

Table 2 shows how such a bond portfolio fares with the increasing expenses shown in Table 1. For this purpose, we assume a beginning portfolio value of $2.5 million; that sets our $100,000 withdrawal need in year one at 4% of the total portfolio, which is considered by many to be a "safe" withdrawal rate.

At first blush, you might think that because the US Agg return was higher than inflation over the last 20 years (3.0% vs. 2.6%, respectively), the bond portfolio would hold up well against inflation.
But that is not the case. Look closely at what's happening in Table 2 and you see that the portfolio can't generate the income the investors need. They have to draw from principal to fund expenses, and that reduces future income, which requires a greater principal withdrawal the next year, and so on. This is the downward spiral we're concerned about, and inflation driving expenses higher every year acts as a catalyst that accelerates the decline.

Table 2[3]

Year	Beginning Value	Annual Expenses	Income/Return	Ending Value
1	2,500,000	(100,000)	72,000	2,472,000
2	2,472,000	(102,600)	71,082	2,440,482
3	2,440,482	(105,268)	70,056	2,405,271
4	2,405,271	(108,005)	68,918	2,366,184
5	2,366,184	(110,813)	67,661	2,323,033
6	2,323,033	(113,694)	66,280	2,275,619
7	2,275,619	(116,650)	64,769	2,223,738
8	2,223,738	(119,683)	63,122	2,167,177
9	2,167,177	(122,794)	61,331	2,105,714
10	2,105,714	(125,987)	59,392	2,039,119
11	2,039,119	(129,263)	57,296	1,967,152
12	1,967,152	(132,624)	55,036	1,889,564
13	1,889,564	(136,072)	52,605	1,806,097
14	1,806,097	(139,610)	49,995	1,716,482
15	1,716,482	(143,240)	47,197	1,620,439
16	1,620,439	(146,964)	44,204	1,517,680
17	1,517,680	(150,785)	41,007	1,407,902
18	1,407,902	(154,705)	37,596	1,290,792
19	1,290,792	(158,728)	33,962	1,166,027
20	1,166,027	(162,855)	30,095	1,033,267

[2] *Source: Dimensional Fund Advisors, Matrix Book 2025, pg. 9.*

[3] *For simplicity of presentation, we ignore tax consequences and assume the investors withdrawal their annual expenses at the beginning of each year.*

At the end of year 20, the Table 2 portfolio still has roughly $1 million, but the investors are in serious trouble. The average non-smoking married couple with $2.5 million at retirement should be anticipating that at least one of them will live for 30 years or more.

Unfortunately, what these investors have left after year 20 won't last that long. Table 3 shows how the downward spiral plays out if we project things forward.

Table 3

Year	Beginning Value	Annual Expenses	Income/Return	Ending Value
21	1,033,267	(167,089)	25,985	892,164
22	892,164	(171,433)	21,622	742,353
23	742,353	(175,890)	16,994	583,456
24	583,456	(180,463)	12,090	415,083
25	415,083	(185,156)	6,898	236,825
26	236,825	(189,970)	1,406	48,261
27	48,261	(194,909)	-	-

As you can see, the $1 million left after year 20 only sustains these investors for six more years and they run out of money in year 27. At that point, financial independence is lost, and their remaining years will require drastic lifestyle adjustments.[4]
[*Essay continued on page 5.*]

Team Kooman Corner

We have some major milestones for Team Kooman this quarter!

This summer, Justin Best passed the CERTIFIED FINANCIAL PLANNER® Exam and is now a CFP Professional®. We're all proud of Justin's achievement and excited for him to begin this next chapter of his promising career. Congratulations, Justin!

We're also pleased to welcome Rob Krimmel as the newest member of Team Kooman. Before joining K&A, Rob spent 25 years coaching the men's basketball team at St. Francis University. He's excited to begin his career as a financial advisor, and we are thrilled to have him on our team. Welcome, Rob!

