Our Monthly Free Newsletter
TheInvestor
In our 32nd year of service to the investing public of South Africa

By Richard Cluver November 2019

The great majority of the world's population is a lot less well off than you think and until you can come to terms with that fact you will never be able to adjust to your own position in the pecking order of wealth.

I have dealt with this a few times recently because most people fail to grasp the fact that if you have assets of more than R10.9-million you are in the world's top one percent. That means that 99 out of every hundred own less than you. It's a sobering fact for folk who constantly complain that their income never quite meets their spending needs and who are as a result always getting into debt…particularly so if you can just take to heart the fact that if you can learn to set aside a tenth of your income for around ten years you never need work ever again. Imagine spending the rest of your life doing just what you want to without ever having a boss to answer to!

But back to that figure of R10.9-million and what it really means, if you care to cast your eyes over the property ads the surprising fact is that there are homes not far from you with an asking price greater than that. And if you own one of those mansions, you need a great deal more to meet the rest of your living costs, not to mention the municipal rates bills. But they are definitely not the norm. The remarkable fact that 99 percent of the world's population has wealth of less than R10.9-million each is a somber commentary upon most people's perceptions of how wealthy they are and much income they require in order to enjoy a comfortable living standard.

Noting that on average people who seek my advice on how to set about building a retirement nest egg claim that they would need at least R50 000 a month to live comfortably, the reality is that to achieve a sustainable income of that level would require them to create savings of not less than R12-million. That number derives from the self-evident fact that R12-million gives you the interest/dividend income off R1-million each month upon which to live.

Currently, with the Johannesburg Stock Exchange standing at arguably its most depressed levels in the past half century, a Blue Chip portfolio worth R12-million would on average give an investor a monthly income of R48 000. After deducting the 20 percent tax levied upon all investors by their silent partnership with the Receiver of Revenue, this implies they would have R38 400 a month to live on. On average, however, the yield of a Blue Chip would be closer to 2.5 percent implying a monthly R25 000 less dividend tax of R5 000 which would offer our intending retiree just R20 000 a month to live on.

In order to achieve the balance of the required income amount, it is normal to place a portion of the capital in interest-bearing instruments like bank call accounts which might be expected to yield a little over 8 percent currently. Here, if you do the maths, R12-million would offer you a pre-tax income of R80 000 a month. However at an average tax rate of 26.98 percent that income would leave you with just R58 417 a month to live on…and you would be one of fortunes favoured one in a hundred wealthiest people.

The Ten Minute Millionaire

By Richard Cluver

So how much does a modern family actually need to enjoy a reasonably comfortable lifestyle? According to Numbeco which claims it is " the world's largest database of user-contributed data about cities and countries worldwide and, in the case of Durban, maintains constant surveys of the living costs of a cross section of 197 contributors, the cost of maintaining a four-person family is currently R24 796 without taking rent into account.

Furthermore, renting an average three-bedroomed house in a South African city could cost anywhere between R7000 and R25 000. The average utility bill in this country runs upwards of R 1,200 per month. Utility costs cover water, electricity, gas and waste disposal. Consider the following average costs for Durban:

Utilities (Monthly)	[Edit]	
Basic (Electricity, Heating, Cooling, Water, Garbage) for 85m2 Apartment	1,129.26 R	800.00 – 1,700.00
1 min. of Prepaid Mobile Tariff Local (No Discounts or Plans)	1.90 R	1.20 – 3.00
Internet (60 Mbps or More, Unlimited Data, Cable/ADSL)	879.00 R	600.00 – 1,200.00
Sports And Leisure	[Edit]	
Fitness Club, Monthly Fee for 1 Adult	479.77 R	300.00 – 700.00
Tennis Court Rent (1 Hour on Weekend)	146.67 R	80.00 – 250.00
Cinema, International Release, 1 Seat	80.00 R	70.00 – 104.00
Childcare	[Edit]	
Preschool (or Kindergarten), Full Day, Private, Monthly for 1 Child	2,704.38 R	1,800.00 – 4,300.00
International Primary School, Yearly for 1 Child	49,324.09 R	24,000.00 – 100,000.
Clothing And Shoes	[Edit]	
1 Pair of Jeans (Levis 501 Or Similar)	720.90 R	500.00 – 950.00
1 Summer Dress in a Chain Store (Zara, H&M, ...)	494.23 R	250.00 – 700.00
1 Pair of Nike Running Shoes (Mid-Range)	1,155.69 R	800.00 – 1,500.00
1 Pair of Men Leather Business Shoes	1,078.30 R	600.00 – 1,700.00
Rent Per Month	[Edit]	
Apartment (1 bedroom) in City Centre	4,733.33 R	3,000.00 – 6,500.00
Apartment (1 bedroom) Outside of Centre	5,071.43 R	3,000.00 – 7,500.00
Apartment (3 bedrooms) in City Centre	9,573.91 R	6,500.00 – 13,000.00
Apartment (3 bedrooms) Outside of Centre	10,981.48 R	6,500.00 – 15,000.00
Buy Apartment Price	[Edit]	
Price per Square Meter to Buy Apartment in City Centre	10,341.79 R	6,000.00 – 14,000.00
Price per Square Meter to Buy Apartment Outside of Centre	10,575.00 R	7,500.00 – 16,000.00

