Pensions must be protected over the long haul

By Dan Gallagher

Wise investment decisions can only be made after careful analysis of your unique needs. For example, most retirees have pensions which rise, but at a rate much slower than inflation.

Retireees become increasingly dependent upon investment income. Eventually, their income is well below that needed to support their lifestyle. They face depleting their nest egg to pay inflated living and other expenses.

Few calculate the rate needed to avoid this. Fewer invest accordingly. Even that needed return must be higher in early retirement than later because risk should decline with age.

Of great or modest means, most investors sorely need such planning and adjustments over a lifetime.

Investments generate returns by two methods — owning or loaning. One either owns the means of production, as with stock, or one loans money to a company, such as with bonds and CDs. Ibbotson Associates and other researchers calculate that, given at least five years, "owning" usually produces twice the total return of "loaning". The reason is that corporations pay only a fraction of what labor, equipment and borrowed money is really worth. The difference accrues to the stockholders.

This means equities are the only opportunity to beat both taxes and inflation. For example, fixed annuities and fixed insurance products pay scant more than inflation. Such fixed accounts are subject to creditor claims, unlike mutual funds and investment accounts within variable insurance products.

There are two types of risk: Losing asset value until the market recovers or having buying power halved every decade. Investors must incur the first type of risk to get better returns. Most need better returns to avoid the results of the second type — running out of assets before running out of lifetime.

Asset allocation, as distinct from products which use this name, is a conservative investment practice. It uses sophisticated concepts, such as risk-reducing diversification and the Capital Asset Pricing Model, to build and adjust an "efficient portfolio". Its aim is to produce the investor's needed return while minimizing risk.

All investments have cost and risk, even US Treasuries.

For example, a Treasury note has a guaranteed return only if you hold it to maturity. If you sold it or it was called, you could have a loss.

Most no-load products have early surrender fees. Most no-load products without surrender fees have high service fees, which often equate to as much as a 5% front-end load. That's one reason even some high-load funds are top performers.

Yet, regardless of costs, the very critical point is whether the investor's strategy is objectively based on correct income needs analysis and wise asset allocation. Some people assume that if all is well now, this will continue. Others act as their own advisor out of fear that a professional would misappropriate funds.

Professionals must have both custody of and discretion over assets for this risk to be possible. The vast majority do not. Without extensive training, do-it-yourself medical care would be as prudent as do-it-yourself investment advice.

Advice is often available from salesmen, such as bankers, stock brokers and insurance agents. They must be specially licensed to sell or even discuss equities. Statistically, few accept the special demands of this level of licensing.

For example, if your banker is not licensed to offer equities, he or she is unable to provide inflation hedges. Proper sales licensing does not necessarily imply analytical ability or legal sanction to advise. Even if an agent is competent and duly registered as an investment advisor, that person may be bound by contract to sell mostly for one or a small number of product-issuers.

A key indicator is whether the person's business card and most of the products he or she sells bear the same brand name. Even active securities trading has been found to underperform market averages. A landmark study of this was first conducted in 1983 by Brinson, Hood & Beebower. It and many others found that the practice of gradual asset allocation, which takes the "own or loan" view of investments rather than the "hot picks", "value" or "buy and hold" approaches, outperformed all other methods.

You will determine your needed rate and how best to pursue it by using advisors who are not tied to a product-issuer and who, if they sell products, will guarantee to work in your best interest.

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