

# thoughts

FROM HANSON+DOREMUS



## Fall 2026

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### WHAT'S INSIDE THE ISSUE

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#### 2 What can I spend in retirement?

It's one of the most important questions in financial planning, and one without a simple answer. We explore the tools and frameworks that help us navigate it.

*By Evan Pemberton*

#### 4 Our view of the stock market today

With stocks near all-time highs at the time of publishing, we take a look at the two main factors that drive share prices.

*By Anne Doremus*

#### 6 A certain kind of Fed Chair

Mark looks back on his time at the Fed, a memorable phone call, and eight years of watching Jerome Powell navigate one of the most difficult jobs in public service.

*By Mark Andrews*

#### 8 1873 and the AI Boom

Why did Microsoft's CEO recommend a book about a 19th-century financial crisis during the AI investment boom? Neil explores what Liaquat Ahamed's latest book can teach us about investing in transformative technologies.

*By Neil Macker*

#### 10 Chart of the Quarter - Who shows up to vote in a midterm election?

From Visual Capitalist, an infographic on midterm voter turnout by generation.



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# What can I spend in retirement?

One of our main tasks as financial advisors is to answer the question, “What can I spend from my investment accounts in retirement?”

There are many variables that factor in—your age at retirement, asset allocation, financial market returns, and when you might file for Social Security, to name a few. And there are some familiar rules of thumb, like the 4% withdrawal rule, that look to collapse all that down into a simple answer. However, in practice, determining an approach to sustainable spending can be more nuanced. As advisors, we love nuance and spend a lot of time thinking about it! At the risk of getting a bit technical, we thought we’d take a look under the hood of the retirement planning process.

First, let’s understand how spending typically changes over the course of retirement.

Each retirement is different, but, for many people, spending often shifts through a few distinct phases (popularized by financial planner Michael Stein in *The Prosperous Retirement*):

- **The “Go-Go” years**—retirees are usually still healthy and active and spend more on travel, entertainment, and hobbies. They may also be paying down a remaining mortgage

balance.

- **The “Slow-Go” years**—activity levels and travel often decrease with age, reducing spending on travel, entertainment, and hobbies. Mortgages may be paid off and living expenses become more predictable.
- **The “No-Go” years**—healthcare and potential long-term care needs become more prominent and can push spending higher, sometimes sharply.

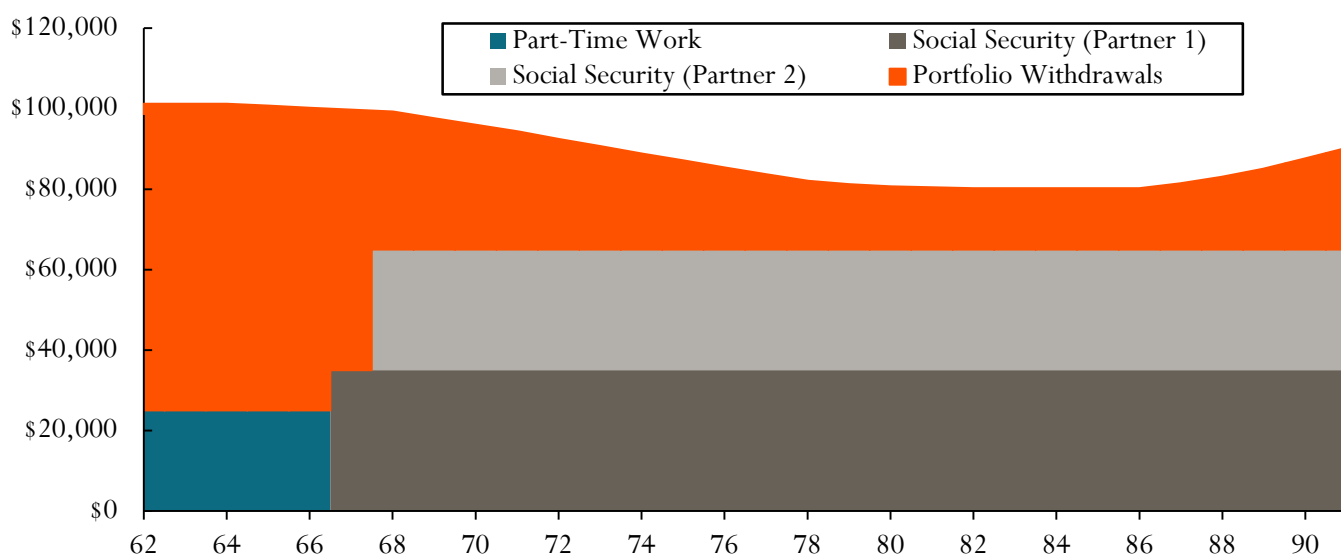
These changing pressures help explain the “Retirement Smile” (coined by researcher David Blanchett), or vaguely “U-shaped” pattern. But that doesn’t mean portfolio withdrawals necessarily follow the same pattern, since other forms of retirement income play a role. In the early years of retirement, for example, individuals may delay filing for Social Security to increase their monthly benefits. That can mean higher portfolio withdrawals initially. At the same time, retirees might still work part-time during the Go-Go years, which can offset the need for withdrawals. When we combine changing spending needs with the stag-

gered start of retirement income, portfolio withdrawals can end up looking like a hatchet—the “Retirement Distribution Hatchet” (described by Derek Tharp and Justin Fitzpatrick on Kitces.com), illustrated in orange in the stylized chart below.

So that’s the general pressure an investment portfolio might feel in retirement. And while it’s great to have a sense of how spending varies over time, it doesn’t neatly match rules of thumb like the 4% rule, which sets an initial dollar withdrawal and then increases it with inflation. Nor does a spending pattern tell us what happens if the market decides to misbehave. So how do we account for both?