Restaurants	[Edit]	Range
Meal, Inexpensive Restaurant	120.00 R	70.00 150.00
Meal for 2 People, Mid-range Restaurant, Three-course	400.00 R	350.00 550.00
McMeal at McDonalds (or Equivalent Combo Meal)	55.00 R	49.00 70.00
Domestic Beer (0.5 liter draught)	25.00 R	20.00 35.00
Imported Beer (0.33 liter bottle)	29.00 R	24.00 40.00
Cappuccino (regular)	25.21 R	20.00 30.00
Coke/Pepsi (0.33 liter bottle)	12.15 R	9.95 16.00
Water (0.33 liter bottle)	9.54 R	6.00 14.00
Markets	[Edit]	
Milk (regular), (1 liter)	13.99 R	10.12 18.00
Loaf of Fresh White Bread (500g)	12.53 R	9.00 15.00
Rice (white), (1kg)	17.43 R	10.00 30.00
Eggs (regular) (12)	23.20 R	18.00 34.00
Local Cheese (1kg)	93.00 R	80.00 119.00
Chicken Breasts (Boneless, Skinless), (1kg)	65.88 R	40.00 75.00
Beef Round (1kg) (or Equivalent Back Leg Red Meat)	91.15 R	78.00 112.00
Apples (1kg)	20.21 R	15.00 25.00
Banana (1kg)	16.60 R	11.00 24.00
Oranges (1kg)	18.80 R	11.00 25.00
Tomato (1kg)	14.50 R	10.00 24.00
Potato (1kg)	12.60 R	7.00 16.00
Onion (1kg)	13.45 R	10.00 17.00
Lettuce (1 head)	13.36 R	8.99 16.00
Water (1.5 liter bottle)	15.80 R	12.00 25.00
Bottle of Wine (Mid-Range)	50.00 R	40.00 70.00
Domestic Beer (0.5 liter bottle)	15.01 R	9.87 25.00
Imported Beer (0.33 liter bottle)	22.80 R	15.00 30.00
Cigarettes 20 Pack (Marlboro)	40.00 R	35.00 46.00
Transportation	[Edit]	
One-way Ticket (Local Transport)	15.00 R	10.00 18.00
Monthly Pass (Regular Price)	306.56 R	200.00 600.00
Taxi Start (Normal Tariff)	20.00 R	10.00 25.00
Taxi 1km (Normal Tariff)	12.00 R	7.00 15.33
Taxi 1hour Waiting (Normal Tariff)	70.00 R	20.00 100.00
Gasoline (1 liter)	15.82 R	15.00 17.00
Volkswagen Golf 1.4 90 KW Trendline (Or Equivalent New Car)	250,000.00 R	180,000.00 325,000.00
Toyota Corolla 1.6l 97kW Comfort (Or Equivalent New Car)	267,841.67 R	200,000.00 322,000.00

Numbeco rates Durban as follows in respect of its principal indices:

Purchasing Power Index	79.32	Moderate
Safety Index	19.44	Very Low
Health Care Index	56.05	Moderate
Climate Index	95.61	Very High
Cost of Living Index	37.07	Very Low
Property Price to Income Ratio	3.44	Very Low
Traffic Commute Time Index	26.83	Low
Pollution Index	51.09	Moderate
f Quality of Life Index:	141.13	High

Taking just these few items together makes it clear that the income off R12-million would not go very far in a South African city. From these figures it is just a short step to asking the question that if Durban enjoys what Numbeco claims is a “Very Low” cost of living index just 37.07 percent of the global index, how are the 99 percent with fewer assets than R12-million managing to live?

If you are just getting by in a South African city, it is clear that you have a lot to learn from your fellow man everywhere!

The Crash of 2020

By Richard Cluver

Last month I warned of the pending world economic crisis which has a very high probability of occurring in the coming year. Hence the title of my latest book “The Crash of 2020” which I am currently preparing for publication.

To understand the coming global monetary crisis I need again to provide you with a little monetary history and this time take you back to the world’s first coinage.

The image of the world’s first coin, the Lydian Lion takes us back to 630 BC to the Paktolus River in Lydia which is now part of modern-day Turkey which was at the time the world’s richest source of gold**.** Lydia was noted by ancient authors as a significant centre of commerce, and it was the first to establish retail shops in permanent locations.

The Lydian Lion coinage began with the kings Sadyattes and Alyattes. Its weight indicates that its denomination is a “Trite” which is generally thought to represent about one month’s wages and, according to other references, able to purchase up to eleven sheep.

