Saving is Superior to Speculation

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Abstract

The Financial Independence Retire Early (FIRE) movement provides valuable lessons—the true path to rapidly achieving financial independence is the seemingly obvious strategy of maintaining a high savings rate, coupled with disciplined investments in a portfolio of broadly diversified stock indexes. Without compromising Vaishnava principles, devotees may incorporate the straightforward financial principles developed in the FIRE movement, fully knowing the value of this material world and how to properly utilize it in the service of the Supreme Lord Krishna. This article builds on concepts and calculations developed in an earlier report titled **Enlightened Investing**.

FIRE Movement

The international Financial Independence Retire Early (FIRE) movement gained traction and visibility in the 2010s with the advent of internet based online communities. However, it is based on ideas that significantly predate the 2008 financial crisis. TD Ameritrade published a **report on the FIRE movement**, documenting findings from survey based research as well as in-depth interviews with 11 key FIRE leaders / pioneers. (None of these FIRE leaders have any affiliation with TD Ameritrade). Practitioners and proponents of FIRE follow a minimalist lifestyle, embracing the fact that happiness is not expensive—they tend to save and invest at least half of their income. These adherents often have environmental concerns, recognizing that pollution and waste are consequences of overconsumption. They trace their love of nature and ideas of a fulfilled, liberated life back to 19th-century writer Henry David Thoreau, who at least claims to have been inspired by the Bhagavad-gita. FIRE followers tend to give their free time for philanthropic activities, helping their neighbors, and of course in creating blogs.

Strategy for Achieving FIRE

Members of the FIRE movement became monetarily self-supporting by saving and investing 50-70% of their after tax income in broadly diversified stock indexes that charge minimal fees. There is no substitute for austerity. No amount of financial speculation or machinations will circumvent the need to eliminate credit card debt and save. Stock trading is different from investing. This article focuses on the latter, which entails systematically purchasing and holding diversified funds that hold thousands of stocks.

The stock market is the single best performing investment class over the long run. For example, in 1974 the Dow Jones Industrial Average closed at 616. By 2011 the Dow climbed to 12,217. In 2018, the Dow closed at about 23,000. However, the path from Dow 616 to Dow 23,000 has not been a smooth, straight line. This period from 1974-2018 has been incredibly turbulent, marked by massive geopolitical and economic crises. The calamities that have occurred over the past 44 years have not prevented the stock market from marching higher and higher.

Stock market crashes, being part of the process of creative destruction, are to be expected. Whenever the market collapses, it always recovers and goes on to attain new highs. If an individual had remained invested in the market from 1974-2018, the upward trend from Dow 616 to Dow 23,000 would have generated substantial wealth, despite all of the horrible events that occurred over this period. How could anyone have lost money if they remained rigidly invested in the stock market? The answer is simple. Whenever the market collapses, it induces fear, panic, and irrational behavior, and as a result, people sell at the wrong time i.e. after the downturn.

FIRE is **not** achieved by speculating on the stock market, i.e., attempting to time the market and/or utilizing stock picking strategies, both of which are counterproductive. Empirical evidence shows that even well-connected and highly informed financial professionals have little success at predicting winning stocks, despite employing the brightest and best analysts. Stock picking is a loser's game. Market timing reduces returns to an even greater degree than stock picking. A key determinant of long term capital accumulation is a disciplined methodology of remaining steadfastly invested in broadly diversified stock indexes, even in the face of economic and geopolitical crises and severe market volatility.

Size of Portfolio Needed to Retire

Materialistic consumers who save only a small fraction of their salary will have to work several decades in order to build up enough assets to maintain high levels of sense gratification during retirement. An austere devotee can minimize his working years by carefully tracking and controlling costs, while relentlessly following a disciplined investment program of dollar cost averaging. The level of assets needed to sustain financial independence can be estimated from a useful guideline known as the 4% rule. Following the 4% rule, an individual withdraws 4% of his portfolio to cover living expenses in the first year of retirement, then increases the size of the withdrawals to keep up with inflation (**Enlightened Investing**, page 8).

