



Jonathan Pond's One Pager

The Biggest Risk in Investing is Taking No Risk at All

No one wants to risk losing money, especially losing money on investments. But there are two kinds of risk: the kind you can see and the kind you can't. The kind you can't see is the risk that comes from inflation and what it means to the buying power of your dollars. Here's an example. At a 3½ percent inflation rate per year, your cost of living doubles every twenty years. It could go higher than that, although we all hope it will be lower. Alas, we can't predict these things, so it's best to err a bit on the high side when it comes to inflation estimates. At a 3½ percent annual inflation rate, for every \$20 you spend today, you'll need \$40 in twenty years, and double that again for the next twenty years. In forty years, for the \$20 you need today, you'll need \$80 to purchase the same items.

So let's consider someone at age forty-five whose living expenses are \$50,000 today. Assuming he retires in twenty years when he is sixty-five, he'll need to spend \$100,000 for the same expenses if inflation averages 3½ percent per year. In another twenty years when he's 85 and still going strong, he will need \$200,000 to enjoy the same purchasing power that he had forty years earlier. While your living expenses will almost certainly decline when you retire, the important thing to remember is that whatever your spending level might be, it will increase each year throughout your retirement due to inflation.

These numbers are pretty scary, I admit. But they show how much risk is involved in just letting your money sit and not grow enough to outpace inflation. Some fear investing because they can see the stock market go up and down and interest rates go up and down. That's the kind of risk you can see. So they think they should put their money somewhere where it will be safe, but that pays low interest. If you don't take into account what you can't see from inflation, you will really be missing the boat.

Now you may conclude that there is a risk in everything. And there is, but you can minimize the risk that you can see – the visible risk from investments. Inflation is an invisible risk – you can't see it and you have no control over it and everyone has to deal with it. You actually have more control over visible risk – that is the kind you have when you invest in stocks and bonds – because you can control how much and what kind of risk you take.