Financial planners and advisors commonly use software to model these more realistic, uneven spending patterns. This involves entering clients’ spending goals, retirement income, investment assets, and asset allocation, along with assumptions about lifespan, taxes, inflation, and investment returns. In essence, we map out the hatchet—or whatever tool (a saw?) your particular retirement goals might resemble. The planning software then runs 1,000 scenarios with different

## HYPOTHETICAL RETIREMENT SPENDING PATTERN



Source: Author; Kitces.com

sequences of market returns, some bad and some good, and calculates how many leave enough money to fund the retiree's goals throughout the planning period. This is called Monte Carlo simulation, and its "probability of success" is simply those successful trials as a percentage of the total. Advisors can then solve for a comfortable probability of success, say 80%, by adjusting portfolio income and spending needs.

Monte Carlo gets us much closer to a useful retirement plan. But the analysis isn't dynamic, those scenarios assume the retiree sticks to the planned spending path regardless of what markets do. That leaves out one of the main things individuals can control each year: how much they spend. You thought we were already in the weeds? Enter the "guardrails."

Jonathan Guyton and William Klinger ("G-K" from now on) proposed a set of retirement spending rules they dubbed "financial guardrails," in a 2006 *Journal of Financial Planning* article. Similar to

the 4% rule, G-K starts with an initial withdrawal amount. For illustration, that might be \$4,200 a month from a \$1 million portfolio—a 5.0% annual withdrawal rate. Withdrawals generally rise with inflation, but G-K adds rules for maintaining or adjusting them. Instead of committing to one spending path from the outset, the retiree cuts withdrawals if they become too large a share of the portfolio's value, and increases them if they become sufficiently small. Simply put, a large enough market decline can trigger a cut, while strong gains can permit a raise (see figure below).

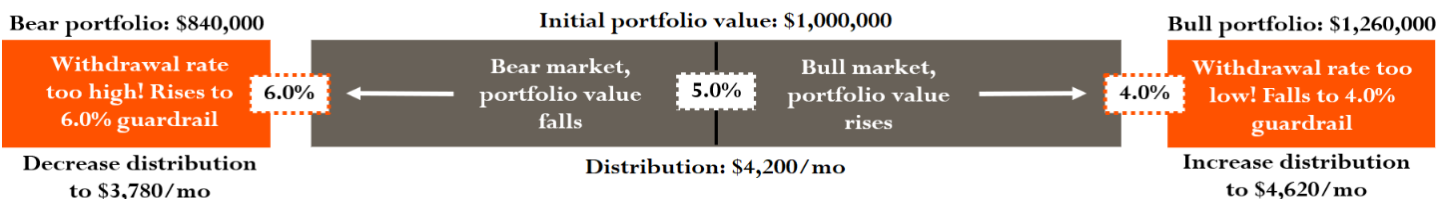
This dynamic approach can support higher initial withdrawal rates and greater overall retirement spending in modeled scenarios because making cuts in difficult periods prevents selling assets in down markets. The tradeoff is that it requires a willingness and ability to adjust spending, sometimes accepting lower income for an extended period.

And that flexibility is the real crux

of it. We never know what the market will throw at us or deliver in terms of returns. The whole exercise of financial planning offers guidance, not certainty, because reality rarely unfolds according to the neat assumptions we enter into a software program. An asset allocation, across stocks, bonds, and cash, tailored to an individual's investment objectives and risk tolerance can help us weather many storms. But the willingness and ability to adjust our spending and, if necessary, our lifestyles, may be the most powerful hedge we have against bad states of the world.

So, "What can I spend in retirement?" So much of any recommendation depends on the nuance of individual situations. While we can't offer a pat answer, we can endorse a process for arriving at reasonable guidelines. Our obvious bias is to seek the help of a trusted advisor, one who can choose among these tools and help adapt the plan as circumstances change. 🧠

## G-K GUARDRAILS, ILLUSTRATED



Source: Author, Guyton and Klinger, SurgeTK

# Our view of the stock market today...

“In the short run, the market is a voting machine...but in the long run, the market is a weighing machine.”

—Benjamin Graham, as quoted by Warren Buffett

How long can the market keep moving up? This is one of the most common questions we get these days, and for good reason. Over the past three years, the S&P 500 has produced an average annual total return of just over 23%. While we have seen strings of strong returns before, this rate is more than double the 10% average stocks have provided over the long term.

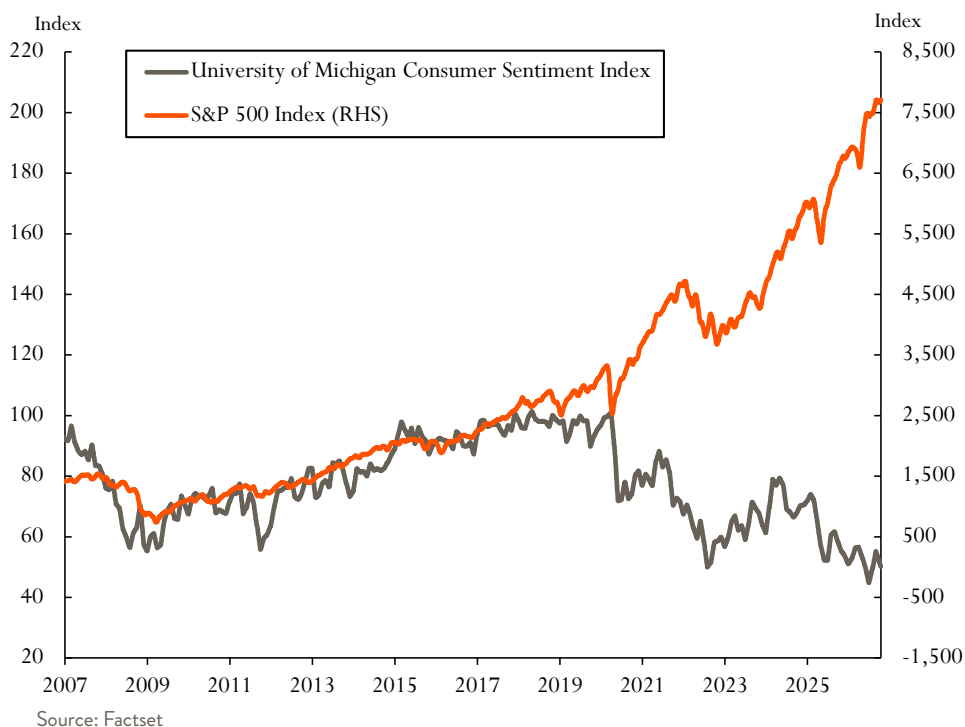
What seems particularly confounding is that these gains have occurred amid so many economic and political headwinds. While each of us will have our own list, mine is topped by rising interest rates. Higher rates can dent corporate profits by making borrowing to fund inventories, expand production, and increase payroll more expensive. Higher bond yields also make bonds more attractive relative to stocks. Why accept the risk of owning stocks, you might ask, if government bonds yield over 5% and even your money-market fund is paying a nice, comfortable 3%–4%?

