On Course Financial Planning
Facing the Future with Optimism and Courage
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Vectors
geo@oncoursefp.com
425-861-9997

Desert Musings

My wife and I are enjoying the Arizona sunshine. So, it's time for my annual desert musings --

Will we ever see the day when most investors receive financial advice that is based on their needs, goals, and time horizon instead of someone's prediction about what the market or the economy is going to do in the next 12 months?

When it comes to investing, the words "future" and "uncertainty" are synonymous. In good times we ignore uncertainty. In volatile times we fixate on it.

There's nothing in 1, 3 or 5 year past performance data that will help you invest for the next 1, 3 or 5 decades.

Too often, people forgo prudent investing and risk management in an attempt to lower their tax bill. Let's get real; we still have to render unto Caesar what belongs to Caesar. Make a profit, pay taxes, be happy.

Trying to beat the market over a multiple decade timeframe through stock picking and/or market timing is a fool's errand. I understand why amateur investors, who have a limited knowledge of history and investing, try to do this. But why do so many financial advisors promote this fantasy? Financial advisors should eat their own cooking -- they should own the same assets they recommend to their clients. This way if they do something dumb, they'll suffer along with their clients. When was the last time anyone asked to see their financial advisor's portfolio?

According to the latest data from research firm Cerulli Associates, 70% of new advisors drop out in the first five years, with most of these leaving within three years. Although 93% of new advisors believe training on financial planning topics is important to their success, only 55% said their firms provide sufficient training. So, from sea to shining sea we have newly minted financial advisors who have been taught how to sell financial products but who know little about stock market history, asset allocation strategies, or financial planning who are providing investment advice to retiring baby boomers. Am I the only person who thinks this is a crazy state of affairs?

Historically, the price of a single-family home has gone up by about 1% more than inflation. This is before the carrying costs are deducted (taxes, insurance, maintenance, mortgage interest, etc.). So, stop considering your home as an investment. Owning a home is a lifestyle decision. Owning a single-family home as a rental? 2,500 sq. ft. of future regret.

In 2024, the costliest scams were cryptocurrency investment schemes, with a reported median loss (half lost more, half lost less) per individual of $30,000, according to Fraud.org. Typically, victims were approached by someone offering low or no-risk returns on cryptocurrency investing. Add a little FOMO and some legitimate looking fake websites and the deception is complete. After the victim invests sufficient funds, the scammer disappears along with the money.

I've heard predictions about the imminent end of America my whole adult life. They've all been wrong, which doesn't seem to dissuade today's Chicken Littles. It amazes me how newsletters and social media bloggers, who proclaim nothing but doom and gloom, manage to maintain an audience and subscription income despite having always been wrong. They are the masters of grift, making money by catering to people who, for reasons that I can't understand, want to hear that the world, and everything that they hold dear, is about to come to an end. But worse, and more numerous, are the purveyors of greed who promote get-rich-quick, easy money schemes in social media and YouTube videos. People who try to get-rich-quick don't realize that doing so increases the likelihood that they'll get-poor-quick. It seems that the more electronic media one is exposed to, the greater the likelihood of falling under the spell of the FOMO virus.

The biggest risk faced by do-it-yourself investors is that they think they know more about investing than they do. This may not be a nice thing to say but it is what I have observed repeatedly over the past twenty years.

The latest lesson in the risk of owning individual stocks comes from DeepSeek. On January 27th, the Chinese start-up announced that its AI models offered performance equal to the more renowned AI programs using just a fraction of the power and energy. Semiconductor shares tumbled, and Nvidia (NVDA) fell 17%, shedding $589 billion in market cap – the largest single day market cap loss of any stock in history, according to CNBC. This was more than the total market cap of Costco, Exxon, or Netflix.

Like modern-day Pied Pipers, successful active fund managers attain a cult following and performance chasing financial advisors shovel clients' money their way. All great active fund managers come and go. I say this because all great fund managers have come and gone. Passive investing works because index funds are tax efficient and charge miniscule management fees. More good news for index fund investors - Vanguard just announced it is lowering the management fees on 87 mutual funds and ETFs that will lead to over $350 million in investor savings this year. Active managers proclaim, "I can do better than an index fund." But most are just bragging, to the eventual dismay of their shareholders.

Outflows from active funds reached new records in 2024. Index mutual funds and ETFs reported estimated net inflows totaling $886 billion, while active funds reported estimated net outflows totaling $165 billion during the year. Active funds still contain more assets than index funds, proving once again that outdated ideas, like TV broadcast news, often manage to persist long after their obsolescence and shortcomings have become known.

Last year, the S&P LargeCap 500 yielded a total return of 25%, the S&P MidCap 400 rose 13.9% and the S&P SmallCap 600 Index climbed 8.6%, according to Bloomberg. Despite these outsized returns, stock funds experienced inflows of $136 billion in 2024, while bond funds reported net inflows totaling $530 billion. After two years of outsized equity returns, I'd like to think that this was the result of the surging popularity of annual rebalancing, but I doubt it.

