Mindful Advisory, LLC
Investment & Behavioral Insights

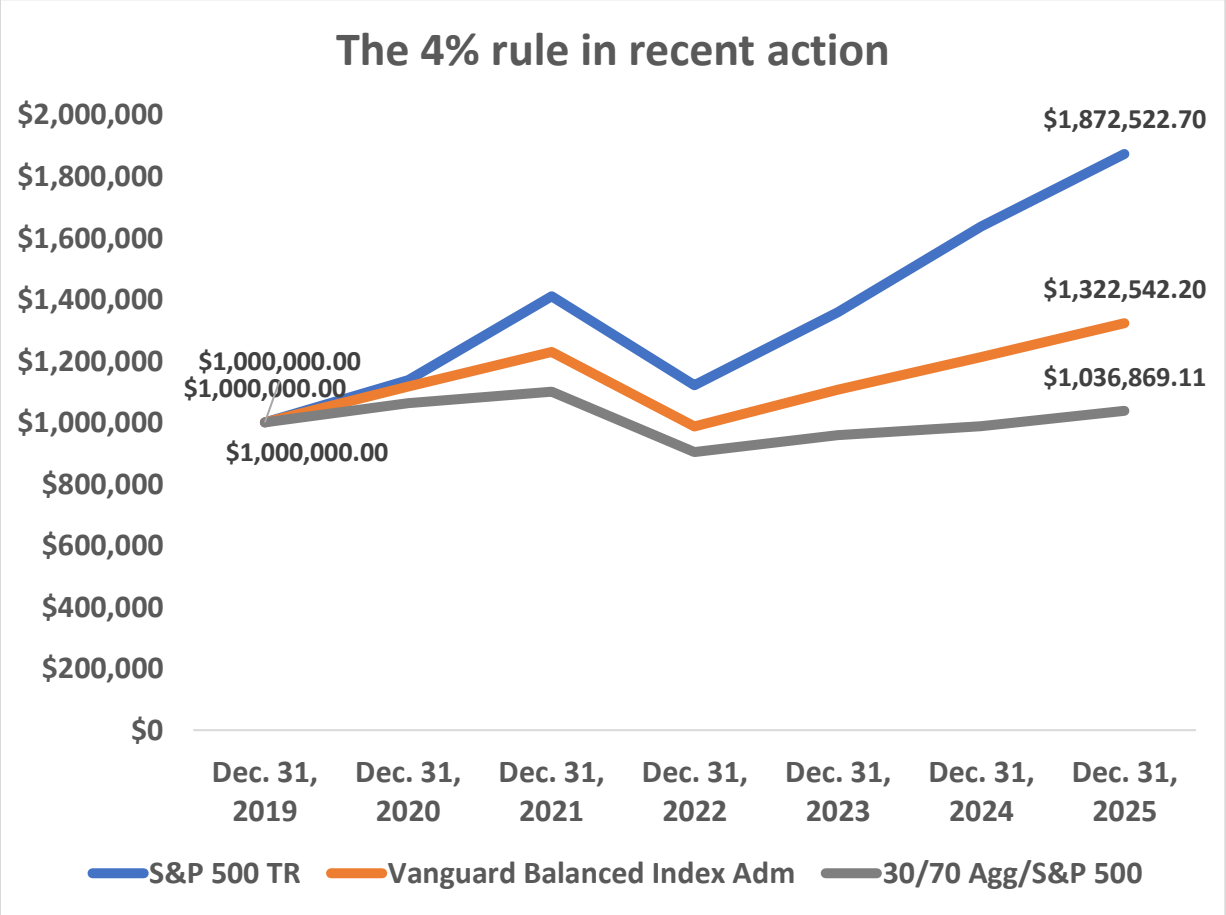
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Dear Investor,

Everyone knows the S&P 500 has gone gangbusters in recent years.

The main US stock index, including dividends, is up 15.1% annualized for the six-year period from 2020 through 2025, including an 18.1% swoon in 2022. This year, it's up another 13.4% through October 19.

Many analysts and commentators run simulations showing the growth of capital to emphasize how impressive these returns are. We did something different. We ran a simulation of three retirement scenarios starting in 2020 with $1 million.



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We distributed $40,000 (or 4%) on January 1, 2020 to three retirees from their $1 million, and invested the remainder in the S&P 500, the Vanguard Balanced Index (VBIAX) fund, and a 30/70 mix of the S&P 500 and Bloomberg US Aggregate.

In each subsequent year, we increased the distribution at the start of the year for the headline consumer price index (CPI) for the previous year, running the simulation through 2025.

The original $40,000 distribution turned into a $49,000 distribution by 2025, which includes inflation spiking 8% in 2022 and the 2023 distribution increasing accordingly.

All of this, of course, is a common variety of "the 4% rule" that many advisors use to help their clients distribute their assets in retirement.