Companies and consumers also face inflationary pressures from rising fuel costs and higher tariffs. Finally, and perhaps most puzzling, is the mood among U.S. consumers. As the chart at right shows, consumer sentiment is now below the lows reached during the 2008 financial crisis. How can the outlook for corporate profitability, and by extension the markets, be so bright when consumers, whose spending typically drives roughly two-thirds of economic activity, are so in the doldrums?

While stock prices can behave irrationally over shorter periods, there are good reasons for the market's strength today. At the most basic level, two factors drive stock prices: 1) the level of (and rate of change in) corporate earnings, and; 2) the valuation that investors place on those earnings. Let us examine where both measures stand today.

From 2022 to 2025, S&P 500 company

## CONSUMER SENTIMENT AT ALL-TIME LOW, STOCKS NEAR ALL-TIME HIGH



earnings grew at a 12.6% average annual rate—more than twice the 5%–6% long-term historical average. A look into the earnings of constituent companies reveals the source of these gains. Over the period, the tech and AI-focused “Magnificent 7” (i.e., Apple, Amazon, Alphabet, Nvidia and the like) grew earnings by just over 30% annually while earnings growth for the rest of the market came in at an anemic 3% rate (see chart opposite). This year, S&P 500 earnings are expected to expand by more than 30%, according to J.P. Morgan.

While AI-related companies are doing most of the heavy lifting, other forces are contributing as well. Higher oil and commodity prices are fueling profits at energy and basic materials firms. And despite weak consumer sentiment, consumers are still spending. The two aren’t necessarily at odds. Surveys capture attitudes across the income spectrum, but higher-income

households do the bulk of spending. Many have benefited from rising stock and real estate prices, creating a “wealth effect” that helps sustain consumption even as the broader mood remains depressed.

So, what about valuations? The price-to-earnings (P/E) ratio measures what investors are willing to pay for corporate earnings and reflects, among other factors, investor sentiment or how optimistic or pessimistic they feel. At the end of the third quarter, the S&P 500 traded at 19x expected earnings, slightly above its 17x long-term average. A year ago, that multiple was around 23x. While this metric suggests that valuations are not particularly stretched, there are a few caveats to keep in mind.

First, the larger, growthier corners of the market (largely technology-related) are trading 10%–35% above their 20-year average P/E levels, according to J.P. Morgan. The strong outperformance of these firms has left broad market benchmarks highly

concentrated. Consider that the top ten largest companies in the S&P 500 index today represent a record high 40% of its total value. Any stumble in the outlook for these firms will have a disproportionate impact on the market at large.

Second, what we are willing to pay for expected earnings depends on our confidence in those estimates, and earnings visibility today is particularly murky. The uncertain outlook for AI-related spending levels rightfully tops the list of investors' concerns. The current rate of spending will inevitably slow, but how and when this occurs is anyone's guess. Supply chain bottlenecks, safety concerns, or

regulatory issues could force a pullback in spending, while rising costs could make customers more careful about how they incorporate these tools into their workflows.

What is the average investor to do in the face of this uncertainty? The best advice is to resist the temptation to sidestep a downturn by jumping into and out of the market. That approach requires getting two decisions right: when to get out and when to get back in. As much academic research has shown, the odds of success in this endeavor are slim.

