The Tragedy of Low Interest Rates

Interest rates in the United States will remain artificially and abnormally low for the foreseeable future, likely for at least the next 5 years, and probably longer. You will hear a variety of reasons proposed, including to support the economy and create jobs after the COVID crisis, boost the stock market, encourage affordable housing, and whatever else. But the real reason is to bail out debtors, the largest of which is the U.S. government. The end result of the suppression of interest rates by the central banks represents a transfer of wealth from thrifty savers like you, to profligate, undisciplined spenders, allowing them to live beyond their means.

But all of this is beyond your control. What does it mean to you personally?

The traditional asset allocation is 60% stocks (equities) and 40% bonds (fixed-income), the former to generate real growth, the later to provide safety and income during the inevitable bear market in stocks. This concept is no longer viable, since 40% of your portfolio would produce near nothing, nothing, or, God forbid, even less than nothing if interest rates are negative.

Let me provide a personal example. I recently renewed a $10,000 Certificate of Deposit. Ten thousand dollars is a hard-earned year of savings for a policeman, steelworker or teacher. After 18 months it generated exactly $25.10 in interest: not even a nickel a day. I find more money on the ground in my walks around the neighborhood.

Stop for a moment and let that sink in. Forty percent of our portfolio will generate minimal return. You will have to save more and work longer. I estimate that for every 2 years interest rates are abnormally low, you will be forced to work a year longer. (A) You cover your living expenses for that year, and (B) your savings and investments have another year to grow. If you are older than 50, start to plan now that you will need to work at least another 3 to 5 years. If you are already retired, unless you are otherwise independently wealthy, you will need to make a significant adjustment in your life style, to spend less and save more.

Before making suggestions on where to put your money to hopefully generate a better return, let me caution you about what to avoid. Do not be seduced into shaky investments you do not understand in search of yield. At the top of the list are the flimsy deals packaged as Limited Partnerships and peddled to naïve, unsophisticated physicians.

General financial advice says that everyone still working should keep at least 6 months of living expenses in risk-free cash and cash equivalents, such as a checking account, money market, Certificates of Deposit, and short-term Treasury bills. If you are retired, you should have at least 3 years of living expenses in such risk-free investments.

After establishing these prudent reserves, you will need to invest more in stocks, especially those with a higher dividend, including REITs (Real Estate Investment Trusts), Utilities, and possibly preferred shares. More should also be devoted to hard assets, including real estate, especially residential, and the precious metals, such as physical gold kept in your personal possession. Some of your allocation to fixed income could be placed in TIPS (Treasury Inflation Protected Securities).

In the 20th century, the 60/40 portfolio generated a return of about 7-8% per year (10% from stocks, 5% from bonds). An article in *Barron's*[1] projected the 60/40 portfolio will return an anemic 3.5% per year for the next decade. With some of the alternatives described previously you might be able to increase the return to 4%+.

The U.S Federal Reserve, created in 1913 with a single mandate—price stability—now has a target of 2% inflation per year, and recently noted that some years they will tolerate even higher inflation. In mid-October, 2020, the U.S. 10-year Treasury yielded about 0.8% per year. With inflation at 2% per year, you are guaranteed a loss of purchasing power year in and year out for the next decade. Here is the tragedy, the bottom line of artificially suppressed interest rates. In the not-too-distant past, you saved money, you made money. Now, you save money, you lose money.

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Disclosure

Dr. Doroghazi is not a registered financial advisor under federal law or any state law. The advice provided is of a general nature, and should not be interpreted as personalized or individualized to your specific portfolio.

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