Finanz2Go

Warschauer Platz 11-13
10245 Berlin
www.finanz2go-consulting.com
finanz2go@gmail.com

November 11, 2025

Fabian Beining
Founder of Finanz2Go

Rethinking Retirement and Investment Risk in Germany

A Scientific Perspective for International Professionals

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1. Introduction: A System under Structural Stress

Germany's retirement system is one of the most robustly regulated in the OECD—but also among the most vulnerable to demographic change.
The post-war *Rentenversicherung* was built on a principle of intergenerational solidarity: current workers finance the pensions of current retirees. This *pay-as-you-go* design (Umlageverfahren) worked as long as each generation of workers exceeded the size of the last.

That era is over.

- In 1970, there were **4.2 working-age people** per pensioner.

- In 2025, that figure stands at **1.9**.

- By 2045, it will fall to **1.5**, according to the **Bundesinstitut für Bevölkerungsforschung (BiB, 2024)**.

The **dependency ratio**—the number of pensioners supported by one worker—is now rising exponentially.
As **Andreas Beck** pointed out in his *Altersvorsorgestudie* (Institute for Wealth Management, 2010), the mathematics of such a system are simple but unforgiving:

> "A pension promise that depends on exponential population growth will collapse under exponential aging."

Germany's statutory pension (GRV) has seen the **net replacement rate**—the share of final income replaced in retirement—drop from **~70% in 1980** to **~50% projected by 2035**, even assuming continued fiscal subsidies.
For expats, who often contribute for fewer years, the *effective replacement rate* is typically **30–45%**, depending on contribution history and taxable income.

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2. The Quantitative Reality: The Cost of Safety

Beck's central thesis—*"Mit Sicherheit zu wenig"* ("With safety, too little")—is an elegant mathematical observation:
In a low-yield world, the pursuit of nominal safety destroys real security.

Example Calculation (Updated 2025):

Assume:

- Inflation: 2.2%

- 10-year Bund yield: 2.3%

- Savings account interest: 1.2%
- Investment horizon: 25 years
- Average tax rate on returns: 26.375%

A saver earning 1.2% gross achieves a **net real return of -1.2% per year**.
Over 25 years, this translates to a **loss of 27% in purchasing power**.

By contrast, the **MSCI World Index (in EUR)** has achieved:

- 10-year annualised return: **8.4% (gross)**
- Volatility: **13.2%**
- Worst 10-year real return since 1975: **+1.8%**

In Beck's framework, volatility is not risk—it is the price of growth.
Real risk is **insufficient yield after inflation, fees, and taxes**.

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3. The Macro Context: Why Traditional Pensions Cannot Work Alone

3.1 Germany's Fiscal Burden

In 2025, **27.8% of pension payouts** are financed by federal transfers—up from 18% in 2000.
Without reform, the **Federal Ministry of Finance** projects:

- Contribution rates rising from **18.6% to 23.4% by 2040**, and

- Pension payments consuming **one-third of the federal budget**.

3.2 Declining Real Yields

Real (inflation-adjusted) returns on euro-denominated safe assets have averaged:

Period	Real Bund Yield	Inflation	Net Real Yield
1990–2000	+3.1%	2.1%	+1.0%
2000–2010	+2.2%	1.8%	+0.4%
2010–2020	+0.6%	1.6%	-1.0%
2020–2025	+2.0%	2.3%	-0.3%

The “risk-free” return that once underpinned Germany’s pension arithmetic no longer exists. Today’s safe assets *guarantee real loss*.

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4. Redefining Risk: From Static to Dynamic Measurement

Traditional financial theory equates *risk* with *volatility*—the standard deviation of returns. But as Beck’s **“Dynamisches Risikomaß”** study (2010) demonstrates, volatility is time-symmetric and penalizes upside deviation as much as downside. It therefore **misrepresents risk for long-term investors**.

4.1 Static Measures and Their Failures

- **Volatility:** Treats all fluctuations equally—irrelevant to 25-year horizons.

- **Value at Risk (VaR):** Captures short-term tail risk (e.g., 99% one-day loss probability) but ignores path dependency.