The better strategy is to understand your investment horizon (when you need

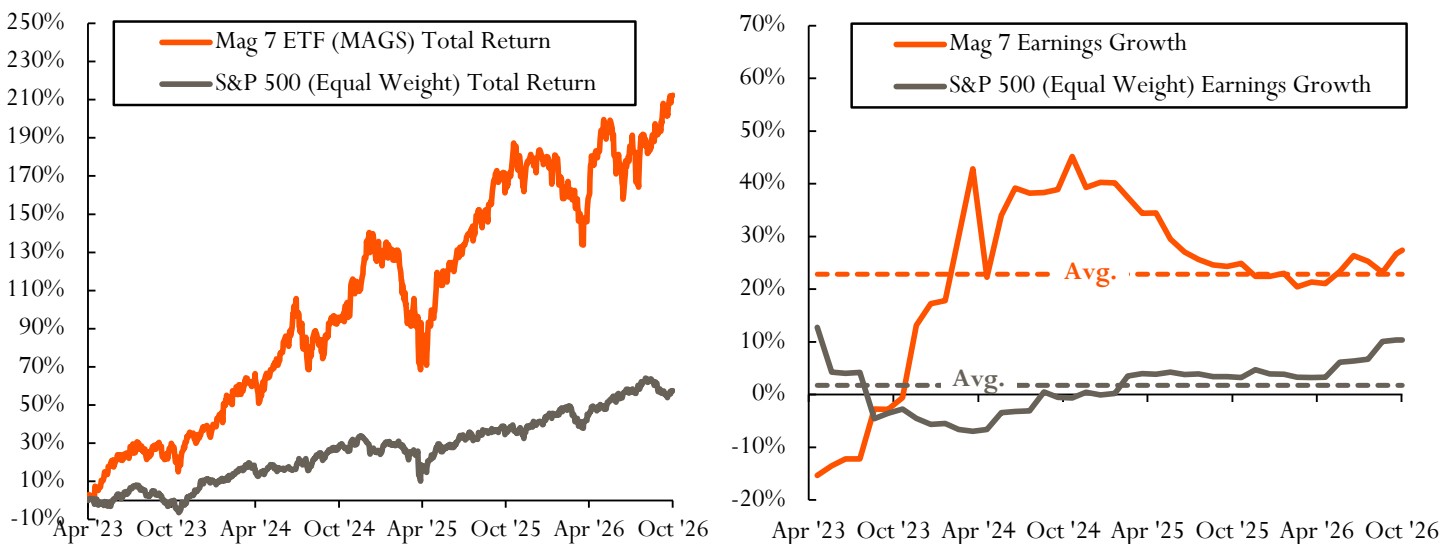
access to your funds) and your own risk tolerance. How much pain (read: losses) can you endure before being tempted to sell? With this information in hand, you can develop a mix of stocks, bonds, and cash that lets you sleep at night while also seeking a return that suits your goals.

We began this article with one quote, and we'll end it with another.

"Knowing yourself is the beginning of all wisdom."

—Aristotle 🍷

### TOTAL RETURN AND EARNINGS GROWTH FOR THE "MAGNIFICENT 7"



Source: FactSet. "Equal Weight" gives each stock equal weight, regardless of market capitalization. Earnings growth in this chart is measured before interest and taxes (EBIT), year-over-year—averages are for period shown in chart.

# A certain kind of Fed Chair...

The Fed's mandate sounds straightforward enough: keep inflation low and stable and support a strong job market. Doing so is another matter.

Between the summer of 2016 and the end of 2022, I worked in the New York Fed's Markets Group—the team responsible for implementing monetary policy decisions and monitoring financial markets. My time there gave me an appreciation for the difficulty of the job and the judgment and character of the people called upon to do it. As Jerome Powell exits the Fed, I want to share some reflections on the important role of Fed Chair and a public servant I came to admire.

Financial market participants love a good doomsday moniker. Over the years, there have been all kinds: the “SaaS-pocalypse” earlier this year, the “Repo-calypse” of 2019. Don't worry about what they mean. If your job is in financial markets, especially if your job is to monitor developments and brief policymakers, days when things are imploding are always big days. One I'll never forget is the “Vol-pocalypse” of 2018. It was also the day I got a phone call from Jerome Powell.

Monday, February 5th, 2018, was Powell's first day as Chair of the Federal Reserve. Coincidentally, it was also my first day staffing the policy briefing “Desk” in the Markets Group. Financial markets didn't care about any of that. Stocks were tumbling, and massive “short volatility” bets that depended on relatively calm markets were blowing up.

At around 4 p.m., the phone rang.

“Markets, this is Mark.”

“We have Chair Powell on the line...”

I have no idea what I said next, but that call was my first encounter with Jerome Powell. In the years that followed, I watched every one of his press conferences, through the pandemic, the inflation surge of 2022, the banking crisis in 2023, tariffs in 2025, and every “apocalypse” mentioned above. This is a personal history of sorts, so I won't hide my bias: Powell was the consummate public servant. He had a strong sense of duty grounded in the Fed's mandate, an appreciation of what he

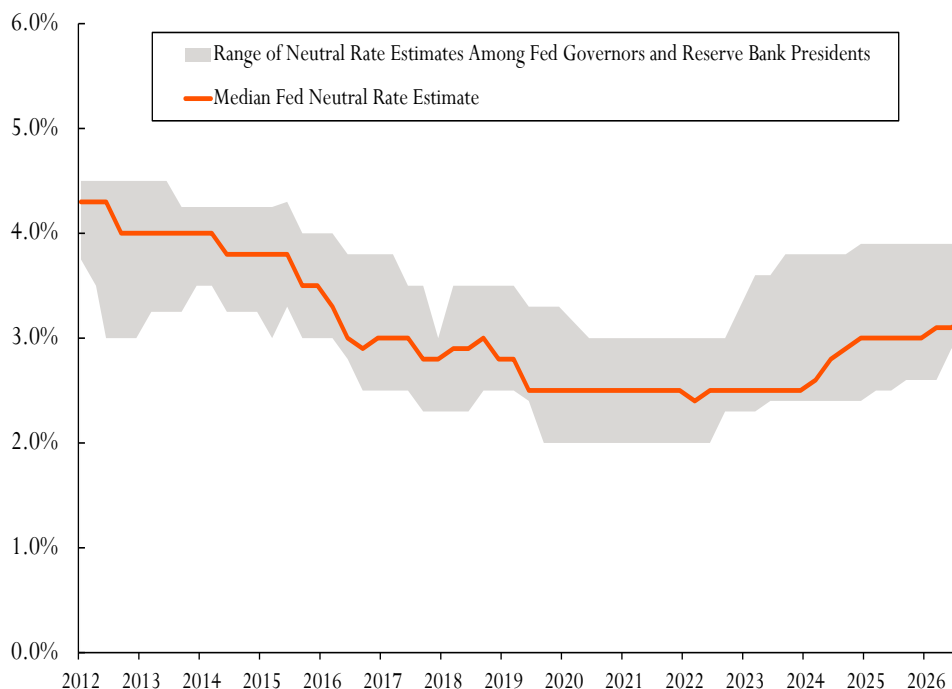
didn't know, and little interest in making himself the center of attention.