The (Not-So?) "Risky" Alternative

As an alternative, let's consider a diversified equity portfolio based on the S&P 500, which had an average annual return of 10.4% over the last 20 years.[5] Table 4 shows the results from such a strategy with the same expense levels reflected above.

Table 4				
Year	**Beginning Value**	**Expenses**	**Return**	**Ending Value**
1	2,500,000	(100,000)	249,600	2,649,600
2	2,649,600	(102,600)	264,888	2,811,888
3	2,811,888	(105,268)	281,489	2,988,109
4	2,988,109	(108,005)	299,531	3,179,635
5	3,179,635	(110,813)	319,158	3,387,980
6	3,387,980	(113,694)	340,526	3,614,812
7	3,614,812	(116,650)	363,809	3,861,971
8	3,861,971	(119,683)	389,198	4,131,486
9	4,131,486	(122,794)	416,904	4,425,596
10	4,425,596	(125,987)	447,159	4,746,768
11	4,746,768	(129,263)	480,221	5,097,726
12	5,097,726	(132,624)	516,371	5,481,473
13	5,481,473	(136,072)	555,922	5,901,322
14	5,901,322	(139,610)	599,218	6,360,931
15	6,360,931	(143,240)	646,640	6,864,331
16	6,864,331	(146,964)	698,606	7,415,974
17	7,415,974	(150,785)	755,580	8,020,768
18	8,020,768	(154,705)	818,071	8,684,134
19	8,684,134	(158,728)	886,642	9,412,048
20	9,412,048	(162,855)	961,916	10,211,110

Unlike the bond portfolio in Table 2, the equity portfolio in Table 4 comfortably generates the rising income stream needed to mitigate the impact of inflation. Moreover, despite the investors' increasing withdrawal needs, their overall portfolio value continues to grow as the years pass. As a result, at the end of year 20, these investors have ~ $10.2 million – nearly 10x what the bond investors in Table 2 had at that point!

Table 5 then shows that this trend continues well beyond the point where our hypothetical bond portfolio (from Tables 2 and 3) ran out of money in year 27.

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[4] *Note that the **timing** of this outcome depends on both annual expenses relative to the size of the portfolio (the distribution rate) and the investment strategy's return relative to inflation (what we call "real" return). A higher distribution rate or lower real return would expedite the point of exhaustion; a lower distribution rate or higher real return would delay it. But the broader point is that a fixed income strategy eventually sets up a downward spiral and it's **only a matter of time** until longevity risk comes into play.*

[5] *Source: Dimensional Fund Advisors, Matrix Book 2025, pg. 9. Coincidentally, 10.4% is also the long-term average annual return for the S&P 500 from 1926-2024. Ibid.*

Table 5				
Year	Beginning Value	Expenses	Growth	Ending Value
21	10,211,110	(167,089)	1,044,578	11,088,599
22	11,088,599	(171,433)	1,135,385	12,052,551
23	12,052,551	(175,890)	1,135,385	13,111,834
24	13,111,834	(180,463)	1,344,863	14,276,233
25	14,276,233	(185,156)	1,465,472	15,556,549
26	15,556,549	(189,970)	1,598,124	16,964,704
27	16,964,704	(194,909)	1,744,059	18,513,854
28	18,513,854	(199,976)	1,904,643	20,218,521
29	20,218,521	(205,176)	2,081,388	22,094,733
30	22,094,733	(210,510)	2,275,959	24,160,182

It's All a Matter of Perspective

Now let's come back to the idea that bonds are "safe" and stocks are "risky." Hopefully at this point you see that "risk" and "safety" are a matter of perspective.

The fixed cash flows associated with quality bonds offer relative price stability and play an important role in managing shorter-term risks. But those fixed cash flows are vulnerable to the ravages of inflation and unlikely to support increasing income needs throughout retirement. Far from being "safe" as a long-term proposition, bonds can put investors in a dangerous spiral that risks them outliving their wealth.

