On Course Financial Planning
Facing the Future with Optimism and Courage
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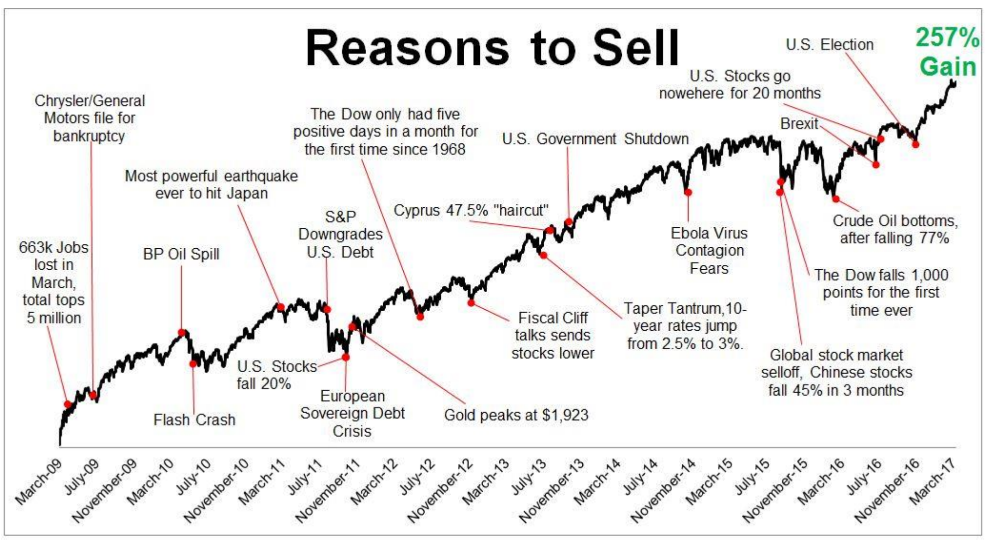
Fake News and Financial Journalism

Fake news has been a hot topic in recent months. The dictionary defines "fake" as *something that is designed to deceive or cheat; not real; counterfeit*. Using this definition, fake news isn't a new phenomenon. For as long as I can remember, it has been a regular feature of financial journalism. Most of what passes for financial news is nothing more than opinions and speculations; pure fake news. Fake news is so common in financial journalism that it goes unnoticed. Unfortunately, it harms investors who confuse opinions and forecasts with actionable information. Being on the receiving end of numerous opinions and forecasts is not the same thing as being well-informed. Here are some ways that financial journalism's fake news harms investors –

- It is relentlessly negative; presenting worst-case scenarios for today's real or imagined crises. It does this because it's the best way to attract eyeballs, ears and clicks. Michael Batnick, The Irrelevant Investor, created this "Wall of Worry Chart" depicting the performance of the S&P 500 Index since the market bottom in March 2009. (The gain does not include reinvested dividends; which brings the gain close to 300%.) Each of the noted events was headline news – most of which have been forgotten. Stock market gains aren't linear – they occur in fits and starts and often go unnoticed. But something was happening behind the headlines that caused the market to go up for eight consecutive years. What wasn't reported – that things were slowly improving - was the real story. But it's a boring story; one unlikely to attract a big audience, so it went unreported. You didn't need to be an investing genius to have received acceptable portfolio returns these past eight years. Unfortunately, many investors remained in cash the entire time because financial journalism's drumbeat of negativity kept them in constant fear of another market crash.



- Economic and market forecasts are fake news. There are no "facts" when commentators talk about the future – they're just spouting opinions. No one knows what events are going to transpire in the future or what the market's reaction to them will be. Media pundits, regardless of their academic credentials or years of experience, cannot predict the future. Most forecasts are mere extrapolations of the recent past into the future and contain more opinion than insight. Having long ago lost the ability to blush, financial journalism never apologizes for the damage done by its guests' previous forecasts and recommendations. Investors seek market and economic forecasts and the financial media will always exploit its viewers' naïve desire to know the unknowable. Instead of forecasts, investors should be more interested in history, which reveals how people reacted when events unfolded in unforeseen ways.
- I doubt that there is any subject more riddled with fake news than personal finance journalism. What percentage of journalists who offer investing advice have the academic qualifications to do so? The financial media employs too many noncredentialled journalists whose columns are often just restatements of previously published, unsourced articles. They repackage old, bad ideas that are sure to mislead a new generation of history-challenged investors. If media pundits were so astute, they wouldn't be wasting their time giving you investment advice; they'd be investing their own money and making a fortune.
- Financial journalism rarely, if ever, mentions financial planning. It always focuses on performance; reinforcing the fake proposition that investing is a timing and selection activity. "What to Buy Now" articles appear to have a certain amount of logic behind them – if you accept the fake proposition that outperformance is a legitimate financial goal.