That does not mean he got everything right. Getting it right matters immensely, but so does the character with which a Fed Chair faces uncertainty, because the job requires acting in a world that does not offer easy answers. The questions and conditions change from one crisis (or apocalypse) to the next, and the playbook has to change with them. Financial markets and the economy don't explain themselves with neat “fundamental” drivers, as badly as we'd like to account for every zig and zag. Maybe that sounds obvious, but it is easy to overlook how much certainty we demand from our central bankers. The pressure to get it right is enormous.

Inside the Fed, the drive to make sense of things can be intense. A Fed Governor once asked me to quantify the extent to which investors' efforts to manage the risk in mortgage-backed securities might be exacerbating a sharp increase in Treasury yields. He interrupted my nuanced (and I'm sure highly competent) explanation of “convexity hedging,” demanding to know exactly how many basis points—hundredths of a percentage point!—the 10-year Treasury yield had moved as a result. What he wanted was a degree of precision no evidence could support.

Of course he wanted a precise and reliable answer. But those are hard to come by—even the basic guideposts that help policymakers set interest rates leave plenty of room for judgment. Higher rates generally make borrowing more expensive and slow spending; lower rates encourage it. The so-called “neutral rate” is the level that neither heats up nor cools down the economy. Central bankers use it to judge whether they have their foot on the gas or the brakes, yet the neutral rate itself cannot be observed directly. As Powell often put it, “we know it by its works.”

## FED OFFICIALS DISAGREE ON THE NEUTRAL RATE BY A WIDE MARGIN



Source: Federal Reserve Board Summary of Economic Projections; Long run estimates of the Fed Funds rate are used as a proxy for the neutral rate

Measures of financial conditions also help inform officials how easy it is to access credit, but they combine a whole mess of inputs, and someone has to decide how to weight them. Economic indicators are far from perfect, too. Employment data rely on household surveys, many conducted—*gasp*—by phone. Even the all-important inflation number is measured several ways, and different components might matter more at different times. Meanwhile, the effects of interest rate decisions can take a long time to work their way through the economy, arriving with those famous “long and variable lags.” How’s all that for certainty?

Still, the job requires making decisions, explaining them, and accepting responsibility for their consequences. Even as the Fed was late to recognize how persistent post-pandemic inflation would be, Powell was transparent in laying out how he saw things, what might change his mind, and acknowledging what he didn’t

know. Once the incoming inflation data convinced him, the Fed acted firmly. All along, Powell was frank about the pain both inflation and higher interest rates would cause households.

On top of economic uncertainty and monetary policy decisions, Powell had to weather an unusually contentious political environment. Twice a year, the Fed Chair testifies before Congress. Lawmakers on both sides often use the occasion to grandstand, asking rhetorical questions designed to produce soundbites that play well with their base. Powell refused to take the bait. Even when a question struck me as absurd, he took it at face value and answered thoughtfully.

That made it all the more striking when Powell did speak up. Earlier this year, political pressure escalated to threatened criminal charges. Powell defended the Fed’s ability to make decisions on economic grounds, keeping the focus on the office, not the officeholder. He let the

many personal attacks pass but drew the line at threats to the institution’s independence.

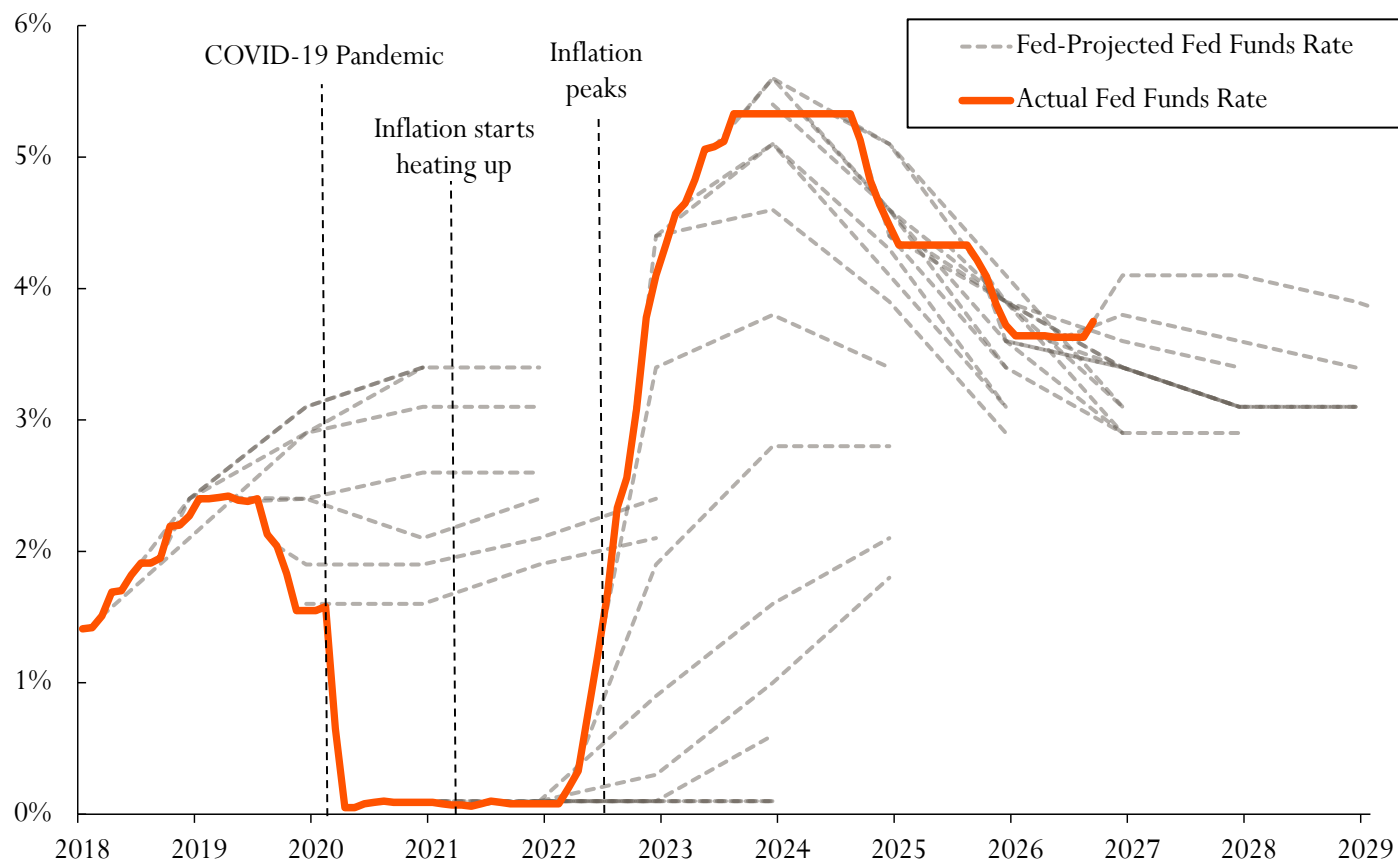
And that independence matters well beyond Powell’s tenure. It allows the new Chair, Kevin Warsh, and those who follow him to make difficult decisions with imperfect information, free from political coercion. The strength of our institutions depends on the integrity of the public servants who lead them. To me, Powell was one of the best.

