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Impact of Biden Economic Policies on Americans' 401k and Other Retirement Plans

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Executive Summary

- The average 401(k) retirement savings plan has seen historically large nominal losses year to date of about $34,000 or 25%. In aggregate, these losses are approximately $2.1 trillion.
- Adjusting for inflation in 2022, 401(k) plans have lost more than 25% of their value as of Oct 10, 2022.
- Pension plans, in aggregate have sustained roughly a 15% decline, totaling $4 trillion in lost value.
- From President Biden's inauguration to October 10, 2022, the DJIA, NASDAQ, and S&P500 have declined 6%, 18%, and 6%, respectively.
- In 2022, the DJIA, NASDAQ, and S&P500 have declined 20%, 34%, and 25%, respectively. The bond market is down approximately 11% due to higher inflation and interest rates.
- Real assets in Americans' retirement plans have been declined sharply due to two factors: seven straight months of inflation over 8%, reaching 40-year highs, and the bear market in stocks. The primary cause of the surge of inflation from 1.4% in January 2021 to over 8% today has been the $4 trillion of government spending financed by debt.

Background

After the brief but deep recession in the first half of 2020 related to Covid and the government-imposed lockdowns, the economy in the second half of that year saw a very rapid recovery with economic growth of 35.3% in the third quarter and 3.9% growth in the fourth quarter as the economy reopened. The economy in the second half of 2020 grew at an annualized rate of $1.5 trillion. In 2021, economic growth slowed, before turning negative for the first half of 2022. At the time of this writing, both we and the Federal Reserve Bank of Atlanta estimate that real economic growth in the third quarter of 2022 will be positive, but we estimate that real economic growth will be near zero for the year in toto, based on the latest data available.

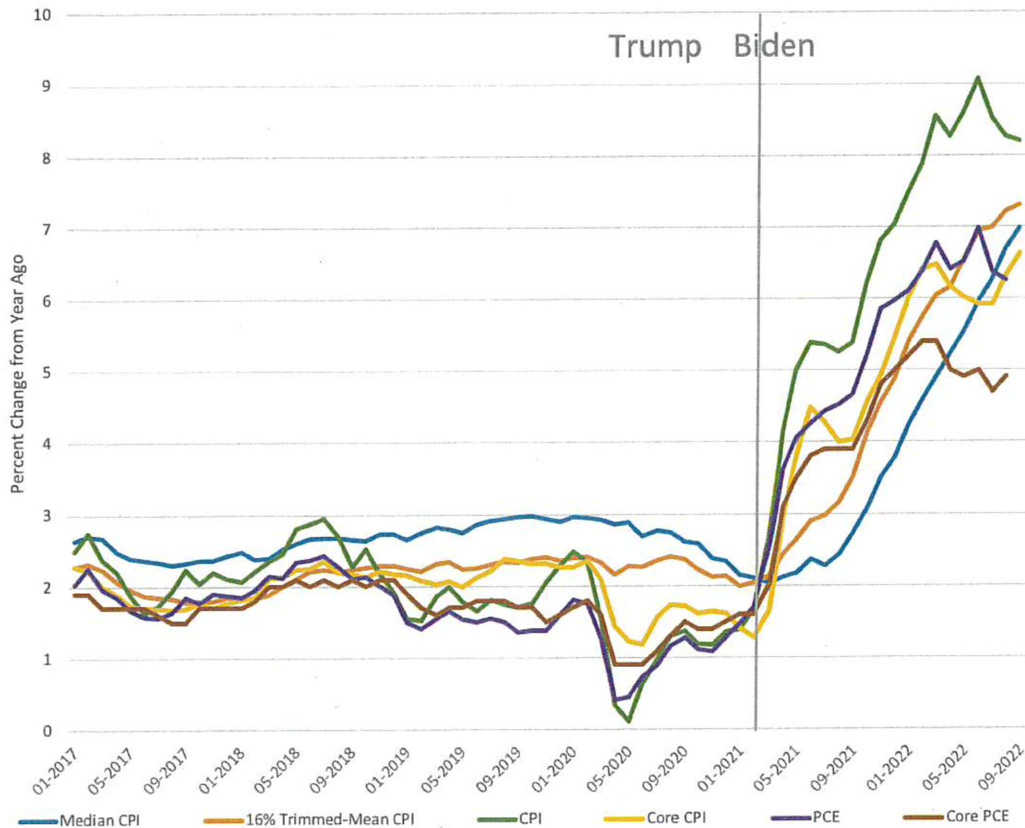
Throughout 2022, many leading economic indicators have trended downward. They are too numerous to mention them all here, but we offer three examples weighing on markets. First, the yield curve on 2- and 10-year Treasuries is more inverted than at any time in the last four decades. This reversal of the normal yield curve has proven a relatively reliable predictor of recession and has always preceded recessions when it reaches the extreme levels of inversion seen this year.