Therefore, when an individual has accumulated a portfolio that is 25 times higher than his or her annual living expenses, they are financially independent and able to retire at any time. For instance, if a devotee can live on $20,000 per year, this figure is multiplied by 25. Thus, he will require a portfolio of $500,000 (computed as 25 x $20,000) to achieve financial independence.[1] In contrast, a karmi that is addicted to high levels of sense gratification with expenses of $50,000 per year will require a portfolio of $1.25 million. These calculations assume that the retiree will receive nothing in social security and/or pension payments. The 4% withdrawal rule was created to survive worst case market scenarios. Results from Monte Carlo Simulations reveal that most of the time, the 4% rule leaves behind a large amount of unspent principal, indicating a significant margin of safety.

[1] 4% of $500,000 is $20,000.

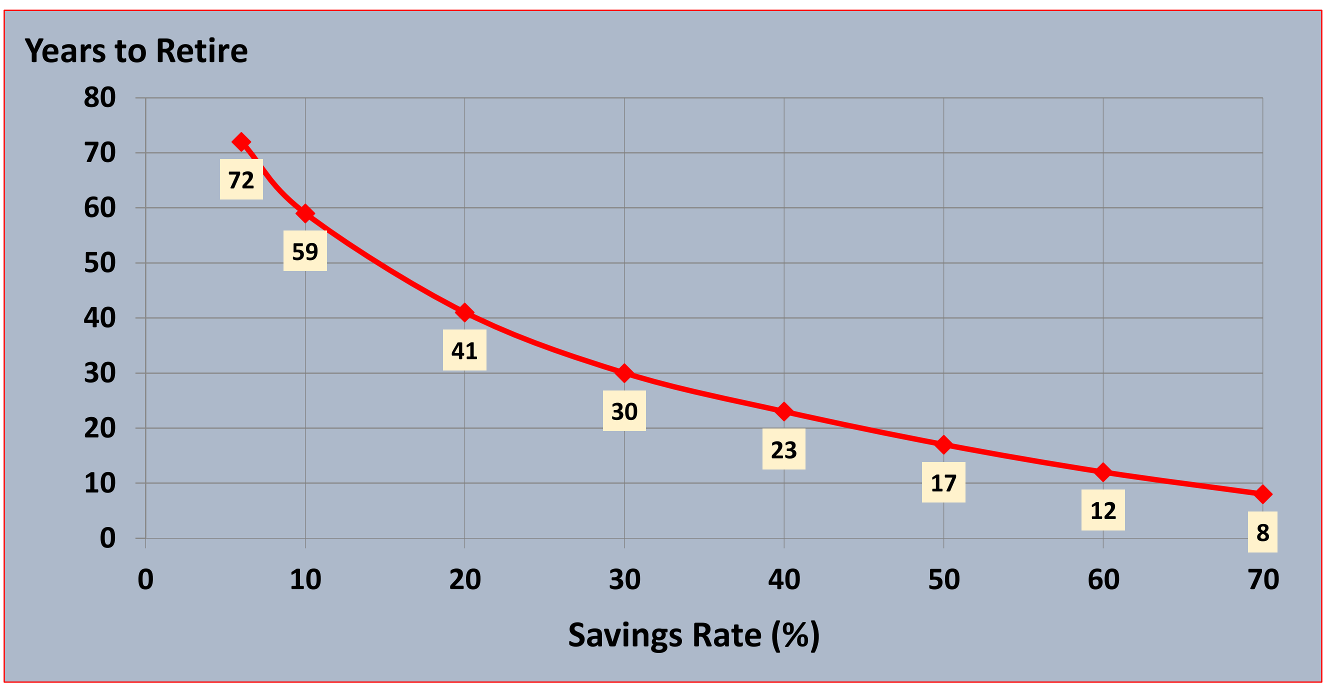
Time Needed to Retire

The number of years one needs to work in order to reach retirement is more strongly influenced by the amount saved and invested, rather than the rate of return on investments. We demonstrate these points by examining a range of scenarios. Consider an individual with an after tax income of $50,000. In this example, living expenses rise 3% per year due to inflation; income / salary keeps up with inflation, also growing 3% per year. Investment returns from the stock market are 7% per year.

Scenario I

This scenario is based on a savings rate of 50%, i.e. the individual starts out by saving and investing $25,000 per year. The investor maintains this 50% savings rate even as his or her salary grows—the number of dollars saved rises with each annual pay increase. For instance, when his salary rises to $60,000, the amount saved is $30,000 or 50%. After 17 years, the portfolio has grown to $1,048,437, driven by two factors (1) by saving regularly, an investor consistently adds funds to his or her portfolio (2) the money that was invested generates money on its own, i.e., the investor earns profits on their profits (compounding). Of course, expenses also rise over time. After 17 years, annual living expenses have grown to $41,321 due to the impacts of inflation. However, since the portfolio of $1,048,437 is 25 times higher than the living expenses ($41,321), it is possible to retire, even without social security or a pension. The bottom line is that with a 50% savings rate it is possible to retire in 17 years (Figure 1).