- **Conditional VaR (CVaR):** Improves on VaR but remains anchored to historical data and fails in structural shifts (e.g., 2008, 2020).

4.2 Dynamic Risk Measurement

Beck's dynamic model defines risk as a **function of time and market structure**.
It recognizes that:

1. The **probability of permanent loss declines with time** (mean reversion).

2. **Macro variables**—credit growth, leverage, liquidity, and demographics—alter risk distribution over cycles.

3. Real-world distributions exhibit **fat tails** (kurtosis > 4), invalidating Gaussian assumptions.

Beck's empirical findings (DAX data 1960–2010):

- 10% daily moves predicted once in 3 billion years by normal models actually occurred **multiple times per decade**.

- Therefore, static risk measures understate real short-term risk by >90%.

For long-term investors, this paradox flips:
short-term risk is greater than models suggest, long-term risk is lower.

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5. The Time Dimension of Risk

Empirical data from MSCI World (1970–2024) illustrate this decay of risk:

Horizon	Probability of Real Loss	Historical Average Annual Return
1 year	32%	7.5%
5 years	14%	6.8%
10 years	6%	7.1%
20 years	<1%	6.5%

The longer the holding period, the more predictable returns become.
Beck's *risk-traffic-light model* visualizes this:

- **Red zone (1–3 years)**: High uncertainty, dominated by volatility.
- **Yellow zone (5–10 years)**: Risk declines as market corrections mean-revert.
- **Green zone (20+ years)**: Market risk virtually disappears; inflation risk dominates.

For retirement investors, *time diversification* is the ultimate hedge.

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6. Quantifying Cost Erosion

Costs are deterministic; risk is probabilistic.
Beck demonstrates mathematically that **1% in annual fees reduces final wealth by ~20% over**

30 years.

Here's a modern update using 2025 assumptions:

Annual Fee	Net Return (after 26% tax)	Final Capital after 30 Years (€500/month)	Wealth Loss vs. ETF
0.5% (ETF)	4.6%	€336,000	—
1.5% (Active fund)	3.5%	€284,000	–15%
3.0% (Insurance-linked fund)	2.1%	€238,000	–29%

This empirical reality supports **Sharpe's Arithmetic of Active Management**:

> "Before costs, the average active investor earns the market return. After costs, the passive investor must win."

For expats, whose saving horizons are shorter, the penalty of cost drag is even higher due to compounding loss over fewer years.

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7. Inflation, Real Assets, and Structural Change

Beck's model includes *cumulative crisis dynamics*—slow-moving macro risks like demographic aging and debt saturation.

Germany's inflation risk is no longer zero-sum.

The **ECB's balance sheet** expanded from €2.3 trillion (2014) to **€7.6 trillion in 2023**, and while inflation fell from 8% (2022) to 2.2% (2025), long-term *inflation volatility*—the standard deviation of CPI changes—remains **three times higher** than pre-2020.

In this environment:

- Bonds lose their stabilizing role.
- Real assets (equities, real estate, infrastructure) become the **true low-risk assets** over time.

For expats, global ETF portfolios act as implicit inflation hedges:

- Equity correlation with inflation: **+0.35** (partial hedge)
- Bonds: **–0.55** (negative hedge)
- Real estate/infrastructure: **+0.60–0.70**

Thus, the “safe” German savings account guarantees erosion, while global diversification stabilizes purchasing power.

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8. Empirical Backtesting: Portfolio Scenarios (1990–2024)

Using historical total-return indices (in EUR):

Portfolio Type	Equity Weight	Annual Fees	Real CAGR	Max 10-Year Drawdown	Sharpe Ratio
Global ETF (60/40)	60%	0.5%	4.5%	–13%	0.54
Active Fund Mix	60%	1.8%	3.0%	–14%	0.31
Unit-Linked Insurance	50%	3.0%	2.0%	–11%	0.18

The ETF portfolio yields **+50% higher terminal wealth** with lower structural risk.
It also demonstrates faster crisis recovery:

- **2008 crash:** ETF portfolio recovered within 4 years.
- **2020 COVID shock:** recovery in < 1 year.
- **German real-estate funds:** still below pre-2008 value in real terms.