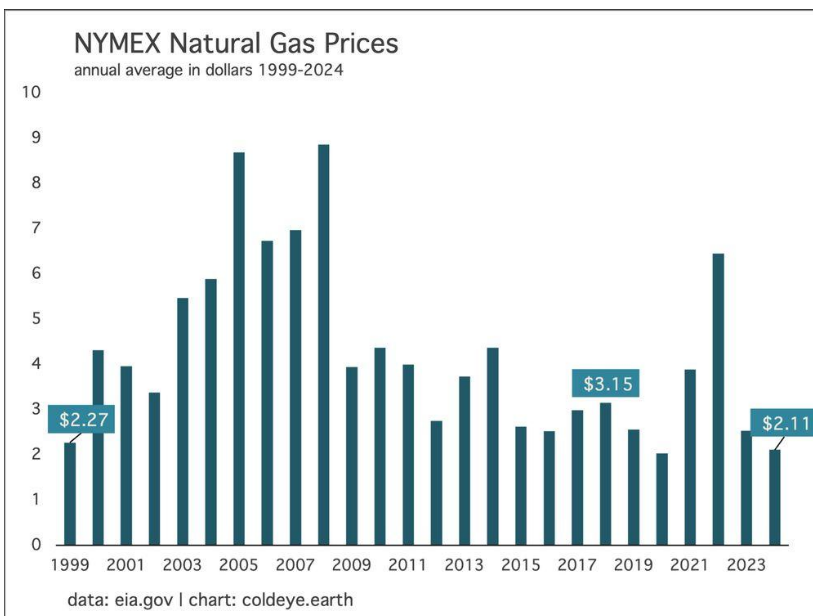
Vanguard's Jack Bogle split his portfolio evenly between stocks and bonds in a 50/50 portfolio. He once commented, *"I spend about half of my time wondering why I have so much in stocks, and about half wondering why I have so little."*

Financial journalism's daily mission is to explain why the stock market went up or down. But the global economy is too complex to be broken down into sound bites or 500-word articles. If the market rose today, a piece of good news will be noted. If it fell, some bad news will be noted. No proof will be provided for the supposed cause/effect relationship. The financial media won't admit that the market often rises and falls for no apparent reason because if they did, their audience would tune out and their advertisers would get antsy.

We tend to assess the relative importance of issues by the extent of coverage in the media. Psychologists refer to this as availability bias, and it's a big problem in investing. When making important or complex decisions, we don't consider all alternatives. Instead, we tend to focus our attention on those that come to mind first. Even though we all want to buy low and sell high, we are less inclined to invest in stocks after reading large font headlines during a market decline. Active investors can't resist stocks with recent exceptional performance, and nothing generates media hype more than a price chart that looks like the left side of the Eiffel Tower. Unfortunately, this is usually a precursor to the right side of the chart looking like the right side of the Eiffel Tower. What we pay attention to tends to drive the decisions we make, and investors are continually exposed to meaningless noise masquerading as meaningful information.

Many sales pitches for investment products are just wishful thinking supported by flawed analysis, exaggeration, misstatements, and dramatization -- all designed to impress the client who too often will mistake complexity for sophistication. It might help warn investors if financial professionals who pitch commissioned products of questionable value were forced to do so wearing ski masks.

All financial bubbles have a short, easy to understand story that sounds true but isn't. We continue to jump on bubble bandwagons because we like get-rich-quick stories and ignore the lessons learned from past manias, bubbles, and crashes.



Natural gas is traded on the NYMEX Exchange and priced in dollars per 10,000 million British thermal units (MMBtu). This chart shows the annual average price of natural gas for the past 26 years. I can remember reading an article on the price of natural gas sometime in 2008. The author predicted that we would never again see natural gas prices below $8 per MMBtu. Even though US domestic natural gas use has increased over the past 15 years, today, natural gas sits at 20-year lows and has an inflation adjusted price of about $1.20 in 1999 dollars. One of the biggest contributors to low natural gas prices is the boom in U.S. shale gas production. Advances in hydraulic fracturing (fracking) and horizontal drilling allowed energy companies to access large reserves of natural gas previously locked in shale rock formations. This significantly boosted supply, driving prices down.

Two years ago, everyone in the smart money crowd was predicting that we were heading into a recession. Yet, somehow, it never came to pass. Economists in a *Wall Street Journal* survey now see a 22% likelihood of a US recession occurring in the next 12 months, the lowest percentage since January 2022. This is noise masquerading as news.

During last year's election season, there was talk about price controls on food. Rent control has always been a popular topic of the political left. But apartments aren't any different from bread, eggs, or potato chips. Politicians can set limits on prices, which is popular with voters, but other than in the most dictatorial countries, they can't force suppliers to produce goods at regulated prices that don't allow for reasonable profits. Politicians can make promises of unlimited benefits and free stuff for everyone. But in the real world of economics, it never works.