Figure 1. Years to Retire, Based on 7% Investment Return for Various Savings Rates



Scenario II
In some cases, FIRE practitioners have achieved savings rates of about 70%. They tend to work in professions with salaries that are substantially above average, particularly engineering. It may be argued that it is easier to save heavily with a high-paying job. There is truth in that contention. However, even the most cursory observation reveals that the vast majority of high-earners save little. For example, lawyers often feel that their profession obligates them to project a certain image which entails living an expensive lifestyle. In contrast, members of the international FIRE movement have been efficient stewards of their financial resources. With a 70% savings rate, it is possible to retire after 8 years of working (Figure 1).

Scenario III
The average savings rate in the United States is only about 6%. In this scenario, the individual starts out by saving and investing only $3,000 and maintains a 6% savings rate as his salary grows. Investment returns from the stock market are 7% per year, as in Scenario I.[2] Runaway expenses / expenditures of the sort considered in this scenario preclude early retirement—financing such high levels of sense gratification necessitates a $9.8 million dollar portfolio which would be accumulated after 72 years of work (Figure 1). If the goal is to stop working at age 65, it would be necessary to implement sharp, painful reductions in living expenses during the retirement years, mitigated perhaps by receiving social security, pension payments, or depending on individual circumstances, a large family inheritance.

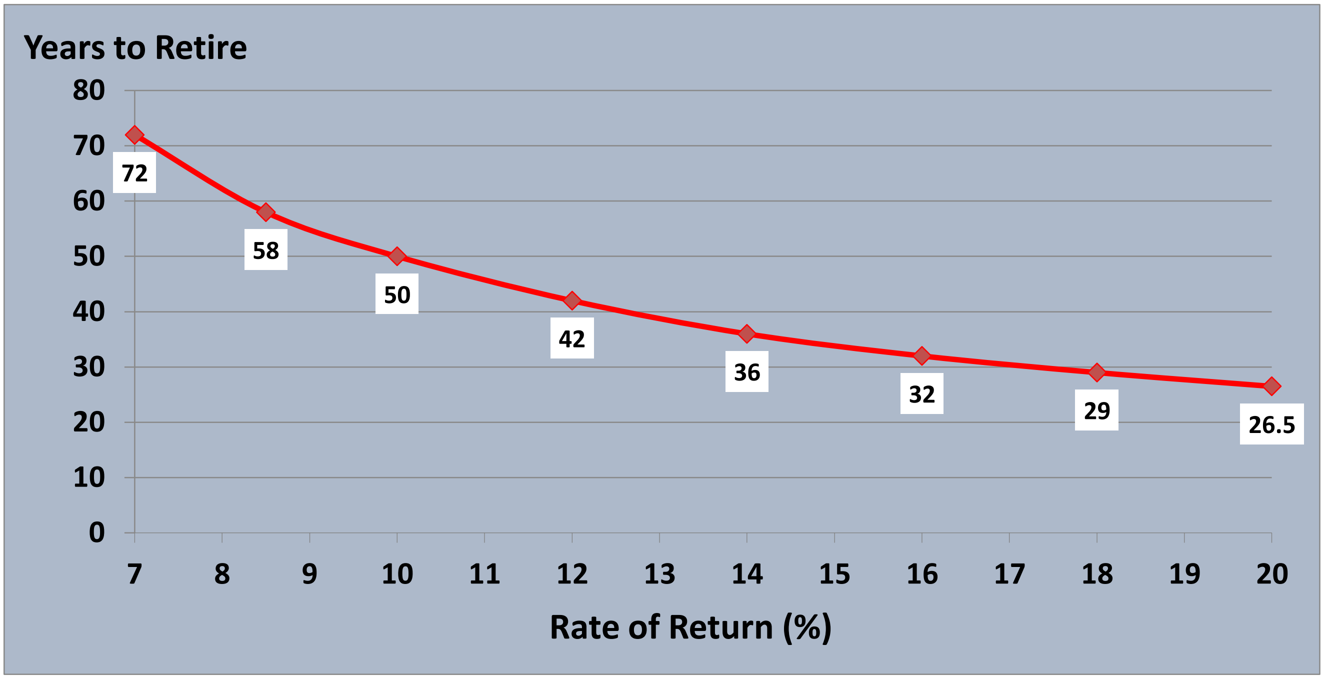
Some may argue that a 6% savings rate is a viable path to retirement because (1) in addition to their retirement accounts, they have also purchased a house (2) they can achieve investment returns that are well above the 7% figure assumed thus far in this article. However, based on the calculations presented in **A Place of Worship**, homeownership is an inferior method of building equity and is not a retirement plan. The remaining sections of this article show that there is no reasonable range of investment returns that would permit early retirement with only a 6% savings rate.