Another sign of recession is the collapse of new orders, both in the manufacturing and nonmanufacturing sectors. Because of an unprecedented level of backlogs from the prior two years, unfilled orders at businesses remains high, but is quickly declining as businesses work through their backlogs. Current output levels are being sustained not by growth in new orders, but by

the completion of unfilled orders. Once those backlogs are gone, however, output levels (and employment levels) cannot be sustained without healthy increases in new orders, which have not yet materialized and seem unlikely to do so. Faced with this reality, many businesses will likely see declines in revenues and sales in the near future.

Another consideration is Inflation, likely the most negative force on the economy. Figure 1 shows various measures of inflation in the Trump years and so far in the Biden presidency. The consumer price index has accelerated from 1.4% in January 2021 to 8.2% in September of 2022. Higher inflation means higher interest rates. The 10-year Treasury yield has spiked from 1.10% to 3.97% in less than two years. The average fixed rate on a 30-year mortgage has risen from 2.73% to 6.92%.

Fig. 1: Six Measures of Inflation



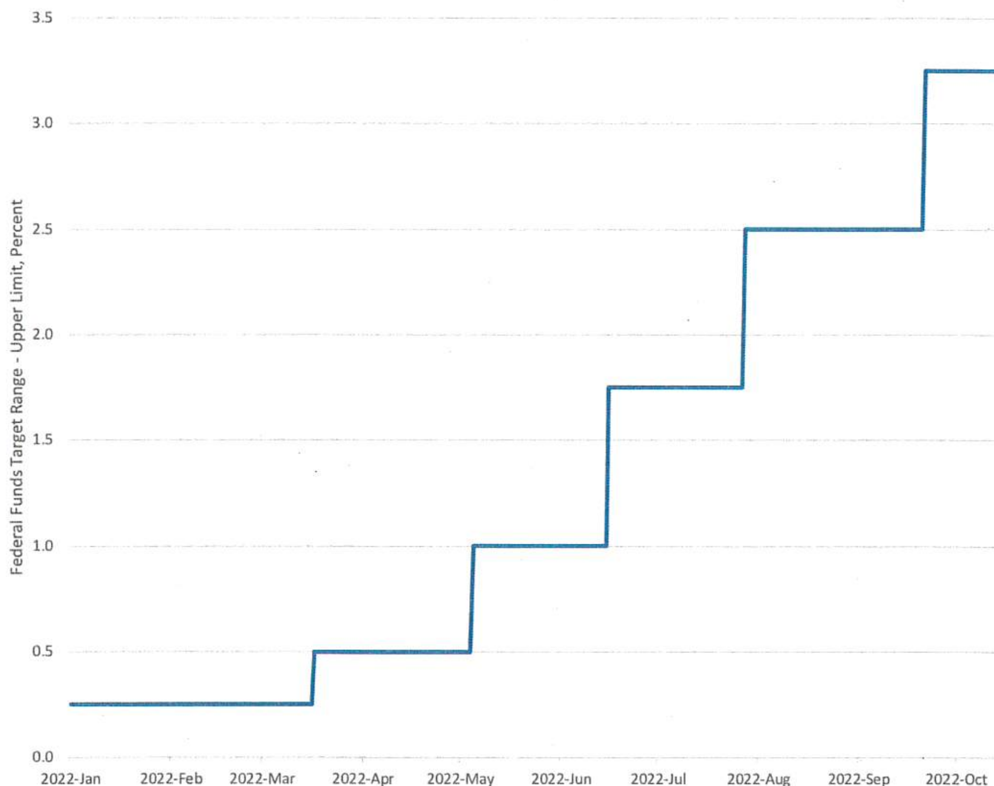
Source: Federal Reserve Banks of St. Louis and Cleveland

Every time prices increase at the pace seen in 2022, a recession has always followed. The idea of a "soft landing" engineered by the Federal Reserve has largely been replaced with the understanding that the central bank is engineering a recession to reduce inflation. While it is difficult to overstate the Federal Reserve's impact on financial markets, the central bank itself is currently operating under constraints imposed by federal deficit spending.