I never spoke to Jerome Powell again, but I listened to him for eight years. If Kevin Warsh calls the Desk during the next apocalypse, someone else will pick up. But we’ll all be listening.

Good luck, Chair Warsh.

Thank you, and so long, Chair Powell. 🍷

## INTEREST RATES SELDOM FOLLOW THE FED’S FORECASTS FOR LONG



Source: Federal Reserve Board; each dashed line represents projections at different dates from the “Summary of Economic Projections”

# 1873 and the AI boom...

Quarterly earnings calls give company executives a chance to discuss results, outline plans, and answer analysts' questions. They sometimes move stock prices. Rarely do they inspire listeners to buy a book about nineteenth-century finance.

And yet, Microsoft CEO Satya Nadella did just that on the company's fiscal fourth-quarter call in July. Asked about the risk of excess investment in AI infrastructure, Nadella said the management team was reading *1873: The Rothschilds, the First Great Depression, and the Making of the Modern World* by Liaquat Ahamed. His key takeaway: "you've got to run an efficient railroad." The comments sparked articles, social media chatter, and plenty of hot takes—and put the book on the Hanson + Doremus book club's reading list.

Ahamed's first book, the Pulitzer Prize-winning *Lords of Finance*, examined the role of central bankers in the Great Depression that began in 1929. His new book, published in June, delves further back to the turbulent time of 1873 and what he describes as the first truly global financial crisis, spreading from the major western financial capitals to Latin America, North Africa, and the Middle East. The Rothschild banking family helps connect the many interwoven threads of the story, but the book's lessons reach well beyond one family or one century.

So why would a book about a Victorian-era financial crash interest the CEO of Microsoft? The 1873 crash was driven by a speculative mania in railroad investment, financed heavily by debt. That already sounds like a cautionary tale for AI investment today, and Ahamed makes the parallel explicit near the outset. He translates the roughly \$500

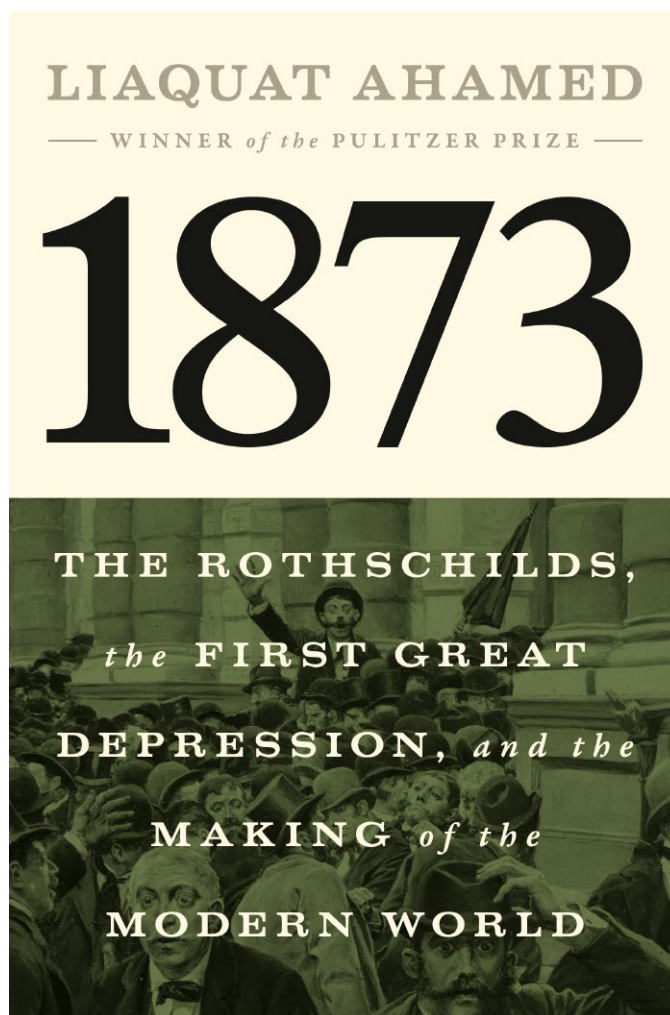
million flowing annually into U.S. railroad bonds in the early 1870s into a modern equivalent of about \$600 billion. At the time of publication, that roughly matched

Edward Chancellor describes a familiar pattern: "speculative manias commonly occur at the inception of a new industry or technology when people overestimate the potential gains, and too much capital is attracted to new ventures." Weak regulatory oversight, excessive borrowing, and investment flowing into even the worst companies in the speculative sector can follow. The observations drawn by both authors leave the reader with an uncomfortable sense of déjà vu.