Lydian Lions, however, only weighed 4.7 grams whereas modern Sovereigns, Gold Dollars Thalers, Krugers etc, all contained precisely one Troy ounce which is equal to 31.1034768 grams of pure gold and this week they were priced at R22 600 eaxch. Thus the value in pure gold of a Lydian Lion would this week be R3 415.05 and were it still able to buy eleven sheep, the implication. is that a Lydian housewife could buy a sheep for R310.45 while ewes were selling for R1 400 this week in South Africa.

Clearly, in real terms, modern farming methods have not helped the housewife if today she must pay four and a half times more for a lamb chop than her Lydian counterpart.

Unlike modern gold coinage, however the Lydian Lion was made of a gold and silver alloy but otherwise it met all of the modern dictionary requirements of coinage inasmuch as it had certified

markings that signified a specific exchange value and was issued by a governmental authority for use as money.

Intriguingly, scholars believe that the Lydian Lion might have been the first counterfeit confidence trick inasmuch as creating a coin of a specific weight with consistent and clearly-identifiable markings was arguably a clever ploy to pass off an alloy as pure gold. However, creating a coin with identifiable markings of authentication was clearly very convenient for a world that had previously existed on a basis of barter between tribes.

People rapidly got used to gold coin as a medium of exchange and the idea spread like wildfire throughout the known world with Lydia's Golden Lions being exchanged between traders operating far beyond the borders and influence of the kingdom. And for the first time, regional leaders who had taken on the responsibility of administration had to learn the concept of a cash shortfall.

A leader could, after all, only remain a leader provided he remained popular with the majority of his people and people quickly learned that loyalty could be equated with their palms being greased with gold coin.

Croesus

Croesus who is remembered to this day by the expression, "As rich as Croesus," was believed to be the richest man in the ancient world and his wealth allowed him to pursue wars against the Asian Greeks, bringing all the Aeolian and Ionian settlements on the coasts of Asia-Minor under Lydian rule, and from whom he exacted tribute, in the process forcefully demonstrating to all the power of money. Croesus was, moreover, the first monarch to mint a pure gold coin.

Now this was all right for Croesus who ascended to the throne of Lydia in 560 BC and who enjoyed a rich supply of alluvial gold with which to create his coins. But other leaders in the surrounding areas of Asian Greece were not so fortunate.

When the gold coin in their treasuries ran out and there was a host of disgruntled generals, courtiers and tradesmen to be paid, other than going out and plundering their neighbours, the logical alternative was to melt down the gold coinage and mix it with a suitable metal like copper or silver in order to produce something that looked like gold but actually was not of the required purity. And so the first counterfeiting began and no doubt many got away with it for the next several hundred years.

For all his wealth, however, Croesus did not long to enjoy it. In 547 BC he besieged and captured the Persian city of Petra in Cappadocia and enslaved its inhabitants. In retaliation the Persian king Cyrus The Great marched with his army against the Lydians and captured their capital city of Sardis by 546 BC. Lydia became a province (satrapy) of the Persian Empire, and remained so until Persia was in turn conquered by the Macedonian king Alexander the Great.

When Alexander's empire ended after his death, Lydia was possessed by the major Asian diadoch dynasty, the Seleucids, and in turn by the Attalid dynasty of Pergamum. Its last king avoided the spoils and ravage of a Roman war of conquest by leaving the realm by testament to the Roman Empire.

But then came Archimedes. Born in Syracuse, Sicily, in 287 BC Archimedes was mythically reputed to have run naked down the streets of Syracuse after noticing that upon entering his bath he displaced an equal volume of water, allowing him to conclude the basis for calculating the specific gravity of metals and accordingly determine their purity. Thereafter, the issuers of gold coin had a means of trapping the counterfeiters whose actions were debasing the value of their coinage and thus their value and reputation as a means of trade.

Coinage was understandably jealously guarded against counterfeiting. Indeed there were heavier penalties for counterfeiting than for the most heinous crimes. As recently as 1690 the English couple Thomas and Anne Rogers were convicted for "Clipping 40 pieces of Silver". Thomas Rogers was hanged, drawn and quartered while Anne was burnt alive.

In ancient Rome the punishment for embezzlement of public property and counterfeiting of coins is laid down in the *lex Iulia peculatus*, a law dating back to Julius Caesar. Counterfeiters along with deserters, poisoners, sorcerers and their customers, kidnappers of children and leaders of rebellions were executed by *damnatio ad bestias*; by being torn to pieces by lions.

Counterfeiting is as old as money itself and has always been equated with treason. It was sufficiently prevalent throughout history to be called "the world's *second* oldest profession". Before the introduction of paper money, the most prevalent method of counterfeiting involved mixing base metals with pure gold or silver. A common practice was to "shave" the edges of a coin. This is known as "clipping". Precious metals collected in this way could be used to produce counterfeit coinage.

The theory behind such harsh punishments was that one who had the skills to counterfeit currency was considered a threat to the safety of the State, and had to be eliminated. Another explanation is the fact that issuing money that people could trust was both an economic imperative, as well as a (where applicable) Royal prerogative; therefore counterfeiting was a crime against the state or ruler itself, rather than against the person who received the fake money.