It is important to note taxes and fees are not accounted for in this simulation, and that the simulation does not reflect an actual portfolio managed by Mindful Advisory.

Simulation shock

However, if the rule is commonplace, the results for this time period were astonishing. The retiree who invested all their money in the S&P 500 finished 2025 with $1.87m, even after six years of inflation-adjusted spending including an 8% spending increase in 2023 following headline CPI in 2022.

It turned out they could have taken much more than 4% in the first year. And if this hypothetical retiree exists anywhere, perhaps they should tap their savings harder and enjoy life a bit more now that they have 87% more capital than they started with. (Again, we didn't make any adjustments for taxes or advisory fees.)

The investor in the Vanguard Balanced Index fund finished 2025 with $1.32m. That's totally respectable, but also more than $500k less than the pure S&P 500 investor.

The Vanguard Balanced Index fund maintains a constant 60% stocks, 40% bonds allocation with the MSCI USA index serving as the stock portion's benchmark. That index has more midcap exposure than the S&P 500.

Finally, the conservative investor with only 30% stock exposure finished 2025 with $1.04m.

Each increased allocation to bonds led to a worse outcome. That makes sense not only because stocks did so well, but because the Agg hasn't been a great portfolio buffer, dropping 13% in 2022 and nearly 2% so far this year.

Sequence significance

That's not always the case, as another simulation your correspondent ran for the *Wall Street Journal* in 2019 showed. That simulation deliberately picked a poor period to retire, the start of the bursting of the technology bubble in 2000.

The hypothetical 2000 retiree faced two periods within a decade of the S&P 500 plunging 50% from top to bottom, the air coming out of stocks from the tech meltdown (2000-2002) and the great financial crisis (2008). Every additional dollar allocated to bonds during that period helped instead of hurt.

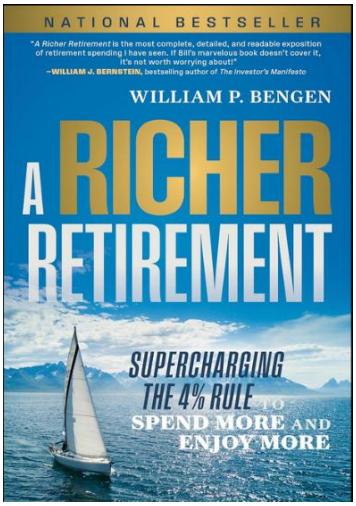
Even the dramatic recovery of stocks starting in March 2009 couldn't bring the all-stock portfolio back through 2018 due to the distributions combined with market losses in early years. The phrase used to describe a portfolio unable to bounce back from early investment losses combined with increased distributions is "sequence of return risk."

The 4% rule stems from Bill Bengen's original study in 1994, which ran simulations like this from 1926 trying to understand what people could spend from a portfolio of large-cap US stocks and government bonds, and have their money last for 30 years into retirement. It found that around 4% was a kind of worst-case scenario, which applied to the hypothetical October 1968 retiree.

That retiree, due to inflation, faced both increased payments to themselves each year and faltering stock and bond markets. So their money lasted 30 years only with an initial 4% distribution.

Bengen updated his study last year in a new book called *A Richer Retirement* to include more asset classes than U.S. large-cap stocks and government bonds. Adding small-cap stocks, mid-cap stocks, international stocks, micro-cap stocks, and U.S. Treasury Bills allowed the October 1968 retiree to have their money last 30 years starting with a 4.7% distribution in the first year.

That's a decent improvement over the 4.1% that retiree could take in the original study with less diversification, and it's worth contemplating now given the S&P 500's recent run.



Retirement resilience

"The future ain't what it used to be," New York Yankees legend, Yogi Berra, is reputed to have said. And so it may be for the S&P. Retirees may want to take the simulation above as a warning more than as encouragement. The S&P 500 may continue to perform decently, but it is unlikely to be as kind to investors over the next 5- or 10-year stretch as it has been in the recent past.

Bonds are paying what appear to be decent yields now. TIPS especially are trading with longer maturities, in many cases yielding 2%-3% above their tether to CPI, though they are better held in tax-advantaged accounts.

Finally, foreign stocks seem cheaper relative to their own histories than US stocks. Those who have grown accustomed to rolling their eyes when they hear this may be surprised to know that the MSCI ACWI exUS index in dollar terms has outpaced the S&P 500 over the past two years through October 19 on an annualized basis, 18.15% to 15.94%.

Bengen's updated study emphasizing greater diversification may be timely.

Behavioral Bias

Human beings are wired with "recency bias," making it difficult to look at the chart at the beginning of this letter and not think that pattern of the S&P 500 outperforming will continue.

It may continue, but we should be honest in admitting we simply don't know if it will. And there are at least some reasons to think performance that good isn't sustainable even if it continues to be satisfactory. Investors should generally question their tendency to assume recent trends or patterns will continue.

Respectfully Submitted,
John Coumarianos

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