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	10 Years
REITs 2.4%	Small Cap 26.6%	EM 37.3%	Cash 1.7%	Large Cap 31.2%	Large Cap 18.3%	REITs 40.5%	Comdty 17.5%	Large Cap 26.2%	Large Cap 24.9%	Large Cap 13.0%
Large Cap 1.3%	Mid Cap 20.5%	Int'l Stocks 25.1%	Bonds 0.1%	REITs 28.9%	EM 17.0%	Comdty 31.1%	Cash 1.4%	Int'l Stocks 18.4%	Mid Cap 13.6%	Mid Cap 9.4%
Bonds 0.5%	Comdty 12.9%	Large Cap 21.7%	TIPS -1.4%	Mid Cap 25.8%	Mid Cap 13.5%	Large Cap 28.8%	**EW -11.5%**	Mid Cap 16.1%	Small Cap 8.6%	Small Cap 8.9%
Cash -0.1%	Large Cap 12.0%	Mid Cap 15.9%	Large Cap -4.6%	Small Cap 22.6%	Small Cap 11.4%	Small Cap 26.8%	TIPS -12.2%	Small Cap 16.1%	**EW 7.6%**	**EW 5.4%**
Int'l Stocks -1.0%	EM 10.9%	Small Cap 13.1%	REITs -6.0%	Int'l Stocks 22.0%	TIPS 10.8%	Mid Cap 24.5%	Bonds -13.0%	REITs 11.8%	EM 6.5%	Int'l Stocks 5.2%
TIPS -1.8%	**EW 10.0%**	**EW 12.6%**	**EW -7.2%**	EM 18.2%	**EW 7.8%**	**EW 16.3%**	Mid Cap -13.3%	**EW 10.2%**	Comdty 5.6%	REITs 5.1%
Small Cap -1.8%	REITs 8.6%	REITs 4.9%	Small Cap -8.6%	**EW 17.5%**	Int'l Stocks 7.6%	Int'l Stocks 11.5%	Int'l Stocks -14.4%	EM 9.0%	Cash 5.2%	EM 2.9%
Mid Cap -2.5%	TIPS 4.7%	Bonds 3.6%	Mid Cap -11.3%	Bonds 8.5%	Bonds 7.5%	TIPS 5.7%	Small Cap -16.1%	Bonds 5.7%	REITs 4.8%	TIPS 2.1%
EW -4.7%	Bonds 2.4%	TIPS 2.9%	Comdty -13.1%	TIPS 8.4%	Cash 0.4%	Cash -0.1%	Large Cap -18.2%	Cash 4.9%	Int'l Stocks 3.5%	Cash 1.6%
EM -16.2%	Int'l Stocks 1.4%	Comdty 0.7%	Int'l Stocks -13.8%	Comdty 7.6%	Comdty -4.1%	Bonds -1.8%	EM -20.6%	TIPS 3.8%	TIPS 1.7%	Bonds 1.3%
Comdty -28.2%	Cash 0.1%	Cash 0.7%	EM -15.3%	Cash 2.0%	REITs -4.6%	EM -3.6%	REITs -26.2%	Comdty -9.9%	Bonds 1.3%	Comdty 0.7%

Funds: EEM, VNQ, MDY, SPSM SPY, EFA, TIP, AGG, DJP, BIL

This chart from Ben Carlson's *A Wealth of Common Sense* blog shows the performance ranked annual returns for ten asset class index funds from 2015 - 2024 along with the annualized average return for each fund for the decade. EW is the return for a portfolio allocated 10% to each fund. The EW portfolio can't be the best annual performer, but it wound up in fourth place for the decade – not bad at all. Diversification is the best way to lower portfolio volatility and has historically been the most effective strategy for investors to achieve their financial goals.

The chart shows that returns from one year to the next are random, having no pattern or persistence. The last ten years have been great for investors who have overweighted large cap domestic stocks. It is worth noting that the same chart for 2000 - 2009 had large cap stocks in last place, with an annualized average loss of 1% for the first ten years of the 21st century. This chart reveals the large variation in the annual returns of each asset class. Investors are often warned of "reversion to the mean". If an asset class has outperformed its long-term rate of return in the recent past, like Emerging Markets in 2017, REITS in 2021 and Commodities in 2022, we should expect that a period of underperformance will follow.

The unpredictability of the relative performance of asset classes and the large variation in the annual return of each asset class is why portfolio rebalancing is so important. It is the most effective way to deal with the randomness and unpredictability of returns. Investors who rebalance annually back to the portfolio allocation in their financial plan will do the opposite of what human nature tells them to do. They will buy last year's performance laggards and sell last year's outperformers. This is the opposite of what performance chasers do. In the years to come both are likely to experience reversion to the mean -- to the benefit of rebalancers and the detriment of performance chasers.

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