It is also worth noting that counterfeiting has been widely employed as a means of warfare. The idea is to overflow the enemy's economy with fake bank notes, so that the real value of the money plummets. Britain did this during the American Revolutionary War to reduce the value of the Continental Dollar and Germany returned the compliment by forging British pounds during World War Two.

But, returning to Archimedes, with a ready means of detecting counterfeits now at hand, a world that was beginning to organise itself into city and nation states at the heart of which was an efficient system of tributes, taxation and a highly-developed accounting system, found itself with a problem of cash shortfalls.

The only ready solution that kings and emperors could come up with when taxes failed to generate sufficient revenue, was conquest which could be sold to their people as a glorious cause aimed at spreading a culture or a religious view but was in reality a simple process of plunder.

With the emergence of money lenders, temporary cash shortfalls could be smoothed over and, with the advent of organised agriculture, and farmers who produced one cash crop a year but needed income throughout the year to both live on themselves and pay their labourers, more complicated systems were needed. Thus developed a very sophisticated system of futures-trading with its associated mathematics surrounding the present value of future cash which in turn required management expertise that only organised money-lending could handle through the creation of banking associations with relative armies of abacus-wielding staff.

It is accordingly a sorry commentary upon mankind that it took another two thousand years to recognise that the wholesale slaughter of fellow human beings in warfare was morally repugnant; that perhaps there might be a better way of managing things than embarking on expeditionary wars when monarchs ran out of cash.

Perhaps we are today unfit to judge our forebears who were far more used than we to death and perhaps the example of Queen Anne is not the best of her era. However, as the first monarch of a united single sovereign state known as Great Britain in 1707, one must consider that Queen Ann enjoyed the best her society could provide, including the best medical care, plentiful food and a freedom from the backbreaking labour that marked the lives of most of her subjects. Nevertheless the stark reality of her life was that the last of the Stuarts became pregnant an astonishing 18 times, though not one of her children survived until adulthood.

There was also the fact of the British system of inheritance where the eldest son inherited the lands and estates and younger brothers who survived into adulthood became soldiers of fortune. So, perhaps previous generations saw better reasons than we for going to war with one another. But it is probably true to state that it took the horrors of the First World War; of officers armed with nothing more than a swagger stick leading battalions of young men into the devastating hail of lead that was machine gun fire, for men to realise there had to be a better way of doing things.

Nevertheless, it took another 30 years of carnage and another world war, coupled with the human misery of the Great Depression, which was in itself the result of mishandled monetary policy, before the world realised that it had better find another way of handling money. Arguably, had the allies not forced Germany to pay “reparations” to the victors of the First World War, a sum of 132-billion gold Marks as agreed to within the Treaty of Versailles which represented another manifestation of the plunder principle forced upon a people deeply impoverished by the consequences of the war, Adolph Hitler’s Nazi party might not have come to power setting in place the probable inevitability of World War Two.

In the early post-war years, German inflation grew at an alarming rate, but the government simply printed more currency to pay debts. By 1923, the “Weimar Republic” as Germany was then known (named for the town where the Treaty of Versailles was signed) claimed it could no longer afford the reparations required by the treaty and Germany began defaulting payments. In response, French and Belgian troops occupied the Ruhr region, Germany's most productive industrial region at the time, taking control of most mining and manufacturing companies. By the end of 1923 over two hundred German factories were working full-time to produce paper for the spiralling bank note production. In 1919, one loaf of bread had cost one Mark and by 1923, the same loaf of bread cost 100 billion Marks. The value of the German currency declined from 4.2 Marks to the US dollar in 1914 to one million per dollar by August 1923.

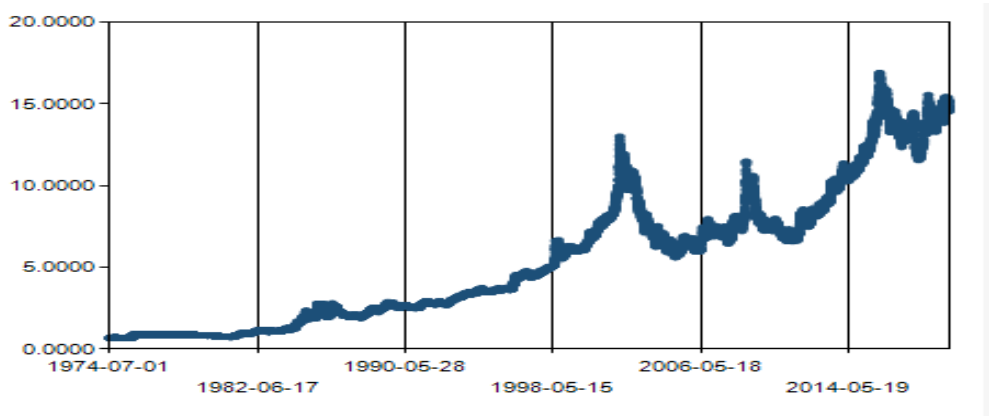
World War II was the deadliest military conflict in history costing an estimated total of 70–85 million people. There had to be a better way of managing the finances of nations and thus in July 1944, in the closing stages of World War Two, 730 representatives of 44 countries met in a hotel in Bretton Woods in New Hampshire USA to try to chart a new world monetary system that they hoped would do away with war between nations.

