

Using Your Imagination Is the Key to Saving More for Retirement

By Tim Maurer, CFP®

I have a proposition for you: I'd like to give you one of two gift certificates to your favorite restaurant. But first, please picture that inviting atmosphere, the thoughtful waitstaff, the right musical backdrop, and the perfect meal in front of you and your ideal dinner companion. Now, choose between a \$100 gift certificate you would receive today or a \$200 gift certificate you would receive 10 years from now.

Time's up. Which did you choose?

Unless you're gaming the system – that is, you're anticipating a financial advisor would never encourage apparent impulsiveness over deferred gratification – you almost surely chose the \$100 gift certificate today. I would too! That doesn't make us wasteful or foolish. It makes us human.

To be clear, our all-so-human behavior isn't inherently foolish or wasteful, especially in this instance. After all, your tastes could change 10 years from now. A new restaurant could come into town. Heck, your favorite restaurant could close, making your gift certificate worthless! A guaranteed hundo today is almost certain to win over \$200 a decade from now for most of us.

The Hyperbolic Discounting Dilemma

This tendency is a cognitive bias called hyperbolic discounting. It suggests that we'd prefer having something today rather than tomorrow, and that our bias for the present only compounds the further away on the calendar we place our hypothetical tomorrow.

But hyperbolic discounting moves out of the hypothetical and into reality when we examine it within the context of saving for retirement. Psychologically – biologically, even – we'll generally default to today over tomorrow, and the result is that a generation of retirees hasn't saved enough to meet their goals in retirement.

The odds were stacked against future retirees when the 401(k) was introduced. Think about it. You're enduring one of life's more stressful endeavors – starting a new job. You've exhausted your mental capacity and willpower on a long series of important decisions. After navigating tax withholding, health insurance coverage, and an array of other benefit options, you arrive at your 401(k) or equivalent retirement plan. And this is how your brain hears the question:

"Would you like to further reduce the amount you can spend today by setting even more money aside for a day decades in the future that might never come?"

How many people do you think opted-in to a 401(k) within the first six months of work? The numbers are atrocious – one study found 34%. But then, inspired by behavioral economists, companies started using an opt-out mechanism, requiring new hires to choose not to set aside at least a modicum of savings. The numbers shot up.

That sounds great, but our bias to choose the default doesn't actually address hyperbolic discounting. More people may be saving, but they still aren't saving enough. How, then, can we solve the hyperbolic discounting dilemma? Can we rewire ourselves to prefer saving more?

Bring the Future Forward

The answer, according to extensive research by Hal Hershfield on the subject, is to picture yourself in retirement. In one of his studies, Hershfield showed that digitally altering images of present-day participants, extrapolating what they might look like years down the road, could positively affect their saving behavior.

Furthermore, we can employ our imaginations to animate those future images. What do you most want to be doing in retirement? How do you want to feel?

In other words, to save more, we should first think about the lifestyle we want in the future and then back into the financial decisions required to make it a reality. And the degree to which these visions of our future self are vivid and positive will increase our propensity to save more.

Now, back to our initial proposition. The notion of \$100 to spend today or \$200 to spend 10 years from now isn't so outlandish. If you're earning an annual average return of 7% – a reasonable expected return for a balanced investment portfolio – your money doubles in roughly 10 years. And in retirement, it's precisely stuff like food – and housing, transportation, travel and recreation – that add up to the lifestyle we desire.

So, wherever you are on the continuum from *now* until your personal retirement *then*, consider using your imagination to help increase your motivation to save for the future.

360 Insights

Market Declines and the Long-Term Investor

By Jonathan Scheid, CFA, AIF®

The COVID-19 coronavirus sent stock markets and interest rates dramatically lower in the first quarter. As reports of the disease spreading outside of China grew, so did concern – panic at times – about what this meant for people's health and broader, everyday lives. Governments and businesses stepped up preventative measures, but investors were concerned that the disruption would lead to an economic recession.