Austerity Dominates Investing Returns

In these scenarios, an individual earns an after tax income of $50,000. Living expenses rise 3% per year due to inflation; income / salary keeps up with inflation, also growing 3% per year. This simulation assumes a 6% savings rate. With an investment return of 7%, it is necessary to work 72 years before retiring, as already discussed in Scenario III. In the extremely unlikely event that the portfolio grows at double that rate (14%), an individual with a 6% savings rate must work for 36 years (Figure 2). In the late 1990s, many financial advisors posited that the stock market would grow at an annual rate of 20%. An assumed rate of return of this magnitude is a form of delusional arrogance. And even if one could generate 20% annual returns from their investments, it would still be necessary to work for 26.5 years before retiring, with a 6% savings rate.

[2] Clearly, the stock market does not advance in a smooth, straight line, which further underscores the importance of relying on variables that can be controlled—savings rates and the asset allocation of the investment portfolio.

Figure 2. Years to Retire Based on 6% Savings Rate for Various Investment Returns



Attempts to Beat the Market Doom Investors to Low Returns

Even when confronted with straightforward mathematics proving that early retirement is achieved mainly through controlling expenses / expenditures rather than high investment returns, individuals nevertheless cling to the hope of becoming brilliant investors in order to avoid austerity. Stock market participants typically attempt to increase their profits and outperform indexes by anticipating when the market is about to move higher and when it is due for a downturn. In contrast to long term investors that remain rigidly invested as the market exhibits oftentimes extreme gyrations, market timers hope to hold stocks when they are going up and sell them before they go down (buy low, sell high). The empirical evidence reveals that this hope is worse than an illusion because market timers actually end up with lower returns.

Most investors do vastly worse than simple indexes like the Dow Jones Industrial Average or the S&P 500, precisely because they attempt to beat the market indexes. Dalbar financial services is a Massachusetts-based consulting firm that carries out quantitative analysis of investor behavior. Their **research** has consistently found that average investors significantly underperform market indexes. For the 20 year period ending December 2017, Dalbar calculated that the average stock investor earned only 5.29% per year, badly trailing the average annual return of the S&P500 of 7.2%. Similarly, over the past 10 years, Dalbar calculated that the average stock investor earned only 4.88% per year versus 8.5% for the S&P500.

The average investor receives poor returns due to irrational behavior that is typically triggered by some sort of stimulus, e.g., a geopolitical event, news stories, or a hot tip from a colleague that distracts an investor from his or her long term goal. The Dalbar research finds that with their limited retention rates, the average investor does not stay invested long enough to execute a long term strategy, with a tendency to move into and out of investments too frequently. The average investor pays a high price for short term focus and market timing in the form of relatively low returns.

Conclusion

Useful insights can be drawn from the Financial Independence, Retire Early (FIRE) movement, despite the fact that its pioneers / leaders are **not** devotees. Happiness is not expensive. The key determinant of success at early retirement is a high savings rate that enables disciplined investments in a portfolio of broadly diversified stock indexes. There is no reasonable range of investment returns that would permit early retirement with only a 6% savings rate, which is currently the average in the United States.

Members of the international FIRE movement utilize a straightforward strategy that can also be implemented by devotees that have cultivated austerity, detachment, and the ability to remain steadfast in the face of upheavals and crises that plague our “modern” economic systems. Material assets have their proper, beneficial utilization, as a means to serve the Supreme Personality of Godhead. While working in Krishna Consciousness outside of ISKCON, a devotee can build the foundations for the next stage of life: financial independence, early retirement, and more intensive preaching activities.