In contrast, broad equity markets endure frequent, unpredictable, and sometimes substantial declines. That can make stock portfolios a "risky" way to invest funds for short-term needs. But we also know that broad equity markets have ***always*** recovered from their declines and gone on to new highs when given enough time. And Tables 3 and 4 show that diversified equity portfolios are well-situated to deliver rising income ***and*** increasing portfolio values through the course of retirement.[6]

As lifetime investors, we need to look past the next week, month or year and base our investment strategies on what's required to live comfortably and independently for the rest of our lives. That's why we constantly emphasize that we ***need*** the premium returns diversified equities have historically delivered to keep our long-term plans on track. And our team is here to help you keep a balanced perspective, earn those premium returns, and maintain the comfort and independence you seek as a lifetime investor.

[6] *We've discussed the long-term benefits of diversified equity investing and a proper understanding of the risks involved in past editions. If you need a refresher, it's all laid out in our September 2023 essay called "The Importance of Earning the Equity Premium" (available here).*

Innovation and Good News

- Results from a randomized trial released this summer showed that Ozempic (a popular GLP-1 receptor agonist) reversed the biological age of those who received the drug. On average, biological age (measured with epigenetic clocks) decreased by 3.1 years after 32 weeks of treatment!

- Last month there was big news in Alzheimer's research. Scientists at Harvard and Rush universities published results from several studies suggesting that Alzheimer's disease might be caused in part by lithium deficiencies. The studies used mice that were bred to develop the kinds of brain changes that humans with Alzheimer's experience, and they showed that reducing lithium levels in the mice's diet accelerated the onset of symptoms while increasing lithium levels staved symptoms off. Perhaps more importantly, the researchers also identified a lithium salt that shows more promise for future medications than the type of lithium used in current therapies.

- An artificial intelligence (AI) model called OpenEvidence recently achieved a perfect score on the US medical licensing examination. Not only did the model answer all the questions correctly, it also provided the proper rationale for each answer by citing to "gold-standard" sources like the New England Journal of Medicine and Journal of the American Medical Association. The model should therefore be a tremendous resource to medical professionals, and it's available to them on a free and unlimited basis.

- In another AI-related development, MIT researchers used AI to invent two new drugs that can kill otherwise drug-resistant gonorrhea and MRSA. This is a great example of the potential AI holds for creating new medications.

- Scientists at Stanford have developed a brain implant that can turn thoughts into spoken words. Past devices could give voice to patients' attempted speech, but that was a slow process and trying to speak was difficult for many patients (who are often paralyzed). So, the Stanford team designed a device that doesn't require an attempt to speak – it turns thoughts directly into spoken words with ~74% accuracy.

- The World Bank recently announced that nearly 100 million fewer children lived in extreme poverty in 2024 than in 2014. And that's despite the number of children world-wide increasing by approximately 100 million during that time.

- Exciting news for those who enjoy international travel! Apple recently announced that its new air pods will be able to translate foreign languages in real time.

KOOMAN & ASSOCIATES

Important Disclosure Information

This memorandum is not intended as a substitute for personalized investment advice from Kooman & Associates, LLC ("K&A"). To the extent you have questions about the applicability of any specific issue discussed herein to your individual situation, you should consult with a professional advisor of your choosing.

Nothing in the foregoing discussion should be interpreted as a recommendation to buy, sell or hold any specific security. Please remember that past performance and events may not be indicative of future results.

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A copy of K&A's current written disclosure brochure (Form ADV Part 2A) discussing our advisory services and fees is available for review upon request or at www.kooman.com.

Please remember to contact us in writing:

- If there are any changes in your personal/financial situation or investment objectives, so we can review, evaluate and/or revise our previous recommendations as needed; or
- If you would like to impose, add or modify any reasonable restrictions on our investment advisory services.

Unless and until you notify us, in writing, to the contrary, we will continue to provide services as we do currently.

Please also remember to advise us if you have not been receiving account statements (at least quarterly) from your account custodian.