But outperformance cannot be your financial goal because there is no stock picking or market timing strategy that will consistently outperform the market. The legitimate goals of financial planning include attaining financial independence, maintaining your desired lifestyle throughout retirement, educating children and grandchildren and leaving a meaningful legacy to heirs. To achieve these goals, your behavior as an investor – how much you save, your portfolio allocation, how you respond to the daily noise in the markets – is more important than the short-term performance of your portfolio.

- As the number of financial journalism's media outlets has increased, the quality of information provided by these outlets has declined. There's a limited amount of news each day but the financial media must keep viewers entertained 24/7, even when they've got nothing else to say. So, it's not surprising that it offers a variety of opinions and analysis which, although entertaining, are a waste of your time.
- The financial media is in the business to serve its advertisers, not its readers or viewers. If this wasn't true they'd say, "Buy index funds" and stop talking.

Many investors have been fooled into believing that keeping up with today's financial headlines is a prerequisite for achieving their financial goals. But separating the fake news from actionable information is a daunting task for investors. Stocks are long-term investments and when investors get caught up in the ever-changing emotional excitement created by financial journalism, bad things can happen. The financial media will never admit that it is impossible to make sense out of the day-to-day activity in the stock market. Yet each day they try and, more often than they'll admit, turn their audience into speculators who buy what's hot and sell what's not. Wise investors do just the opposite – periodically taking some profits from their outperforming assets and redeploying them to undervalued assets; thereby maintaining the portfolio allocation contained in their financial plan.

In the News

Prior to last year's election, the common wisdom offered by financial pundits (dare I call it fake news?) was that there'd be a sharp stock market decline in the immediate aftermath of a Trump win. Just the opposite happened, with stocks surging in the wake of his surprise victory. Investors quickly warmed to the idea that a Republican President and a Republican Congress would enact a pro-business agenda that would enhance economic growth, and by extension, corporate profit growth. Fed Chief Janet Yellen summed it up this way during her semiannual Congressional testimony - *"I think market participants likely are anticipating shifts in fiscal policy* (tax cuts, infrastructure spending) *that will stimulate growth and perhaps raise earnings."* Corporate earnings and the expected growth of future earnings have the biggest influence on the long-term direction of the stock market. Optimistic investors are pricing in faster economic growth and higher profits. In this year's first quarter, domestic stocks rose 6% and international stocks rose 7%. Pessimistic investors who have been dismissing the rally have been left behind.

The University of Michigan's latest survey of consumer sentiment included this observation: *"Democrats expect an imminent recession, higher unemployment, lower income gains, and more rapid inflation, while Republicans anticipate a new era of robust growth in incomes, job prospects, and lower inflation*". Both groups, however, are making the same mistake. Politics and your investment portfolio should be kept far apart. Your portfolio's long-term performance will be determined by economic activity and corporate earnings growth; not politics. In 30 of the past 35 years, the S&P 500 Index has yielded a positive rate of return – notwithstanding the political party in office, recessions, inflation, market volatility and geopolitical crises of various sorts. Investors should own a diversified portfolio of domestic and international stock funds. Political uncertainty will always create noise and worries that influence investor sentiment in the short-term. That's why investors need to maintain a long-term view and own a portfolio with a permanent allocation to stocks that is appropriate for your financial goals and risk tolerance.

Here's a little-known fact that your broker hopes you'll never discover. Although the S&P 500 Index returned 12% in 2016, there was a large dispersion of returns between the index's best and worst performers. There were 25 stocks that returned at least 45% and 25 stocks that lost at least 22%. All an active manager had to do to outperform the index was overweight the outperformers and shun the big losers. Yet according to Morningstar's year-end 2016 "Active/Passive Barometer", only about one in four actively managed mutual funds that invest in large company domestic stocks outperformed their index fund competitors last year. Additionally, according to the report – "*Roughly half the active funds that existed in this category ten years ago survived the decade and just 5.9% managed to both survive and outperform their average passively managed peer."*

Visitors to the homepage of the Jackson National Life Insurance Company's website are greeted with this invitation -- *Experience the Jackson difference — A company truly committed to your financial future*. Jackson National is the latest financial firm being sued by its employees in a class-action lawsuit for violating its fiduciary duty by using high cost, proprietary funds in its 401(k) plan. Of the 21 funds offered in the plan, 18 are Jackson National proprietary funds. The suit charges – "*The overwhelming majority of the proprietary funds were virtually identical to funds offered by* *unaffiliated financial institutions at a fraction of the cost."* Citing Morningstar data, the suit alleges that these funds' fees were above average and that their performance significantly lagged their benchmarks. Perhaps we need a new phrase – fake fiduciary.

