Road to Retirement: Retired and waiting for interest rates to rise?

By Charlie Farrell
May 5, 2019
Publication: Denver Post, The: Web Edition Articles (CO)

For the last 10 years, interest rates have remained stubbornly low to the disappointment of many retired investors. Back in the good old days of the 1990s, if you were retired, you could have invested in some safe U.S. Treasury bonds and earned 6 percent or more, generating a nice income stream for retirement.

But since the financial crisis in 2008, it's been a different story. Many retired investors have been waiting for interest rates to rise so they can enhance their income. But as the saying goes, you might be waiting until the cows come home.

The hope of higher rates has kept many retired investors on the sidelines, sitting in cash or short-term CDs waiting for the market to rain higher interest rates on them. Compared to investing in the stock market over the last five years, that's been a costly decision. If you had invested $100,000 in the bond market five years ago, you'd have about $113,000 today, if you had invested that money in the broad stock market, you'd have about $171,000.

The good stock market returns have caused some investors to wonder if they should increase their allocation to stocks or continue to hold out hope that interest rates will rise. There is no clear answer on this. It's basically a judgement call. Here is my two cents' worth: I think that interest rates are unlikely to rise much over the foreseeable future. Why? Because we just have too much global debt.

You see, every debtor has a lender. And when the debtor owes the lender a lot of money, the debtor starts to control the relationship. There is a saying that is credited to John Paul Getty that goes something like this, "If you owe the bank $100, that's your problem. If you owe the bank $100 million, that's the bank's problem." This is roughly the situation we have with global debt.

Investors have loaned lots of money to creditors who would have difficulty repaying those loans if interest rates rise. If lenders put too much pressure on borrowers and they go under, then they may not get anything back. If you want to keep your debtors "alive," then a good move is to keep interest rates low. This makes it easier for borrowers to repay their loans. It also makes it easier for borrowers to take on more debt and keep the economy moving along.

I think that's roughly what's going to happen. We may have periods where interest rates rise for a short time, but as those higher rates cause problems in the economy, the interest rates are likely to come back down.

Thus, I think retired investors are faced with a choice. Take on more risk with stocks or live within the paltry returns of bonds. Many retired investors often get quite conservative, feeling like they can't risk losing anything. But with retirement lasting up to 30 or more years, there is a reasonable risk that if you don't earn higher returns, you could run out of money.

What to do?

Over the next 20 years, I think the odds favor being more aggressive; meaning having more in stocks than bonds, even if stocks are expensive these days. The reality is stocks have been "expensive" for the last 25 years. They've traded well above their historical valuations but still provided decent returns, albeit sprinkled with periods of huge volatility. It's also important to note that as every year goes by and stocks trade at a higher valuation, history is being rewritten. So you can't get too anchored to historical valuations that are not fully reflective of our current economic and monetary environment.

Because stocks are relatively expensive, you should expect lower long-term returns, but they have to be compared to your options in bonds. If bonds only return 3 percent (which is a generous assumption considering 20-year Treasury bonds only yield 2.75 percent today) and stocks only return 6 percent (which is well below their long term average of 10 percent), that's still twice as much return, and that can make a big difference in your ability to live off your money for multiple decades.

Don't get me wrong. I like bonds, and most investors need some. But holding too much of your wealth in bonds can create risks down the road since after taxes and inflation, many investors are losing money in bonds. I know this is contrary to how some people think they should manage money in retirement.

They think, "I'm older and should be conservative." But retirement generally doesn't just last 10 years, and interest rates aren't 6 percent. Things change, and you have to adjust. While stocks might not provide the big returns of the past, if they do twice as well as bonds, that's probably enough to justify the risks.

Charlie Farrell is a CEO of Northstar Investment Advisors LLC. This article is for information and education purposes only. Past performance is no guarantee of future returns, and all investing involves the permanent risk of loss. Consult your individual financial adviser for guidance specific to your circumstances.