I should add that the meeting occurred before the US Air Force dropped an atomic bomb on Hiroshima in Japan which forcefully demonstrated to mankind that warfare was no longer an option when the complete annihilation of the human race was the likely consequence of another such war.

However, it wasn't until 1958 that the Bretton Woods System became fully functional. Once implemented, its provisions called for the US dollar to be pegged to the value of gold. All other currencies in the system were then pegged to the value of the US dollar. The exchange rate applied at the time set the price of gold at $35 an ounce.

The Bretton Woods system was developed to try and find a method of unifying the value of a multitude of world currencies so that nations could efficiently trade with one another in a global marketplace. But the system only lasted until 1971 when the USA ended the link between the dollar and gold, effectively ending a system that had served world trade from 630 BC; for a total of 2 601 years. So perhaps it is not really surprising that we have yet to perfect a new system.

As a sub text, the Rand was pegged at R2 to the British pound until June 1974 when the authorities decided to embark on a free float. At that time it initially floated at 72 cents to the US Dollar, a far cry from its weakest level of R16.96 in January 2016: its progress since then in the graph below



But the bitter truth that has emerged from our study of the period since the Bretton Woods agreement in 1944, and the cause of our coming economic crisis, is the fact that without the discipline that the Gold Standard imposed upon our business dealings, our authorities have been unable to resist the temptation to tamper with the current system. And the result, as I have illustrated, is a massive build up of inflationary pressure which will inevitably heap fresh torment upon ordinary folk, and pensioners in particular, in the not too distant future

Attracting financial and human capital through better policies

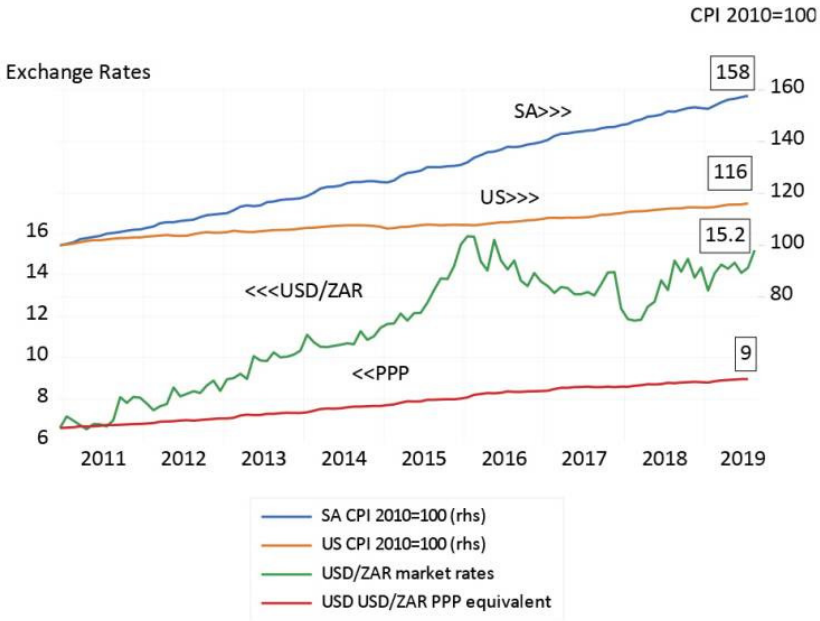
By Professor Brian Kantor
Investec Wealth & Investment

Better economic policies at home would improve the purchasing power of the rand and with it, improve the lives of South Africans.

What inflation gives South Africans by way of higher prices, revenues or incomes, weaker exchange rates might be expected to reduce their value abroad. If this was fully the case, and the move in exchange rates was equal to the difference in inflation rates, the different fields on which we work or play across the globe would be a level one. The rand, when exchanged at market exchange rates, would then have more or less the same buying power everywhere. Our rands almost always have bought us more at home than they do abroad – when exchanged at the prevailing exchange rates.

Clearly economic life does not work that way. The difference between what our rands can buy at home or abroad can be calculated as the difference between the market rate of exchange and its purchasing power equivalent, as determined by differences in inflation rates.

Since December 2010, when a US dollar cost R6.61, consumer prices in SA have increased on average by 58%. In the US, average consumer prices are up by a mere 16% over the same period. If the USD/ZAR had moved strictly in line with the changing ratio of consumer prices in the two economies (168/116 or 1.36) the dollar would have moved from R6.61 rands per dollar in December 2010 to R9 in August 2019. (9/6.61 = 136). An exchange rate of 9 rands to the US dollar would have leveled the playing field (see chart below).



2010 is a good starting point for such a calculation. The rand then was very close to its purchasing power parity (PPP) equivalent, were you to use 1995 as a starting point for the calculation. It was in 1995 that the rand became subject to largely unrestrained capital flows, after the abolition of the financial rand and the lifting of exchange controls on non-residents. Until then, the (commercial) rand traded consistently close to its purchasing power value.