Given the recent increase in market volatility and investor concern, we felt it would be beneficial to discuss how these events impact you, with three concepts that ring true during this market decline and any future declines.

You expected this.

While we don't have a crystal ball and didn't know the most recent decline would be caused by a viral outbreak, we do know that investments fluctuate based on new information. Investing in stocks, as opposed to more conservative investments, increases the likelihood of experiencing both more frequent and greater ups and downs. This fluctuation is what we get paid for, and history suggests that the greater the fluctuations of an investment, the greater the upside potential.

When investing in stocks, a good rule of thumb is to expect market declines of 3% to occur once per month, 5% declines to occur once per quarter, 10% declines to occur once every year, and declines of 20% or more to occur once a market cycle. This means your investment plan should incorporate the virtual certainty that you will experience many significant price declines over your investment lifetime. Thus, your equity allocation should reflect your ability, willingness or need to take risk.

The catalyst behind every market decline is usually different, as is the depth and duration of the decline. This is why we don't recommend stocks for clients who need access to their money in the near future. We don't want to have to sell stocks when they are down. And because your plan incorporates the certainty of such events, they come as less of a shock when they actually occur.

You have a plan.

The portfolios we build for our clients generally contain a mix of stocks, bonds and, possibly, alternative investments like real estate. When sudden market declines appear, the merits of our investment approach appear front and center. By including both U.S. and non-U.S. stocks along with bonds in a portfolio, we harness a variety of asset classes that react differently to new information.

The diversification benefits of our investment portfolios were on display in the first quarter. As we noted earlier, interest rates fell as news of the global impact of the virus spread. Interest rates fall because investors are buying more and more bonds, and that pushes up the price of the bonds we have in our portfolio. So, when our stocks were declining, our bonds were rising. This doesn't happen to all bonds, but it historically has happened to the bonds that we prefer – shorter- to intermediate-term, higher-quality bonds. Additionally, non-U.S. stocks didn't decline as much as U.S. stocks. [\(Continued on page 2\)](#)

(Continued from page 1) When markets decline, planning opportunities may present themselves (depending on each client's unique situation). If the market decline causes a large enough imbalance in our portfolio, there may be an opportunity to rebalance our investments by taking some money from our bonds that have done well and investing that portion in stocks that have recently declined. Market declines and falling interest rates may also provide the opportunity to invest money that wasn't previously invested, convert a traditional IRA to a Roth IRA, or even refinance debt. Following the plan lets us take advantage of these opportunities with a level head.

You invest with the odds.

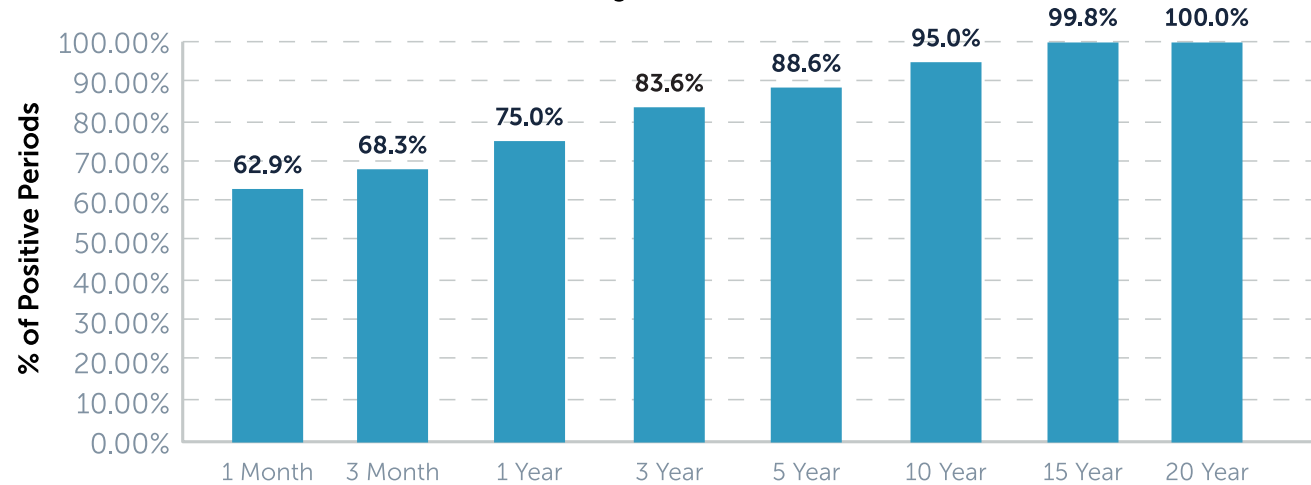
We typically don't like comparing investing to gambling, but we think there is an analogy that is too relevant to our investment philosophy to pass up. Everyone knows that the massive, opulent casinos on the Las Vegas strip were not paid for by winners. Losing is a part of gambling. Given the size of the casinos, it makes sense that every game a casino offers has odds that favor the house.

