Is 5% Really Enough?

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Is the safety of a consistent 5% return worth giving up the potential gain of a more risky investment that projects 8.2% growth? Or, in other words, how much is safety worth in today's economy?

To find out, let's look at two hypothetical million-dollar-portfolios over 20 years:

Portfolio 1: Stock fund projected to earn 8.2% annually
Portfolio 2: Bond fund with an average annual coupon of 5%

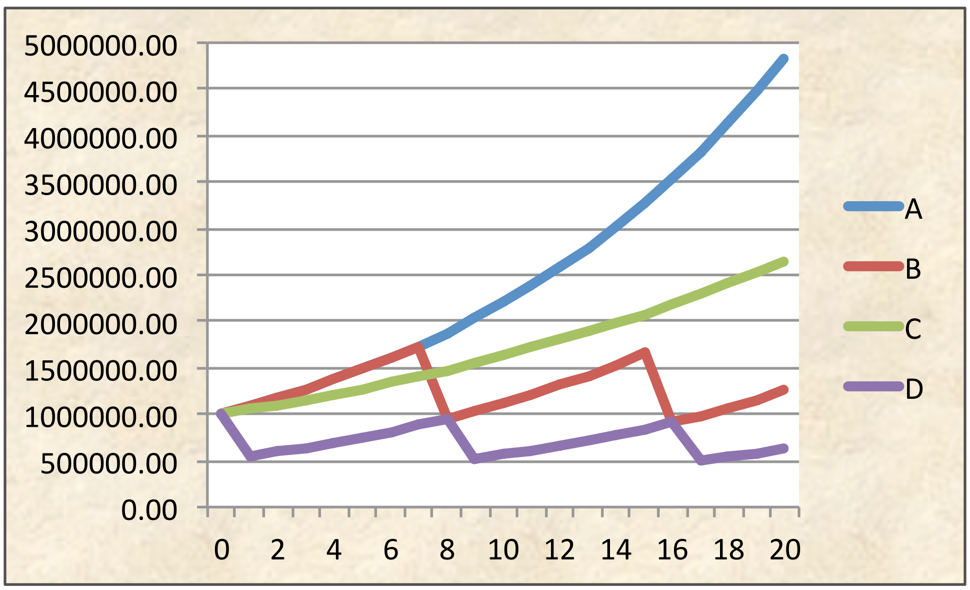
We also need to make a few assumptions about the market for the next 20 years:
1. For both funds, we are going to assume that 5% bond funds, and 8.2% stock funds can be found to reinvest earnings for all 20 years.
2. Since the 2000 Dotcom Bubble burst, U.S. markets have taken an approximate 45% hit every 8 years.

Running the numbers reveals the following scenerios:
B. In the best-case-scenerio, the stock-fund-holder has seven years to build up their investment before experiencing a 45% total loss in value in the eighth year, and then continues their trend of earning 8.2% during the seven-year-periods that separate crises. This pattern of earnings is shown as line B.

C. An income-investor with a consistent, 5% return is indicated by line C.

D. A worst-case-scenerio, where the stock investor invests a year before an economic crisis, loses 45% up front, and then again every eight years is indicated by line D.

What about A?
You may have already guessed, but scenerio A, a high yield stock fund with no market risk, does not, and cannot exist in this economy. It is the teaser rate that gets investors to ignore the reality and probability of the other three scenerios.



So what happened to the million dollars in each fund after 20 years?
Best-Case-Stock: $1,249,729
Safe-Fixed-Income: $2,653,298
Worst-Case-Stock: $635,296

I think it's safe to say that 5% is more than enough!

* 8.2% market return comes from S&P Total Return Index (SPXT) 12/29/1995 to 5/27/2016