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Savers and Investors

It's difficult for pessimists to be successful investors. Successful investing involves practicing deferred gratification and keeping an optimistic attitude while placing money at risk in an uncertain future. Wall Street knows this isn't what you want to hear, so much of its advertising promotes the idea that, with its help, you can invest without volatility and uncertainty. People who defer present gratification for the hope of future gain fall into two distinct categories - savers and investors and it's important to know into which category you fall.

Savers place their money into fixed income assets – bonds, savings accounts, CDs, credit union accounts, etc. Savers can be divided into two groups. The first are those who avoid stocks because they are frightened by market volatility. Typically, they are fearful because they fail to differentiate between temporary market declines and a permanent loss of capital. The second are those who would like to invest in a diversified portfolio of stock and bond funds but don't know where to start. Many suffer from "investor inertia" – putting off until tomorrow what they should be doing today. Typically, they're overwhelmed by too many choices, confusing jargon, perplexing paperwork and the fear that they'll make the wrong decisions.

Savers typically focus on preserving the dollar value of their holdings instead of preserving the purchasing power of their dollars. Everyone should have a portion of their money in fixed income assets to fund near-term spending obligations that require zero risk to principal. But high-quality fixed income assets are savings vehicles, not investments, because they're unlikely to yield a return greater than inflation and will likely trail inflation on an after-tax basis. Placing your investment dollars in assets that will beat inflation over the long run is the only way to increase wealth. Absent deflation, the dollars in a credit union account or CD will likely lose purchasing power over time, turning these "safe" investments into wealth destroyers.

Investors place their assets in a portfolio of stock and bond funds in order to achieve long-term returns that exceed inflation. Wise investors understand that volatility, the unpredictable up-and-down changes in stock prices, is a normal and unavoidable part of investing. They realize that the passage of time has always been the best cure for stock market volatility. Many investors employ market timing strategies in an attempt to be invested in stocks when they are rising and in cash when they are declining. Unfortunately, nobody can control or predict the stock market and no successful market timing strategy has been discovered. Market timing is the modern-day equivalent of alchemy. The pursuit of an illusion. And, as a bonus, it will likely drive you nuts.

There are two types of people who should seek the services of a financial advisor. The first are savers who would like to become investors but don't know how to go about it. The second are investors who realize that they don't know what they're doing. Sadly, the number of investors who realize that they don't know what they're doing is just a small fraction of the number of investors who don't know what they're doing. If you fall into either one of these categories, you need to seek a competent financial advisor to provide these essential services -

- **A written financial plan that reflects your time horizon and financial goals**. It should contain reasonable expectations for future investment returns that are clearly explained to you. A good financial plan is inherently forward-looking. During times of market volatility, your plan will provide the basis on which to act, even when things don't seem to be going well. In the absence of a plan, you will likely react to the fads or fears created by today's headlines. Reacting is inherently backward looking -- trying to find profit in (or protection from) things that have already happened -- at which point it's too late. Be wary of any financial advisor who talks more about investments, investment products and the stock market than your needs, concerns and financial goals.
- **An asset allocation that factors in your risk tolerance.** Your allocation shouldn't change unless significant changes occur in your financial situation. Before a final stock and bond allocation is decided upon, your advisor should provide an analysis of the expected range of your portfolio's annual returns. The goal is to create an allocation with a variation in outcomes that you can live with, not one that maximizes returns. Once you settle on your stock and bond mix, you can let time work its magic and focus your attention on the more significant topics of work, friends and family. Be wary of any financial advisor who provides a portfolio recommendation without a comprehensive financial plan.

- **Behavior modification.** The best financial plan is of no value if you put it in the shredder. Experienced advisors know that investor behavior, not investment performance is the primary factor in long-term portfolio performance. Without proper guidance, few investors can resist Wall Street's noise and nonsense. Our emotions inevitably lead to counterproductive decisions that harm long-term financial wellbeing. A good financial advisor will encourage you to stay the course, see past the headlines, ignore the noise and do the right thing. Be wary of any financial advisor who encourages you to make "tactical" changes in your portfolio based on economic or market forecasts or recent stock market activity. Many do so, even though they have no more idea of what will happen tomorrow than you do. They promote ongoing portfolio changes because they assume that's what you want to hear. Making portfolio changes based on market and economic forecasts will likely do you more harm than good in the long run, by which time your financial advisor will likely be long gone.