When it comes to investing, we choose to invest where we have the most favorable odds of success. And, just as a casino knows that some gamblers will go on long winning streaks, the overall odds still favor the casino, and, eventually, the casino gets that money back. The market is the same, but long-term investors are the casino, so the odds are in our favor.

We put the odds in our favor by investing in asset classes that historical evidence has shown will generate acceptable results. This includes our preference for small and value companies versus large and growth companies. We also put the odds in our favor by investing for the long term. As we can see in the table, the longer we stayed invested in stocks, the better our odds of success.

How Often Were U.S. Stocks Positive?

Various Rolling Time Periods (1926-2019)



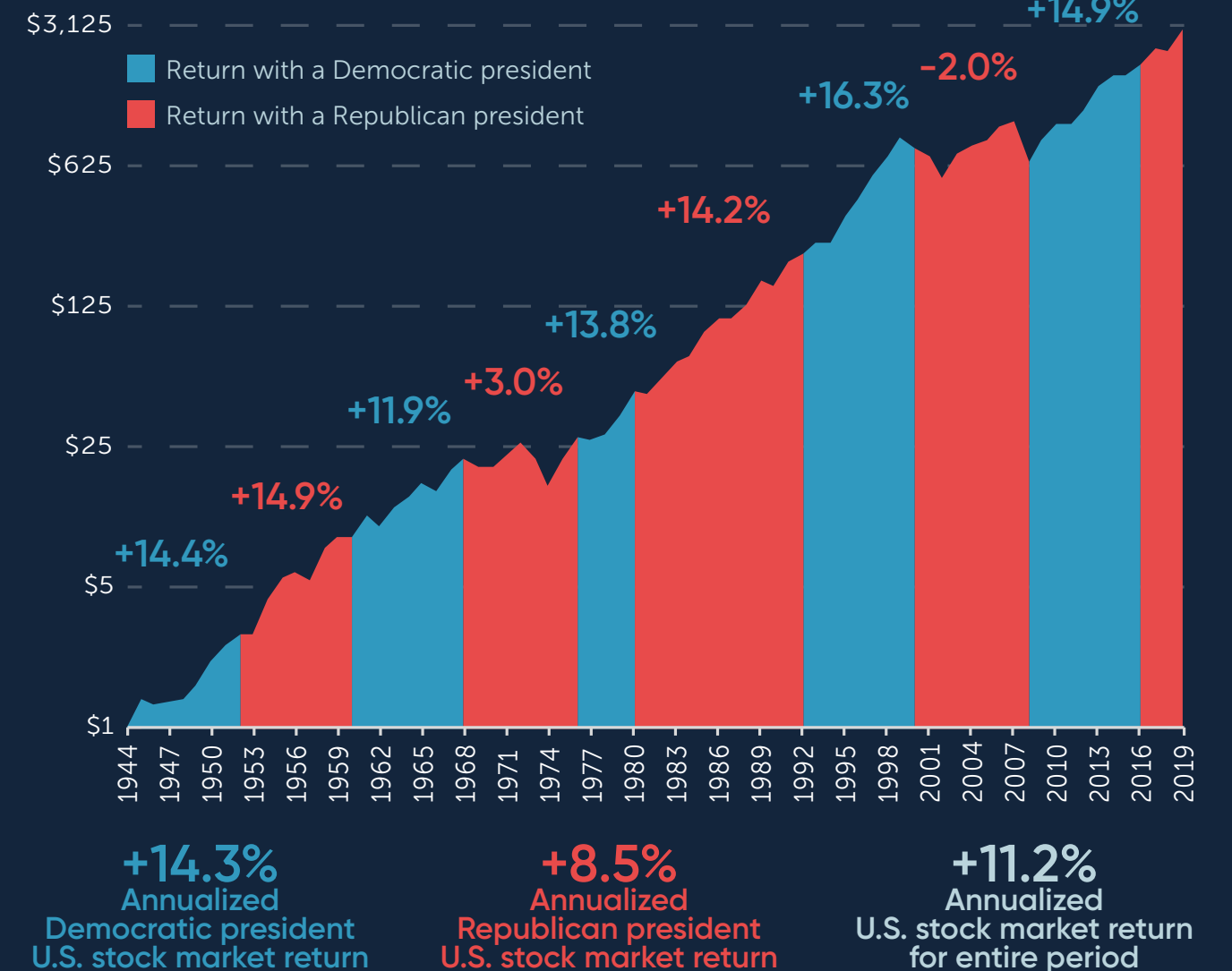
While we don't know when this bout of increased market volatility will dissipate, we have comfort in knowing that our investments were selected and built into a portfolio with this type of volatility in mind. Markets have recovered from every decline like this in the past, so the odds are in our favor that we will recover this time as well. This is the true benefit of being a long-term investor. Not only can we weather the storm, but we typically come out better after it occurs.