Impact and Constraints of the Federal Reserve

Thus far in 2022, the upper limit of the federal funds rate target range has increased from 0.25% to 3.25% as shown in figure 2. This is the fastest pace of rate increases in 40 years. Likewise, inflation in 2022 has been higher than at any point in the last four decades. These historically fast rate increases have substantially chilled financial markets and impacted both the stock and bond markets, contributing to recession fears, liquidity concerns, and other potential financial fallout.

Fig. 2: Interest Rate Increases in 2022



Source: Board of Governors of the Federal Reserve System

As Congress and the President continue adding multi-trillion-dollar spending bills to the budget, the US Treasury must auction more bonds. (This can be viewed as either increasing demand in the total loanable funds market or decreasing supply in the private loanable funds market.) The result of this infusion of government spending for mostly welfare and suboptimal "green" energy policies pushes up federal borrowing which fuels inflation. Since the Federal Reserve targets nominal interest rates, the central bank responds to the Treasury's excess borrowing by providing extra liquidity, which prevents interest rates from rising to their natural level, but also fuels inflation. Higher interest rates are needed in the face of excessive federal deficit spending, which dampens financial markets. Borrowing by the federal government essentially crowds out borrowing by the private sector.

Historical Perspective

So far, 2022's investment declines are firmly in bear market territory. Data from the last 95 years demonstrate that the losses this year in both the stock and bond market are large enough to be considered historical outliers, though not record setting. Historically large estimates of portfolio losses, therefore, are aligned with the data.

As figure 3 shows, there have only been four years in roughly the last century in which both nominal stock and bond returns have been negative. Both 1931 and 1941 were during the Great Depression while 1969 was a year of increasing nominal interest rates, slowing real economic growth, and accelerating inflation which preceded the 1970 recession. The fourth occurrence is 2022, another period of increasing nominal interest rates, accelerating inflation, and low, if not negative, real economic growth.

Fig. 3: Nominal Stock and Bond Returns by Year, 1928-2022

Over these 95 years, 96% of them saw positive returns for bonds, or stocks, or both. The investment losses sustained thus far in 2022 are far outside the historical norm. In fact, even among the four outlier years which saw negative returns on both stocks and bonds, 2022 had the second worst performance. The equally weighted sum of returns on stocks and bonds was -14.8% and -13.3%

in 1941 and 1969, respectively. The same return in 1931, arguably the worst year of the entire Great Depression, was -46.4%. Yet, 2022 has thus far seen a return of -34.5% which is more than twice the decline of either 1941 or 1969 and on pace to nearly reach the historical decline of 1931. Conversely, the best combined return was in the red-letter year of 1995, where stocks and bonds summed together a 60.7% return.

Only five years in about the last century have seen stock market declines worse than the current year. In terms of bonds, only 2009 had worse returns as the mortgage-backed securities (MBS) financial derivatives market was melting down and the Federal Reserve purchased over $900 billion in MBS alone in an attempt to stabilize the free-falling market.

More than a third of the data points in the last 95 years show a positive return for either stocks or bonds and a negative return for the other. Some market factors have opposite effects on stocks and bonds, such as volatility. Increased uncertainty can cause a "flight to safety" where investors shift portfolio allocation away from stocks and into bonds. While the increased demand for bonds can drive down the yield on bonds being issued today (bond demand and yields are inversely related), the price on existing bonds rises. Thus, bond holders can sell their investment for a higher rate of return. It is not surprising, therefore, to see about a third of the data points showing one market with positive returns and the other with negative returns.