Despite the similarities, there are differences between our current environment and the world of the 1870s. Back then, railroads were expanding across the literal Wild West, aided by government land grants and subsidies but subject to limited oversight. The regulatory environment was equally lax in finance, and fraudulent railroad companies were able to raise large sums from investors with few protections. While fraudulent AI companies may exist today, the leading technology firms attracting the most capital are behemoths with established businesses and substantial earnings behind their investments. That gives

them a stronger foundation, although it offers no guarantee against overbuilding or disappointing shareholders.

The real common factor from 1873 to today is human behavior. Investors like to think "this time is different," and that new technology will be adopted more quickly and generate exceptional returns



Source: Penguin Random House

projected spending by major technology firms on AI in 2026. The comparison helps explain why the book caught Silicon Valley's attention.

Ahamed isn't the first one to examine the common features of speculative bubbles. In his 1999 book, *Devil Take the Hindmost: A History of Financial Speculation*,

sooner than anything that came before. While the speed of adoption is accelerating, humans are still prone to all the usual cognitive traps. Groupthink can still cause prices to overshoot and leave little room for disappointment. Fear of missing out and overconfidence continue to draw still more investors into the excitement.

Unfortunately, even calling a bubble as it's occurring is not necessarily enough to protect us. Ahmed cites contemporary observers in the 1870s who identified speculative excess in Vienna's real estate, New York's railroads, and London's foreign securities. Recognizing a bubble, it seems, offers little help in predicting when it will burst, and selling too early can mean sitting out on years of gains.

Recent markets illustrate the cost of staying on the sidelines. From 2023 through 2025, the Magnificent Seven ("Mag 7" - Microsoft, Nvidia, Alphabet, Amazon, Meta, Tesla, and Apple) gener-

ated more than half of the S&P 500's total return. The cumulative return for the index over that period was around 88%. It would have been 40% without the Mag 7. Nvidia alone contributed 15.5% to the index's gain in 2025, with Alphabet contributing another 13.5%.

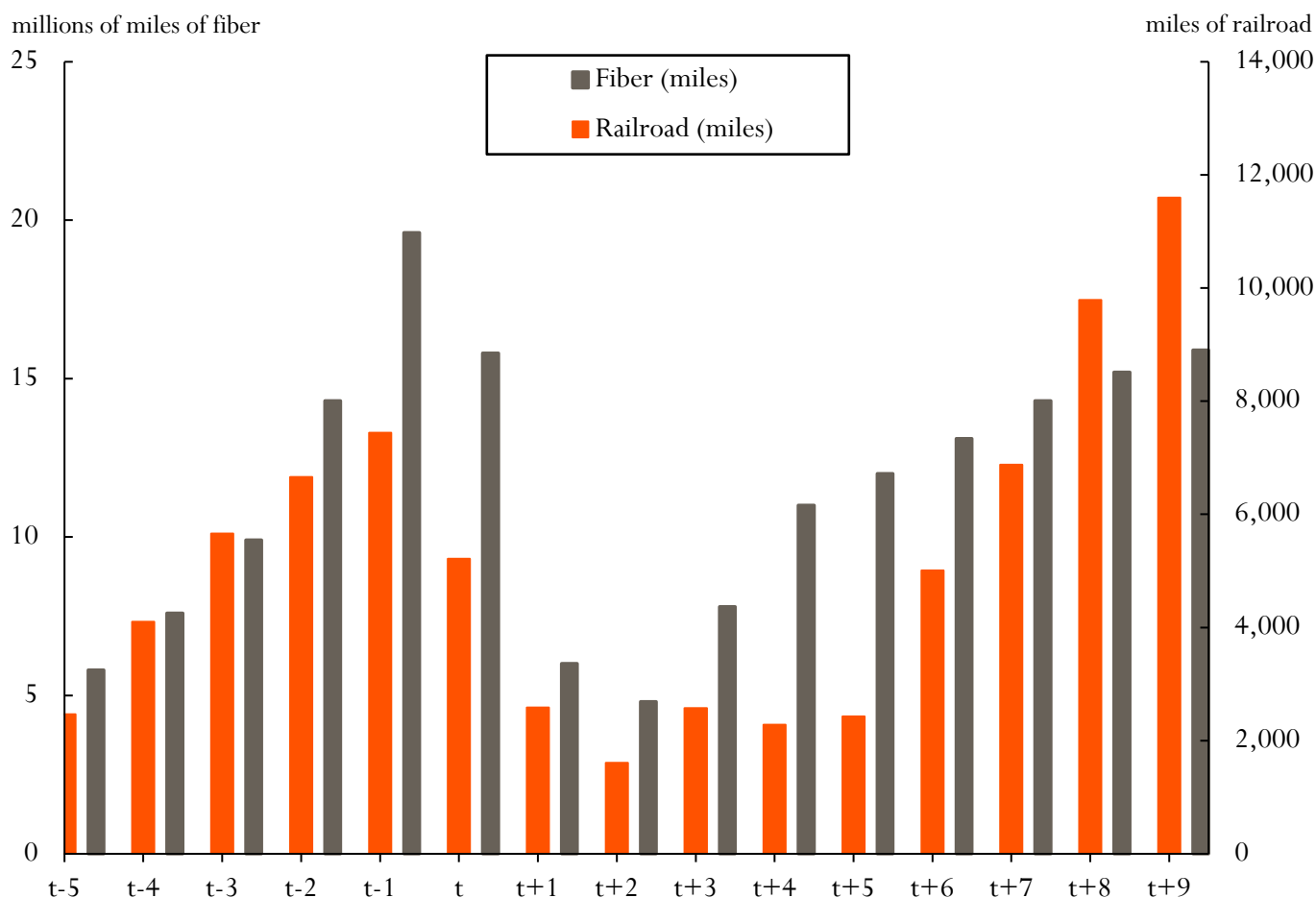
But the aftermath of 1873 offers another lesson. The crash did not end the railroad age. Indeed, construction continued and the network expanded—investment in railroads was even higher in the 1880s than in the 1870s! And railroads transformed commerce. The technology's promise was legitimate, but financial market assumptions far outpaced what the businesses could actually earn. Both things can be true: investment can help build a more productive economy and still disappoint the people who financed it.

