PBS Ep118 How the Debt Ceiling May Affect Your Retirement Assets

Patti Brennan: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives. Today's podcast is part of the ongoing series called "Ask Patti Brennan." Over the last few months, we've gotten a ton of questions. A lot of them are very similar.

Today, I'd like to read two of them that are connected and reflect many of the questions that a lot of you have submitted. I've always believed if one person has the question, chances are there's probably 2,000 or 3,000 of you, out there, listening today who are thinking the same thing, so let's hit it.

The question is, "Given all the volatility in the market and the upcoming debt ceiling, what should I be doing to protect my retirement assets?" Related to that, another question was, "Is there a percentage of my portfolio that should be converted to CDs versus staying in this market?"

Now, I would say this market is awful. That's not what they said, but it has been an awful market. Let's take a step back and reflect. Where are these people coming from? What happened last year? Folks, I'm not the first one to tell you, it was a terrible year. A year of a lot of change in a very short period.

Let's face it, GDP went from six percent down to 1.5 percent, inflation went from two to nine, and mortgage rates more than doubled. That is going to be unsettling for anyone who's listening and watching today, and certainly, all the markets. So, what happened?

By the way, let's not forget about the unprovoked invasion of a superpower to their neighbor, again, contributing to all this feeling of unsettlement throughout the world. The United States was not the only market that was down last year. Pretty much anything that you invested money in in 2022 lost value. Not necessarily money, but value.

Recapping, it was the worst year for a 60/40 portfolio ever. Stocks were down, bonds were down. Hey, guys, I’ve got to tell you something. There's only been three years since 1926 that the bond market was actually down. Last year, it lost 13 percent. That had never happened. Not even close. It was ugly.

What happened? What do you do now? First and foremost, let's step back and reflect on the impact of that volatility on your life today and your financial future. First and foremost, inflation. I really must address this thing called inflation because I find that it's often misunderstood.

Inflation peaked at 9.1 percent. It is going down. Please understand that inflation is the second worst thing that you can experience as an American consumer, and any consumer. What's the first? The first is deflation. I'll address that in a second.

Inflation simply measures the change in prices from one period to another. Prices went up 9.1 percent at one point over last year. That was the 12-month inflation figure. It ended the year at about 6.5 percent. What does that really mean to you?

What it doesn't mean is that prices aren't going down. That's called deflation. It's just that inflation or the change in prices, it's just that they're not going up as fast, but it's still ugly. That's why the Federal Reserve has been so aggressive raising interest rates to try and cut the rate of change in prices. It is what it is.

Many people, Monday morning quarterbacks out there, are saying, "Oh, Jerome Powell, he messed up. He blew it. Inflation was rampant and he didn't address it early enough, and that's why it went up over nine percent."

Before we get into that finger-pointing camp, let's go back to 2020, and remember where we were in 2020 when those two fire hoses were going off. Here's the thing. What is inflation? Inflation is too much money chasing too few goods. Jerome Powell believed that the inflation we were experiencing was transient, temporary, caused by the supply chain shocks.

He was right. We couldn’t get a lot of the things that we want to buy, whether it's toilet paper, TVs, or photocopiers because of the chip shortage etc.

There were too few goods. Then on top of it, there was a ton of money. What do I mean by a ton? How is that measured? It's measured based on something called M2. M2, if you look at the chart, it went nuts, faster and higher than ever before.

Just as M2 skyrocketed, guess what? It has plummeted. Literally this month, and I am recording this on February 1st, M2 actually went negative. That's a good thing because it's not that prices are going down. Prices are going down is called deflation. That's what Japan has suffered since 1989.

Unfortunately, the Federal Reserve can't do much about deflation. That's when prices are going down. In a consumer-based economy, what do we do? I don't know about you guys, but if I think that TV that I want is going to be down in price by 500 bucks in six months, I'm not going to buy one. Then six months goes by and I'm going to wait again.

We're not consuming in a deflationary environment. It's tough to get out of that, as Japan has found. Inflation/deflation. By the way, the question that was asked is, should I move some of my money into CDs?