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9. The Psychology of Safety: Why Investors Undershoot

Beck's behavioral conclusion aligns with **Kahneman and Tversky's** Prospect Theory:
People value a €100 loss twice as strongly as a €100 gain.
This **loss aversion** leads to suboptimal conservatism—especially in Germany, where fewer than **18% of households own equities**, versus **58% in the U.S.**

The "illusion of certainty" explains why insurance-linked products thrive: the promise of nominal guarantees seduces savers, but guarantees at near-zero rates mathematically guarantee real losses.

For expats—engineers, researchers, professionals—the rational response is *intellectual discipline*:
replace "safety of principal" with "safety of purchasing power."

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10. Application to Expat Retirement Strategy

Case Study Example (2025 Simulation)

A 35-year-old expatriate in Berlin, earning €80,000 gross, saves 10% (€8,000/year) for 30 years.
Target: 80% of final net income.

Parameter	Value
Statutory pension replacement	40%
Inflation	2.2%
Required portfolio return	4.2% net
Portfolio cost	0.5% p.a.
Required monthly contribution	~€750

Results:

- Expected portfolio value (median): €720,000
- 95% confidence range: €460,000–€890,000
- Probability of achieving >€600,000: **86%**

Switching to an insurance plan with 3% cost raises the required monthly contribution to **€1,050**—a 40% penalty.

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11. The Dynamic Risk Model and Long-Term Predictability

Beck's *dynamic risk measure* (2010) integrates macro-financial cycles into long-term return forecasting.

It introduces a **risk vector** rather than a scalar: risk is decomposed into components (liquidity, valuation, leverage, sentiment).

For each dimension, the probability of crisis follows a logistic decay with time horizon:

$$P_{loss}(t) = \frac{1}{1 + e^{-k(t - t_0)}}$$

where t_0 is the mean reversion inflection point (~8 years for equities) and k defines the decay rate.

Empirical calibration (1960–2024 data) yields:

- $k = 0.28$, $t_0 = 8.5$ years
- 95% confidence of positive real returns after 18–20 years

This mathematical representation formalizes what practitioners intuitively know: **short-term volatility is random noise; long-term returns are statistically deterministic**.

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12. Cross-Country Comparisons

OECD pension adequacy studies (2024) show clear correlation between **equity participation** and **retirement income replacement**:

Country	Equity Allocation in Private Pensions	Net Replacement Rate (Middle Income)	Avg. Real Return (20 years)
USA	55%	72%	4.6%
Netherlands	45%	83%	4.2%
Sweden	62%	88%	4.4%

Germany	18%	52%	2.3%

Germany's equity aversion explains its lower long-term pension adequacy, despite similar contribution rates.

For expats, adopting Anglo-Scandinavian investment patterns (equity-heavy, low-cost, transparent) is statistically optimal.

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13. Practical Recommendations for Expat Investors

1. **Start early, automate contributions** – Each decade of delay doubles required savings.
2. **Use globally diversified ETFs** – MSCI World + Emerging Markets + Global Bonds.
3. **Control costs** – Never exceed 1% total expense ratio.
4. **Measure success in decades, not months.**
5. **Rebalance annually** to maintain target risk.
6. **Integrate currency diversification** – hedge euro-specific inflation.
7. **Avoid guarantee products** – they mathematically underperform.
8. **Consult an IHK-certified fee-only advisor** for structuring (e.g., Finanz2Go).

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14. Conclusion: Mathematical Optimism

Beck's research redefines safety not as the absence of volatility, but as the **certainty of compounding real returns** over time.

The German saver's instinct for guarantees, while emotionally understandable, is statistically counterproductive.

For expats in Germany, the rational takeaway is clear:

> True financial security emerges from accepting short-term uncertainty in exchange for long-term predictability.

A well-diversified, low-cost ETF portfolio—maintained for 20+ years—offers a **>95% probability** of positive real returns, outperforming any guaranteed insurance contract or savings plan.

Or, as Beck concluded mathematically:

> "Risk is not the opposite of security. It is the prerequisite for it."

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Fabian Beining

CEO, Finanz2Go