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The Safe Investing Dilemma

John was concerned because his 82-year old mother, Betty, was having trouble generating sufficient income to cover her cost of living with interest rates at rock bottom levels. Along with many other investors globally who have poured some $4 Trillion dollars into government bonds since the 2008 Credit Crises, she wanted to feel safe and have her money guaranteed. But the price of safety in a low interest rate world is higher than you may realize.

For example, the best five-year GIC rate among major banks is about 2.2%. The after-tax return is between 1.1% - 1.8%. But include inflation and the net return is likely negative, resulting in a loss of purchasing power.

Legendary investor Warren Buffet recently observed that many fixed income investors missed the party over the past nine months as Wall Street rocketed to all-time highs. It is brutal. I don't know what I would do if I were in that position,? Mr. Buffett said at Berkshire Hathaway's recent annual meeting. I feel sorry for people that have clung to fixed-dollar investments.'

The real dilemma for Betty and other savers, is do they focus on the short term risks or the long term risks? And which is worse - watching your balances bounce around in other investments such as equities, or the guaranteed risk of going broke slowly over time as purchasing power erodes?

Purchasing power loss is one of those things in life that is hardly noticeable on a day to day basis. For example, when John was in his teens, Betty used to send him to the bakery for bread with a dollar and he'd come home with six loaves. Today, he can't even buy two loaves for five bucks.

Another reality today is that the average couple, both aged 65, will be retired for some 30 years due to today's increasing longevity. This is almost as long as the number of years they spent working and building their nest eggs.

Preserving purchasing power is vitally important to avoid running out of money during one's retirement years.

There are ways of investing, such as equities that can maintain and possibly increase your purchasing power over time both for retirees and for younger people still building their savings. For the first time since the 1950's, dividend returns on TSX equities are higher than the interest earned from 10-Year Government Bonds. This is true for the majority of Canadian dividend paying equities.*

We can throw many statistics at you to show how other forms of investing decrease in risk over time. But the reality is it is difficult if not impossible to convince you of this when emotions always beat out logic and facts.

The real question is: are you more afraid of the short term ups and downs or going broke slowly over time? Other options are available to investors who want to invest safely? in today's chaotic world.

* Moneysense Magazine, Summer 2012

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