The reality is that exchange rates are determined by forces that may have little to do with actual price changes in the markets for goods and services. They move in response to global capital flows between economies, rather than to the flows of exports and imports.

If an economy becomes a riskier destination, capital tends to flow away, exchange rates weaken, and interest rates rise to balance supply and demand for the local currency. As a particular economy becomes a riskier destination, capital tends to flow away, exchange rates weaken, and interest rates rise to balance supply and demand for the local currency. If the shocks to the exchange rates in one or other direction are sustained, the inflation rate will respond as the prices paid for imported and exported goods in the local currency increase – but with a time lag. This time lag determines the degree to which exchange rates diverge from PPP. The exchange rate leads, and inflation follows.

Converting your SA wealth or incomes from rands into the equivalent purchasing power in the US at August month-end would, therefore, have required the following adjustment: to reduce the 6.6 dollars received for R100 at market exchange rates by about 60%, this being the ratio 9/15.2. That is to say, R9 that would have represented the difference between faster inflation in SA compared to the US to net out pure inflation effects – rather than the R15.2 you actually had to give up for an extra dollar to spend in New York (9/15.2 x 6.6 = 3.9).

Therefore, any R100 of spending power in SA would have provided the equivalent of less than US$4 of roughly equivalent spending power in the US. In other words, what would be regarded as a substantial fortune of R100m in SA would have provided the equivalent of a mere US$4m of buying power in the US, perhaps not enough to live as well as you could live in SA off your capital.

This purchasing power discount of 40% (((6.6-3.9))/6.4) x 100 = 40%) is a significant deterrent to the relocation of wealthy and skilled South Africans with only rands to convert. For mobile younger South Africans, with a life of income-earning opportunities ahead of them, we could undertake a similar calculation. That is, multiply the prospective hard currency salaries they might be offered abroad, when measured in current exchange rates, by approximately six tenths to account for their lesser purchasing power. Earning and saving rands at home (and perhaps investing abroad) might yield improved lifetime consumption.

We should be relying more on better economic fundamentals, than on an undervalued exchange rate. If SA could play the economic growth cards more effectively, it would reduce its risk premium and attract more capital on better terms. The nominal rand could then again approach its PPP value and the cost of borrowing rands (and dollars) would come down with less expected inflation. SA incomes after inflation could grow at a much faster rate – encouraging immigration rather than emigration, through better economic policies.

US Pensioners' bleak outlook

By John Mauldin

I'm filing this letter on the day I turn 70 which, among other things, means I start receiving Social Security benefits this month.

The good news, at least for me, is I am getting a whale of a deal from Social Security compared to later generations. Frankly, I was surprised at my monthly benefit amount, because I never really paid attention to what it would be. That one payment will put me and Shane within shouting distance of the US median household income, and I am still working. It's a far cry from my humble roots. I have been both blessed and lucky.

Unfortunately, my good news is also bad news for younger Americans, who won't get nearly as much as my age cohort is collecting. Worse, they could actually see negative real returns despite having paid proportionally more into the system. In investment terms, they are getting screwed.

This is not a good situation, obviously, and is even more frustrating because it's easily fixed. Back in 2006, Alan Greenspan said a group of experts could easily fix Social Security in about 15 minutes "only because 10 minutes was used for pleasantries." And he had actually led such a group decades earlier: the 1981 Greenspan Commission which Ronald Reagan formed to recommend fixes to the system that was ailing even then.

Fixes for today's problems are elusive because change is politically hard, especially when it requires sacrifice. But, as we will see, the sacrifice is going to happen anyway if we do nothing. You can't take blood from a turnip and that's what Social Security is becoming. Our present course will make the end (in the not-too-distant future) far uglier than it has to be.

Today we will discuss this exasperating situation, using my own situation as a convenient example. As you will see, the Social Security system is not working as intended. Its internal contradictions will soon be undeniable.

Off the Rails

Social Security is a textbook illustration of how government programs go off the rails. It had a noble goal: to *help* elderly and disabled Americans, who can't work, maintain a minimal, dignified living standard. Back then, most people either died before reaching that point or didn't live long after it. Social Security was never intended to do what we now expect, i.e., be the primary income source for most Americans during a decade or more of retirement.

Life expectancy when Social Security began was around 56. The designers made 65 the full retirement age ***because*** it was well past normal life expectancy. No one foresaw the various medical and technological advances that let more people reach that age and a great deal more, or the giant baby boom that would occur after World War II, or the sharp drop in birth rates in the 1960s, thanks to artificial birth control. Those factors produced a system that simply doesn't work. A few modest changes back then might have avoided today's challenge. But lacking a time machine to go back and make them, we are left with a crazy system that rewards earlier generations at the expense of later ones.