The Rothschilds' relative caution during the boom offers a useful starting point. For investors today, skepticism and

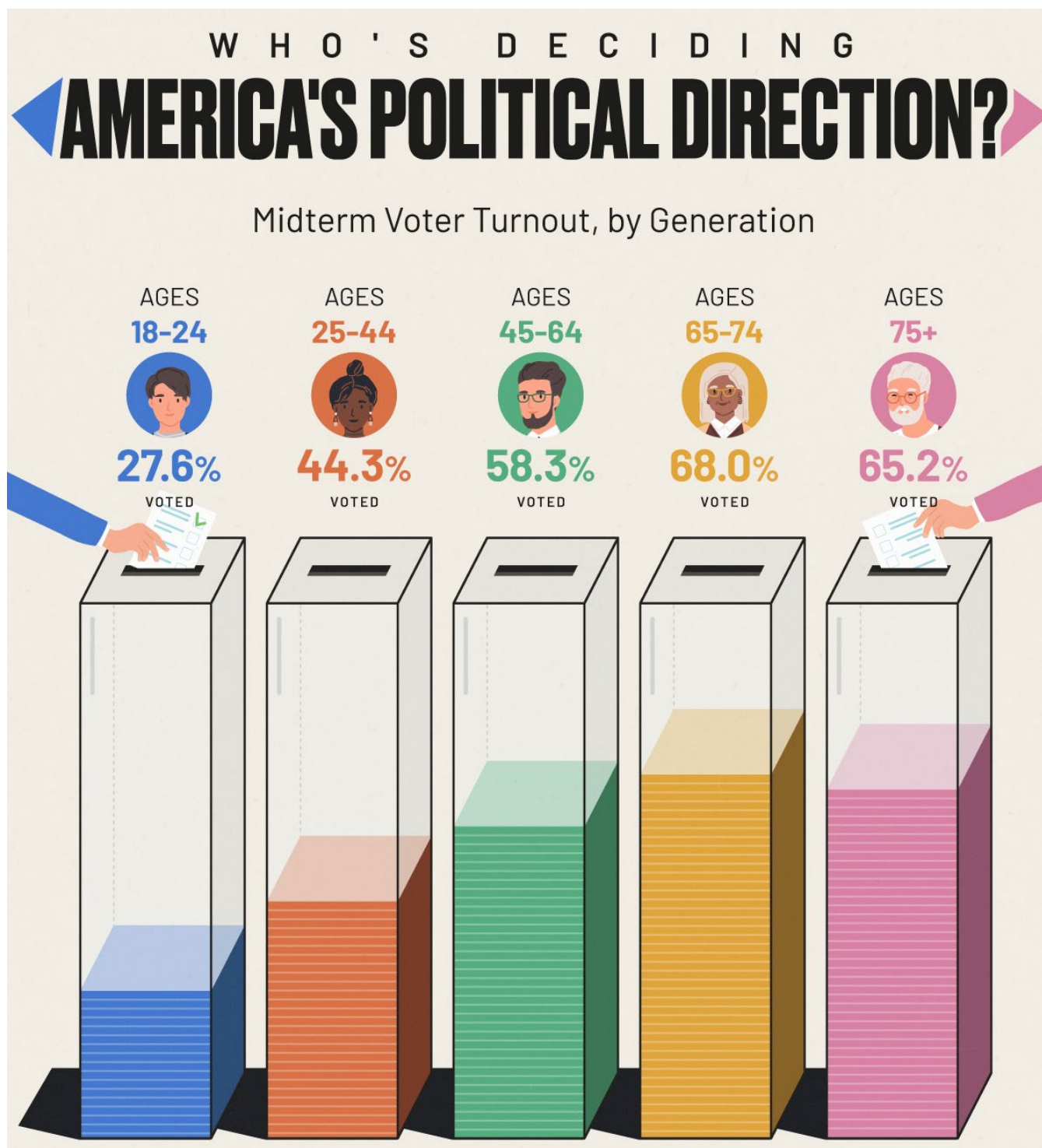
diversification remain sensible defenses. We can question ambitious forecasts, pay attention to valuations, and avoid putting too much of our wealth behind a single outcome. That may mean accepting lower returns if the boom continues, but it can make any eventual setbacks easier to endure.

Back to Nadella: Microsoft's challenge today is to turn all that computing capacity into services customers will pay for, at a profit. "Running an efficient railroad" is a good first step. Our challenge as investors is to determine how much to pay for a share of those profits. AI technology may be new, but the discipline required to invest in it is as old as the railroads. 🚂

## INFRASTRUCTURE BUILDOUTS BEFORE AND AFTER A CRASH



Source: FRED, NBER, Telecommunications Industry Association (TIA) / KMI Research, via U.S. Department of Commerce; t = year of crash (1873 and 2001)



Source: Based on the U.S. Census Bureau's Current Population Survey, November 2022, the most recent completed midterm election.

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