Here's the problem with that. Yes, CDs are paying higher interest, but inflation is still 6.5 percent. I don't know about you guys, but I have not found a CD paying 6.5 percent. In real dollars, you're losing money. By the way, that has happened every year since the early 2000s.

Not even including the taxes that you must pay on that interest, you are losing purchasing power. I got to tell you, that is permanent. You're not getting that back. That's the problem with cash. One thing that I say to people -- and I hope that if anything that you remember in today's podcast, please try to remember this -- don't confuse stable with safe.

CDs are stable. They are FDIC insured, and they are safe. It's a great emergency fund. Long term, because you're not keeping pace with inflation, I wouldn't call that safe. That's an erosion of your lifestyle.

When you think about your portfolio and protecting your portfolio, think about it instead about protecting your cash flow. That's a worthy goal because you're not going to use all

your money all at once. You're going to want cash flow from it, whether it be for tuition, retirement, or that second home. Understand what the goal is for your portfolio and then invest accordingly.

Risk is a function of time. Let's just sit down with your advisor, sit down with people that you trust, and come up with a plan, a strategy that's going to protect your assets no matter what's happening in the world around us.

I love the question related to debt ceiling because that is the current apocalypse du jour. I got to tell you, I've been doing this over 30 years, there's always something to worry about. There always will.

Let me give you a little bit of a different perspective, though. I'm going to go through a couple of facts. First, the thing the market is concerned about is a pending recession. There is a good possibility that we end up in a recession.

Again, for those of you who are working, take advantage of this opportunity to shore up your emergency fund so that if it happens to you, you're ready, and you're not digging into your 401(k) to pay your mortgage. Typically, after a tightening cycle, it is not unusual for a recession to occur.

Again, if we go into a recession, we, Americans, we've never been in better shape. For example, household debt is at 50-year lows. 90 percent of the mortgages out there are at four percent or below. Fixed, by the way. Unemployment stands at 3.5 percent. For every worker out there looking for a job, there's 1.7 jobs available.

Here's one that you probably haven't heard. Since 2019, and even after what happened in 2022, household net worth increased 27 percent. Let me make that number real for you guys. That is $29 trillion, with a T, which boils down to $85,000 per American in just three years, even after 2022. We're in really good shape if we end up going through a recession.

Excess personal savings. Remember, I just said excess, not the normal emergency fund. There's a lot of excess savings sitting in those bank accounts. That equates to $900 billion. I will tell all of you, it's down from $2.2 trillion just after the pandemic.

At this burn rate, that excess savings will be gone by the summer, which is why a lot of people are forecasting the recession to hit about the summer. It's OK. Be aware, now's the time to get your finances in order.

Last but not least, corporations are also holding trillions of dollars in excess savings. As I think about unemployment, and for those of you who may be worried about your jobs, I must play devil's advocate and ask the question, "Are these corporations really going to let go of those people they just got hired and trained, especially since they're sitting on so much cash?"

The smarter managers, senior managers and CEOs are probably not going to because they know if they have great capacity, when we come out of the recession, they're grabbing market share. The key for any business, large or small, is to survive, and they know it. Again, we've never been in better shape headed into a recession.

Let's keep it real. First and foremost, the market went down, a lot. It was down at 25 percent at one point, 20 percent for the year. Let's face it, the one thing that I know, and it's

humbling every time it happens, is that I'm not very good at predicting surprises. We had a lot of them last year.

Here's the thing. We go into every day of every year assuming that the next wicked bear market is starting today. We've been prepared, and I want you to be prepared as well. Take worst case scenario. Look at your portfolio, really run it through that lifeboat drill, and understand that if it happened, would you still be, OK? That is the most important thing.

As we begin to think about next year, let's not get overly pessimistic. More importantly, don't get too cute. ClearBridge did a phenomenal analysis going back to before the depression. What they did was they took the example of somebody who had perfect market. They had perfect timing when it came to moving their portfolio.

What they did is they moved their portfolio out of all the markets 10 months before every single peak all the way up to last year. They did the hard thing. Remember, when you move out, it's just not one decision, it's two. We have already learned money in the money market accounts is going to lose purchasing power. You're losing money, and it's permanent. It can't stay there.