Retirement Savings: 401(k) Plans and Pension Funds

Utilizing data from several financial services firms including Fidelity Investments, Investment Company Institute, Vanguard, and Wells Fargo, we estimate approximately 40% of the workforce, or 60 million Americans, have 401(k) plans. In addition to 401(k) plans, millions of Americans also own stock through direct ownership or in other retirement accounts besides a 401(k), or through pension accounts. Typically, between 60% and 80% of these retirement holdings are in stocks and most of the rest in bonds. Target date funds commonly shift from stocks to bonds as the plan holder approaches retirement.

In approximating losses for Americans' retirement savings, we have aimed to make our estimates conservative and err on the side of caution. (Data from Fidelity Investments, for example, show the average 401(k) plan's balance declining 21% in the first half of the year alone, before any third quarter losses are included.) Since the most recent precise portfolio allocations are unavailable, we have placed slightly less numerical weight on those sectors or indices which have the worst rate of return in 2022, while slightly increasing the numerical weight on those sectors or indices with the best rate of return. We also assume the net effect of various portfolio optimization strategies, such as rebalancing, sum to zero in aggregate.

We estimate that 401(k) plans began the year with over $8.1 trillion in assets, having grown approximately $800 billion in the fourth quarter of 2021, an increase of about 11%. From the beginning of the year to the time of this writing, the Dow Jones Industrial Average declined 20%, the S&P500 declined 25%, the Russell 2000 declined 25%, and the NASDAQ declined 34%, while bond prices have declined about 11% (figure 4). Assuming about 60 million 401(k) plans, the

average account contained over $135,000 in assets at the start of the year. These accounts have lost an average of about 25%, or $34,000 each, falling to about $101,000. That is a total loss across all plans of nearly $2.1 trillion.

Fig. 4: Declines in Major Indices Since Jan. 20, 2021

The historic inflation of 2022 has also decreased the purchasing power of the nominally priced assets in 401(k) plans. Adjusting for inflation this year yields a real asset level even lower the $101,000 above. The average 401(k) plan has lost almost $6,000 in purchasing power this year, bringing the average plan's real value (in 2021 dollars) down to $95,000. That is a real decline of just under 30% in less than a year. Table 1 shows the estimated losses for different sizes of 401(k) plans. We assume identical asset allocation for plans regardless of size so that nominal and real losses are proportional across starting balances.

Table 1: 401(k) Plans Nominal and Real (2021 Dollars) Year-to-Date Losses

1/3/2022 Balance	$100,000	$135,000	$200,000	$300,000	$1,000,000
YTD Nominal Loss	$25,000	$34,000	$51,000	$76,000	$254,000
YTD Real Loss	$30,000	$40,000	$59,000	$89,000	$296,000

Pension funds began 2022 with $27.8 trillion in assets, but that level fell to $27.4 trillion by the end of the first quarter and then to $26.3 trillion by the end of the second quarter. We estimate the level has since declined to $23.8 trillion, nearly a 15% decline from its peak at the beginning of 2022 and a loss of about $4 trillion. We have not made an estimate for losses to the average pension plan.

While these estimated losses to retirement savings are outside the historic norm, we point to the atypical losses in both the stock and bond markets as the basis for these figures. As outlined above, the first three quarters of 2022 have placed it in notorious company in terms of return on investment, being one of only four years in which both bond and stocks returns are negative. Furthermore, 2022 is one of the worst years for either stock or bond market returns, a deadly combination that has left investors to choose among the least negative alternative.

Concluding Comments

In a previous study, we estimated that the average household during Biden's presidency has lost between $4,000 and $7,000 in purchasing power, depending on the chosen metrics, due to consumer prices rising faster than wages and salaries. Paychecks have been shrinking in terms of purchasing power because, despite nominal increases of almost 7% since January 2021, prices have risen over 13%. For the average worker, that is a real decline of 5.5% in annual wages, amounting to over $3,000. In a typical household with two parents, each with average earnings, the decline is $6,000 in annual purchasing power.

This study finds a similar negative effect on savings, especially retirement savings in popular 401(k) plans. This has inflicted considerable financial losses for senior citizens or those in the baby-boom generation who are nearing retirement. For a married couple where each person has the average balance in their retirement account, their $270,000 in savings has decline about $80,000, which can be nearly the equivalent of a down payment on a retirement home.

In this way, Biden's economic policies have not only negatively affected the real take home pay of middle-class American workers but have also effectively stolen tens of thousands of dollars of lifetime savings.

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