Data source "How Often Were U.S. Stocks Positive": Dimensional Fund Advisors, our calculations. U.S. Stocks represented by CRSP 1-10 Index from 1926 to 2019. Calculation periods roll on a monthly basis. Past performance is not a guarantee of future results. All returns greater than 12 months have been annualized. Indexes are unmanaged and reflect reinvested dividends and/or distributions, but does not reflect sales charges, commissions, expenses or taxes. Long-term investing neither assures a profit nor guarantees against loss in a declining market. Stock investing involves risks, including increased volatility. All investing involves risk, principal loss is possible.

When Making Financial Decisions, Look Past Politics

When compared against your overall investment horizon, a single presidential term is relatively brief. A single election cycle barely registers as a blip on the radar. The emotions that come with these events, however, can be expansive, consuming, visceral. Amid everything else that's going on, we hope to put the campaign season between now and November into some financial perspective, because as the data shows, whoever is in the White House does not preordain doom or boom for stock returns. Stock market performance, when grouped by presidential party, historically has favored a Democrat in office, but it doesn't tell the whole story (remember, correlation is not causation). In fact, stocks were up the majority of the time, regardless of who was in office. Even so, our political beliefs can color how we see the world around us – whichever party is in power – and so influence our investment decisions, often with less-than-ideal financial results.

Hypothetical Growth of \$1 in U.S. Stocks 1945-2019



The takeaway, of course, is that you are best served by looking past the upcoming election and focusing on the long term.

Data source: Dimensional Fund Advisors, our calculations. U.S. Stocks represented by CRSP 1-10 Index from 1945 to 2019. Calendar year returns used to calculate performance by presidential term. Past performance is not a guarantee of future results. All returns greater than 12 months have been annualized. Indexes are unmanaged and reflect reinvested dividends and/or distributions, but does not reflect sales charges, commissions, expenses or taxes. Stock investing involves risks, including increased volatility. All investing involves risk, principal loss is possible. Indices is not available for direct investment. the performance does not reflect the expenses associated with the management of an actual portfolio nor do indices represent results of actual trading.