You can control the allocation of your portfolio, but not its performance. All investors will experience unpredictable, temporary portfolio declines. That's what makes investing different from saving. You might not have the temperament to be an investor and there's nothing wrong with being a saver. But it will take much more time and deferred gratification to achieve your financial goals. Your retirement spending will be financed by dollars that you didn't spend during your working years. The important thing is making it to the finish line and it's up to you to decide how to get there.

In the News

This month's useless forecast comes from Paul Christopher and Sameer Samana of the Wells Fargo Investment Institute – "*We believe that capital markets are at an inflection point that could lead to a move in either direction."* No kidding?

Next month, we'll celebrate the 50th anniversary of the Apollo 11 moon landing. It's hard to imagine that an iPhone contains a multiple of the computing power possessed by NASA on the day that Neil Armstrong stepped onto the moon.

US household net worth reached $108 trillion in the first quarter of this year. The personal savings rate is 6.7% and household debt as a percentage of disposable income is lower than at any time in the past 40 years.

In 2018, the United States became the world's largest oil producing nation and by 2020 it is estimated that the USA will be a net exporter of hydrocarbon energy.

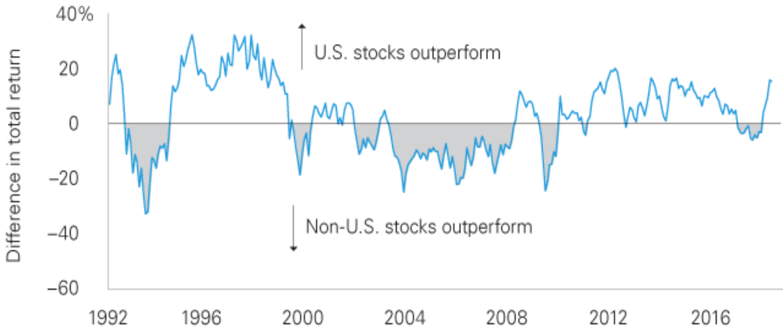
In 1960, I was an 11-year-old coin collector and remember checking the 9 on newly minted pennies to see if I had one of the rare, "large date" 1960 pennies. A fortune was at stake, but alas, no luck. I didn't know it at the time, but over half the world's population lived in extreme poverty and most people on the planet were illiterate. Today the percentages are 10% and 15% respectively. The global middle class is rapidly expanding, and the global stock markets allow individual investors to own a portion of the companies whose products make human progress and higher living standards possible.

Many retirees discovered that they could not deduct their charitable gifts on their 2018 tax return. This is because their itemized deductions were less than the standard deduction, which nearly doubled in the Tax Cuts and Jobs Act of 2017. It is estimated that just 8% of filers itemized deductions on their 2018 return, down from 20% in past years. However, some retirees can still get a tax benefit from their charitable giving. Those over age 70½ can make a qualified charitable distribution (QCD) and donate all or a portion of their required minimum distribution (up to $100,000) directly to a charity. Although there is no tax deduction for QCDs, they are not reported as taxable IRA withdrawals. Some retirees can use QCDs to lower the taxability of Social Security benefits or Medicare part B premium surcharges. Check with your tax professional. To make a QCD, retirees should direct their IRA custodian to send the contribution directly to the charity or a check can be sent to the retiree made out to the charity, which then must be forwarded. The IRA custodian will report the withdrawal on a form 1099–R as a regular IRA distribution. Taxpayers must note on their tax return that the distribution was a QCD, and not taxable.

Fidelity Investments compared the subsequent performance of the retirement accounts of investors who stayed invested during the financial crisis and those who sold their stock funds in 2008 and 2009. The extreme volatility in stocks during those two years led to record outflows from stock mutual funds. Fidelity clients who managed to stay the course saw an average account balance increase of 240% over the next ten years. Investors who fled to cash when the market declined, including those who subsequently returned to the stock market, experienced an average account balance increase of 157% over the next ten years. The reason for this performance disparity is clear in hindsight. In the five months after it reached its low point in March 2009, the S&P 500 Index rose 45%. Most investors who sold their stock funds were still waiting for some sort of signal that it was "safe" to reenter the market and did not benefit from the rebound. Investors who stayed the course during the decline reaped the benefit of the unexpected, rapid recovery.