The Illusion of Wealth

It's been my experience that new retirees who have enough financial assets to sustain their retirement lifestyle often experience anxiety about running out of money. Another left-brained, number crunching analysis won't remedy this malady so I've had to develop a different strategy. I'll ask them to close their eyes, hold their hands out palms upward and imagine the weight of $1,000 in their hands; what $1,000 "feels" like. Then I ask them to imagine what $5,000 "feels" like. So far, so good. But when I ask them to imagine what $1 million or $2 million "feels" like, the exercise ends because no one can "feel" that much money. Most people are more sensitive to (they can "feel") wealth expressed as a monthly income because they can relate it to their monthly financial obligations. Few people know, or know how to determine, if their portfolio's "weight" (lump sum) will support their monthly cash flow throughout retirement.

Recently, there have been numerous articles in the financial media about the benefit of annuitizing the lump sum balance of a defined contribution plan (i.e. 401(k) or 403(b)). A new retiree transfers the lump sum to an insurance company in exchange for a guaranteed monthly payment, creating a personal defined benefit pension. Alternatively, retirees can rollover the account balance of their defined contribution plan into their own IRA. So, how can a new retiree know which is the better option?

For this discussion, we will assume that you are a 65-year-old retiree with $1 million in your 401(k). We assume that inflation will average 2.5% during your 25-year retirement and that the discount rate (the interest paid by safe fixed-income investments) is 3.5%. Would you prefer to receive the $1 million as a lump sum rollover into your IRA or would you rather annuitize the lump sum and receive $5,000 every month for the rest of your life? Using our assumptions, these two options are financially equivalent.

The academic paper: "The Illusion of Wealth and Its Reversal" uses these assumptions in dealing with the question of how people perceive wealth when presented as a choice between a lump sum payout or an annuitized monthly payment for life. The researchers discovered that for lower lump sum values (i.e. $100,000 and the annuitized equivalent of $500 per month) the study's participants were more likely to prefer the lump sum over the monthly check because it seems to represent more wealth than the annuitized payment. At higher wealth levels (i.e. $1 million) the illusion of wealth "reverses". The study's participants were more likely to prefer an annuitized payment of $5,000 per month over the lump sum $1 million payout. Both group's choices are based on faulty illusions of relative wealth, since in both cases the lump-sum and annuitized options are mathematically equivalent.

The authors of the paper concluded that the relative attractiveness of annuities vs. lump sum payouts depends on underlying wealth levels. The larger the lump sum, the more likely it was that the study's participants favored the annuitized payout – because the monthly payments were larger and gave the "feel" of more wealth. But the larger the lump sum, the less likely it is that our new retiree needs a guaranteed monthly income to avoid running out of money in retirement. A conservative portfolio allocation will likely generate a sufficient income stream to fund their spending needs and still leave a meaningful legacy.

There is one huge downside to the annuitization option. Annuitized payments are unlikely to be inflation-adjusted. With 2.5% annual inflation, the $5,000 monthly payment will spend like $3,050 twenty years from now. The safety of fixed, annuitized income payments is illusory in an inflationary environment. This is why annuitizing a defined contribution plan's lump sum balance at retirement has never appealed to me. A retiree who chooses the annuitization option is essentially converting their retirement plan to a 100% fixed income portfolio –– one that over several decades will likely be ravaged by inflation. But few affluent retirees factor in inflation when they are presented with the option of receiving what, today, is a relatively large guaranteed monthly payment.

The findings of this study add to my conviction that the average person has absolutely no clue how to finance a multi-decade retirement. The subject material isn't easy to understand and the math can be confusing. Whether to annuitize the lump sum of your defined contribution plan is probably the most important financial decision you'll make in retirement. It's also a decision that few new retirees can make on their own. Before making the decision, I recommend that you seek advice from at least two financial advisors who have no financial interest in your decision. Don't do business with any financial professional who promotes annuitization but doesn't mention the long-term impact of inflation.

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