The second decision, and probably the more important decision, is when do you move it back in? With ClearBridge, what they did is they moved all that money back into the portfolio 10 months after the bottom. What's wild about that is it's amazing timing, I got to tell you. I wish we were that good.

What's wild about that is the person who did the buy and hold ended up with three times the amount of capital, or the person who got cute and had really good timing ended up with a third. That is real loss, opportunity cost loss. Be careful, especially after the fact.

The market already went down. What is the likelihood that the market's going to go down two years in a row? I can tell you; it has happened. Be aware it has happened about nine percent of the time. As we think about 2023 and we think about what to do, let's not fall prey to something called recency bias. Things aren't necessarily going to be bad, just different.

For example, in the last 15 years, we've had to allocate more of our retirees' portfolio into equities because bonds weren't paying anything. Now, we have choices. Think about the Federal Reserve. Everybody was wringing their hands because the Fed was out of arrows. Now they have more in their quiver.

Everybody was worried the Fed wouldn't be able to deal with the next crisis. Guess what? They just increased interest rates another 25 basis points. It's going to end up at a five percent or above. They've got arrows again. They also have choices.

In addition to that, the market sell-off got rid of a lot of the speculative investments that were being made. We've talked about this before. I was never a fan of digital hotdogs, I'm just saying. The global conflict has resulted in a realignment of NATO. I don't know about you guys, but that makes me feel more secure.

On a personal level, because of inflation, Social Security, whether you're getting it or not, increased by 8.7 percent. If you're not receiving it but could, you got another eight percent bump on top of that. That is a big deal. That's really important. That's a big deal. For the

workers who are listening to this podcast, 401(k) limits were also increased. For any of you empty nesters who just finished putting your kids through college, and who might be feeling a little bit behind, I got news for you.

Each person, two people in a couple, for example, can put $30,000 each into their 401(k), or $60,000 a year. You do that for a few years, you're going to catch up really quick. That is the positive aspect of this.

Also, and I'm going to end with this, please let's keep in mind that some of the greatest innovations happened when the world was on fire. Think about it. World War II. What did we get out as a result of World War II?

It was a terrible, terrible period in our nation's history and the world's history, and yet what came out of it? Let me give you a few examples. We got the supermarket, dry cleaning, radar, nuclear energy, jets, and penicillin. Everybody watching and listening today has experienced this in our lifetime with COVID.

Who would have thought that a technology would have allowed scientists all over the world to come together as human beings to discover a vaccine within...Well, basically, decode this virus within days? That would normally take about five years, now it was days, my friends.

Then come up with a vaccine that would protect us against this lethal virus that literally took the lives of millions and millions of people. That is a miracle. I can't help but wonder, as my friend Chris Davis of Davis Funds said, I can't help but wonder whether that really would have happened if we were all laying on a beach with full bellies.

Adversity, as hard as it is, can be a wonderful motivator. A lot of good things can come out of it. I believe a lot of good things will continue to come out of what we experienced in 2022. What do you do with this information?

I think, personally, if you're watching this, hopefully, you have an advisor, and you already have a very comprehensive 360 view. Not just your portfolio, but your entire financial plan. Let's look at your cash flow. When are you going to need that next car? What about the tuition payments?

When do you really want to retire? How much cash flow from that pool of money are you actually going to need? Let's get it ready now. A comprehensive plan that's being updated every single night with changes, not only in the market, but in your situation because as we know, life changes, right? You want to be ready.

This is a longer version of Ask Patti Brennan. I usually like to keep them to 10 minutes, but as you can probably tell, I riffed. Thank you for tuning in. Thank you for listening.

Most importantly, keep those cards and letters coming, because if you've got a question, a lot of other people are probably thinking the same thing. I want to make sure that we are addressing the things that you're worried about, that you think about, and that you want to make sure that you're taking advantage of.

Thank you so much for joining me. Go on to our website, keyfinancialinc.com and most importantly, have a fantastic day. Take care.