I am a perfect example. I've long said I never intend to retire, if retirement means not working at all. I enjoy my work and (knock on wood) I'm physically able to do it. As presently configured, Social Security let me delay collecting benefits until now, in exchange for which I will get a higher benefit—$3,588 monthly, in my case.

It turns out that when you file for Social Security benefits you get a call from the Social Security Administration verifying your details. I got mine this week. They asked why I had no income in 1981 and 82, as well as 1990. The simple answer is those were recession years and I didn't make money. But in 81–82, a self-employed person could deduct everything that moved and a lot that didn't. I actually had cash flow in those years but deductions took my taxable income to zero. 1990 was just a pretty ugly year.

(Sidebar: My research associate Patrick Watson, who helped with this letter, actually worked for me in 1990 in Arlington, Texas. Because he was an employee, he actually paid more Social Security taxes that year than I did. Again, I had enough cash flow and savings to make all the normal payments and keep the kids in school.)

Looking back over the years on the Social Security form was a trip down personal memory lane. There was the random over-the-top year followed by subpar ones. I spent some time reviewing what happened in all those years. But my income mostly rose over time, except in the early 2000s when I launched a new business that consumed every penny I had. Income-wise, not a good few years, but long-term, one of the best things I've ever done.

Personal note: I came from the wrong side of the tracks in Bridgeport, Texas, except that Bridgeport was too poor to have tracks. I started actually working at age 11, doing door-to-door sales and paper routes. I mostly worked odd jobs but at 16 actually got a paycheck and Social Security says I made $979 that year. I basically got room and board growing up after age 12. I bought my own clothes and everything else. Just what we did. Never thought anything of it. That $979 is $7,662.19 in 2018 dollars. Inflation was just beginning to kick in and in the next 54 years truly eroded the value of that first $979.

I was lucky and got a full tuition scholarship to Rice University, and loans at 3% interest for room and board, though I still had to work throughout college for everything else. I went to seminary, earned a Master of Divinity (that and four dollars will get you a cup of coffee at Starbucks), and went into business for myself shortly thereafter. In the late '70s and early '80s there were times I woke up at night wondering whether to pay the electric bill, buy groceries, or pay a business invoice. I actually had a bank account in North Dakota (I think it was) that I would write checks on because I knew it would take almost two weeks to clear. I ran my payables to 60+ days because my customers ran me to 60-90+. It was the best business school education ever. Real world, not hypotheticals.

A lot of people would look at my life today and not understand that I really get tough times and doing what you have to do just to get by. People just assume that somehow it has always been rainbows and unicorns for me. And it pretty much has been a great life. But being forced to build from the literal ground up made me truly appreciate my blessings.

Now, back to Social Security.

Your Social Security Return on Investment

Now, that $3,588 I will be getting each month isn't random. It comes from rules that consider my lifetime income and the amount of Social Security taxes I and my employers paid. That amount comes to $402,000 of actual dollars, not inflation-adjusted dollars. More on that later. (I also paid $572,000 in Medicare taxes. Again, actual dollars, not inflation-adjusted dollars.) I first paid into Social Security and Medicare in 1966. For most of my life I've been self-employed, so I paid both sides. (Economically speaking, everyone does. Employer contributions are part of your compensation, even though you never touch them.)

What did those taxes really buy me? In other words, what if I had been allowed to invest that same money in an annuity that yielded the same benefit? Did I make a good "investment" or not?

That is actually a very ***complicated*** question, one that necessarily involves a lot of assumptions and will vary a lot among individuals. But my friend Larry Kotlikoff's Maximizer software helps. According to his calculations, if I live to age 90 (a good bet since my parents and grandparents on average did a lot better) and benefits stay unchanged (not such a good bet, as we'll see below), the internal real rate of return on my Social Security "investment" will be 3.84%. If I only make it to 80, that real IRR drops to 0.75%.

While this may not sound like much, it actually is. Even 1% real return (i.e., above inflation) with no credit risk is pretty good and 3.84% is fantastic. If I live past 90 it will be even better.

Alas, this is not due to my investment genius. According to Larry Kotlikoff, four things explain my high returns.

- Double indexing of benefits in the early 1970s (thank you, Richard Nixon).
- I delayed claiming benefits until age 70, which I could afford to do but isn't an option for many people.
- I will probably live longer than average, due to both genetic factors and maintaining good health (thank you, Shane!).

But maybe most of all because

- The system is massively screwing the next generation. From a Social Security benefit standpoint, being an early Boomer is a pretty good deal.

Social Security structurally favours its earliest users. The big winners are not the Baby Boomers like me, but our parents. They paid less and received more. But we Boomers are still getting a whale of a deal compared to our grandchildren.

Larry ran another hypothetical case for me. Consider a male who is presently age 25, and who earns $50,000 every year from now until age 67, his full retirement age. Such a person is not going to get anything like the benefits I do. The money won't be there, necessitating benefit cuts Larry estimates will be 24.5%. That will be politically unpopular, to say the least, so Congress will likely change the law first, but things will clearly have to change.