The Federal Reserve released its latest annual survey of household well-being last month. It reported that one quarter of the 11,400 people surveyed in October and November of last year said that they have no retirement savings. Almost one out of five said that they wouldn't be able to pay all their bills in the current month. Almost 40% said they don't have enough cash on hand to cover an unexpected $400 expense. I've read surveys claiming that many Americans have little or no retirement savings or are living paycheck to paycheck. If this is true, then why did we spend more than $70 billion on state lotteries last year and why are there so many people with tattoos?

Return Differential Between U.S. And Non-U.S. Stocks



As this chart by Vanguard shows, U.S. stocks have outperformed international stocks in recent years. Many companies in the S&P 500 are major players in the world economy. So, many investors ask, "Why do I need international stocks in my portfolio?"

International stocks represent 45% of the global stock market on a market-cap weighted basis. This represents an investment opportunity in the leading companies in emerging and other developed stock markets that shouldn't be ignored.

Historically, as this chart shows, U.S. and international stocks often swap positions as performance leaders. In the first decade of this century, international stocks were favored by the same performance chasing investors who now shun them. No one knows when or if the current trend of domestic stock outperformance will end, but wise investors assume that the trend will eventually reverse. By maintaining an allocation to international stocks in your portfolio, you'll be invested in whatever region outperforms in the years ahead. Perhaps you remember the Seinfeld episode in which Jerry discovered that, what goes up must eventually come down --

Jerry: *Elaine, don't get too down. Everything will even out. See, I have two friends. You were up, he was down. Now he's up, you're down. You see how it all evens out for me?* Kramer (to Jerry): *You know who you are? Even Steven.*

Social Security and Divorce

Social Security claiming strategies are complex and when divorce is thrown into the mix; it becomes even more complicated. Social Security was first instituted 1935 but it wasn't until 1939 that a spousal benefit became available. In 1965 the spousal benefit, based on a former spouse's work record, was made available to a divorced spouse. A divorced spouse can receive benefits if certain conditions are met. The rules can be confusing; especially if there have been several marriages or if an ex-spouse has died. To qualify for a divorced spouse benefit, you must meet these criteria –

- You were married to your ex-spouse for at least ten years. If you married, divorced, then remarried (before the end of the calendar year following the divorce) and then divorced again, the two marriages can be added together (including the time in between) for the purpose of determining the ten years. What a country!
- You are currently unmarried.
- You and your former spouse are at least 62 years old.
- If you have been divorced for at least two years, you can claim a benefit even if your ex-spouse has not filed for his or her own Social Security benefit. After reaching your full retirement age, your divorced spouse benefit will be 50% of your ex-spouse's full retirement age, primary insurance amount (PIA). It will be the same regardless of whether your ex-spouse's benefit is reduced due to early claiming or increased for claiming after full retirement age.
- You cannot claim a divorced spouse benefit if your own benefit is higher than your divorced spouse benefit. This restriction does not apply to anyone born before 1954. If born before 1954, you can file a restricted application for your divorced spouse benefit at your full retirement age and let your own benefit build delayed credits up to age 70.
- A person who has been divorced twice can choose the higher of the two divorced spouse benefits if each marriage lasted at least 10 years. What a country!
- If your ex-spouse is deceased, you can receive a divorced spouse survivor benefit based on your ex-spouse's record, providing that you are currently unmarried and have reached the age of 60.
- Your ex-spouse's marital status is not relevant to your divorced spouse benefit. If an ex-spouse has remarried, both you and the new spouse may receive spousal benefits off your ex's record. What a country!
- If you have been receiving a divorced spouse benefit and have remarried, you must notify the Social Security Administration and your divorced spouse benefit will stop.
- If you are receiving a divorced spouse survivor benefit and you remarry after age 60, you can continue to take your divorced spouse survivor benefit.