So, if this person lives an average lifespan and gets only those reduced benefits, his real internal rate of return will be -0.23%. I suspect very few in the Millennial generation know this and they're going to be mad when they find out. I don't blame them, either.

The Next Quadrillion

The reason Millennials won't see anything like the benefits today's retirees get is simple math. The money simply isn't there.

The so-called trust fund (which is really an accounting fiction, but go with me here) exists because the payroll taxes coming into the system long exceeded the benefits going to retirees. That is no longer the case. Social Security is now "draining" the trust fund to pay benefits. This can only continue for so long. Projections show the surplus will disappear in 2034. A few tweaks might buy another year or two. Then what?

Well, the answer is pretty simple. If Congress stays paralyzed and does nothing, then under current law Social Security can only pay out the cash it receives via payroll taxes. That will be only 77% of present benefits—a 23% pay cut for millions of retirees.

This has been building for a long time. Look what Alan Greenspan said in 1996.

> "*As longevity improved far beyond that contemplated by the creators of the system, and productivity growth slowed after 1973, the original premise of the system of intergenerational balance began to fail. Today the official unfunded liability for the Old Age, Survivors, and Disability funds, which takes into account expected future tax payments and benefits out to the year 2070, has reached a staggering $3 trillion.*

That $3 trillion Greenspan found so staggering is mere pocket change now. Social Security's unfunded obligations on what they call "infinite horizon" (the entire future) are a staggering $43.2 trillion, according to the 2019 Trustee's report.

We can fill that hole by raising FICA "contributions," benefit cuts, or some combination of both. We could also raise the retirement age. This would simply stabilize the system, not enhance it. But anything less means going deeper into the hole.

And please understand, there is no trust fund. Congress already spent that money and must borrow more to make up the difference.

Again, let me stress: This IS going to happen. Math guarantees it. You might say a huge benefit cut will bring riots in the streets, starving seniors, and assorted other ill effects. You're probably right so we should obviously do something. Instead, we—both voters and elected officials—are doing nothing at all despite the mathematical certainty that catastrophe is coming 15 years from now. Would we be similarly paralyzed if a world-ending asteroid were approaching on the same timetable?

Anytime I bring up benefit cuts, I hear indignant cries: "I ***earned*** that money!" Let's talk about that.

Social Security looks a lot like some kind of insurance plan or annuity. We put money in now, we get money out later, according to some formula. A complex and unfair formula, as described above, but there is a method to it.

The vast majority of workers view Social Security as a kind of moral promise. We did our part and we deserve to get what we were assured would come. But as a ***legal*** matter, that's not what it is. Our FICA "contributions" are really a tax. The Supreme Court ruled on this in the 1960 Flemming vs. Nestor case, which established no one has a legal or contractual "right" to Social Security benefits.

I don't think this is a design flaw. I suspect FDR and team thought it would constrain future congresses from disassembling their creation. If so, they were right. But it's also caused anxiety that ***prevents*** Congress from making important repairs to the program.

These challenges will get worse, not better, if the life extension technologies I anticipate reach the market in the 2020s. If you think Social Security is unsustainable now, wait until 100-year lifespans are commonplace. My personal IRR goes up even more if I live to 100 or more. Assuming I still get paid…

Missing Opportunities

These problems would be somewhat less serious if more people saved for their own retirements and viewed Social Security as the supplement it was intended to be. There are good reasons many haven't done so. Worker incomes have stagnated while living costs keep rising.

But more important, telling people to invest their own money presumes they have investment opportunities and the ability to seize them. That may not be the case. The prior generations to whom Social Security was so generous also had the advantage of 5% or better bond yields or bank certificates of deposits at very low risk. That is unattainable now. And let's not even talk about mass numbers of uninformed people buying stocks at today's historically high valuations. That won't end well.

So, if your solution is to put people in private accounts and have them invest their own retirement money, I'm sorry but it just won't work. It will have the same result as those benefit cuts we find so dreadful: millions of frustrated and angry retirees.

So, what is the answer if you are in retirement or approaching it? The easiest answer is to raise the retirement age. Yes, that's really just a disguised way to cut benefits, but making it 70 or 75 would get the program a lot closer to its original intent. Today's 65-year-olds are in much better shape than people that age were in 1936 or even 1970.

(Note, I would still preserve the option for people who are truly disabled to retire younger. I get that not everybody is a writer and/or an investment advisor who makes their living in front of the computer or on the phone. Some people wear out their bodies and really deserve to retire earlier.)

I think the best choice is also the simplest: Don't retire as long as you are physically able to do things that generate income. It doesn't have to be back-breaking labour. Find an occupation that fits your skills and health conditions. Keep your spending under control, pay off debt, and save all you can.

Second, since Social Security is still here, make the most of it. Your benefits aren't etched in stone. There are things you can do to maximize your benefits.

Third, and perhaps most important. If you've been blessed in life like me, remember that not everyone had your advantages, and particularly the younger generations. Find ways to help them. That doesn't have to mean giving them money; your wisdom and advice might be even more useful. But to the extent you can, offer a hand to those who need it.