On Course Financial Planning

Facing the Future with Optimism and Courage

December 2022

Vectors

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Time Travelling

Every so often, investors experience a disappointing year that they'd like to forget. 2022 will join other noteworthy years that, at the time, were proclaimed by the media as the beginning of the end of everything that we hold dear. Let's travel back in TIME to see how it covered the news in several other forgettable years.

October 19, 1987, saw the largest one-day percentage decline in the history of the stock market -- 23%. In its November 2, 1987 issue, Time magazine proclaimed that Wall Street's new bear market had changed the world – whatever that means. Articles in this issue included - *I Feel A Lot Poorer Today, A Shock Felt Round the World, After the Fall*, and *Panic Grips the Globe*.

These articles read as if they were written last week. But the world didn't end in 1987 because the world was not suddenly different.
According to The 500 at your Fingertips, from November 1987 through the end of November 2022, the S&P 500 Index has yielded an annualized average return, with dividends reinvested, of 10.5% and a real (inflation adjusted) annualized average return of 7.6%.

Let's move on to the October 15, 1990 issue. A collapse in real estate prices led to the savings and loan crisis. A good portion of the savings and loan industry was liquidated by the Resolution Trust Company -- a new federal agency set up to manage the crisis. A war with Iraq over Kuwait was imminent. Oil prices were rising. The economy had entered a recession and another bear market arrived on Wall Street. As Harold Lloyd held on for dear life, the cover of *Time* magazine proclaimed –

Looming Recession   Government Paralysis   The Threat of War

In the issue were two frightening articles for investors – *All Shook Up* and *Beware the Day of the Bear*. From October 1990 through the end of November 2022, the S&P 500 Index has yielded an annualized average return, with dividends reinvested, of 10.4% and a real annualized average return of 7.7%.

Eventually, we overcame our high anxiety and the economy and stock market recovered. But then came the summer of 1998. Russia, the world's hottest stock market in 1997, (hard to believe today) defaulted on its debt (not hard to believe today). This led to the insolvency of the world's largest hedge fund – Long Term Capital Management - which had made a highly leveraged bet on Russian bonds. (Hey, what could go wrong?) The global financial system was threatened. Emerging market economies collapsed, and a new bear market began. TIME's cover on the September 14, 1998 issue showed hapless citizens walking the gang plank into economic oblivion. Anyone brave enough to read the issue would have seen the following articles – *Fear Reigns on the Floor (of the stock market), What You Can Do Now,* and *Why Mondays Are Stormy (on Wall Street).*
From September 1998 through the end of November 2022, the S&P 500 Index has yielded an annualized average return, with dividends reinvested, of 7.7% and a real annualized average return of 5.0%.

Those of us who avoided falling into oblivion in 1998 got to enjoy the next bull market until the growling bear reappeared on Wall Street and on TIME's March 26, 2001 cover. Pity the hapless former owner of the hat, tie and shoes. The bear looks like he's still hungry. You may not remember the first three bear markets, but most of us can remember the dotcom crash. Some of the articles – *Zap! - Stock Wealth Is Being Vaporized, (Nasdaq's Boom) Busted by Broadband,* and *In the Bear Cave*.

From March 2001 through the end of November 2022, the S&P 500 Index has yielded an annualized average return, with dividends reinvested, of 7.7% and a real annualized average return of 5.1%.

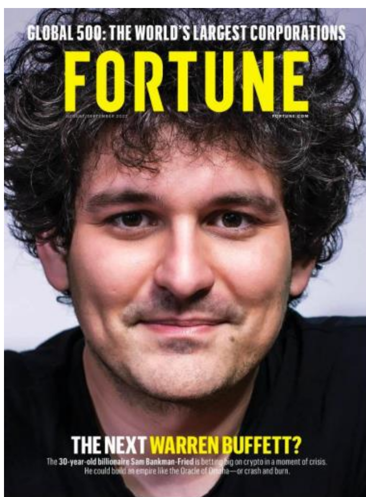
Somehow, we survived, and by October of 2007 the stock market was at a new all-time high. But by the middle of 2008 we were in the middle of the Global Financial Crisis. NINJA (no income, no job) mortgages, excessive risk-taking by global financial institutions, and the bursting of the US housing bubble created a perfect storm. Financial institutions suffered severe damage, reaching a climax with the bankruptcy of Lehman Brothers on September 15, 2008. The October 13, 2008 cover of TIME was as frightening as the previous four. If standing in a soup line isn't unpleasant enough, how about standing in a soup line in the rain? To those intrepid souls with the stomach to read inside – *The End of Prosperity* (Did TIME's editors really think that we were in store for permanent impoverishment?) and *Surviving the Wall Street Storm*.

From October 2008, through the end of November 2022, the S&P 500 Index has yielded an annualized average return, with dividends reinvested, of 12.6% and a real annualized average return of 10.1%.

The world has changed a lot in the past 35 years, but one thing that hasn't changed is catastrophic journalism. As the TIME magazine covers reveal, all bear markets and recessions are proclaimed to be different and more frightening than their predecessors. Today, many pundits claim that the current bear market and the prophesied 2023 recession are the result of unique, ominous circumstances that are sure to bring ruin.

The news is relentlessly negative primarily because pessimism can be easily proclaimed in a headline, tweet, or 30-second news clip. Progress is not visible in the short-run and optimism comes from careful analysis and perspective – two things in short supply these days. Historically, the damage done to stocks in bear markets has been more than overcome in the ensuing economic expansion. Today's lower prices and falling valuations are laying the foundation for tomorrow's gains. Warren Buffett has famously advised investors to remain optimistic, to be greedy when others are fearful. As he has said, *"Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold."*

In the News



In its August/September 2022 issue, Fortune Magazine profiled Sam Bankman-Fried, known as SBF to his admirers, who Fortune thought might be "The Next Warren Buffett". Like Buffett, the billionaire wunderkind of crypto was greedy when others were fearful. *"He could build an empire like the Oracle of Omaha - or crash and burn."* In 2017, the 25-year-old MIT graduate started Alameda Research a hedge fund to trade cryptocurrencies. A few years later, he started FTX, a cryptocurrency exchange. Crypto enthusiasts deposited billions of dollars in FTX to buy, sell and hold digital assets.

The king of crypto apparently had the Midas touch. His personal wealth was estimated to be around $26 billion. Anyone that young and that rich must be a genius. SBF became the white knight of the crypto industry, rescuing several failing crypto exchanges from liquidation by buying their assets. In an industry plagued by greed and fraud, SBF was everybody's favorite nerd who ran crypto's most trusted exchange.

Celebrities like Larry David and Tom Brady appeared in FTX ads during this year's Super Bowl. The FTX Arena is home to the Miami Heat of the National Basketball Association. While many newly minted crypto millionaires led lavish lifestyles, SBF denounced materialism; embracing the philosophy of effective altruism - that by making as much money as possible, you can do the most good for the most people. Crypto's golden boy fascinated his audiences, many of whom didn't understand the first thing about crypto but liked to think that they did. Hey, what could go wrong?

Cryptocurrencies crashed this year (Bitcoin is down 65%) and it was revealed last month that SBF transferred $10 billion in FTX customer deposits to Alameda to cover trading losses. The cash infusion allowed Alameda to continue trading, hopefully to recoup its losses, at which point the $10 billion could be returned to FTX. No harm, no foul. But when FTX customers learned of the transfer, they started a classic bank run to get their money. The crypto crash left FTX undercollateralized and there wasn't enough money to cover the $6 billion in withdrawal requests. On November 11, FTX filed for bankruptcy. SBF has resigned as FTX's CEO. Alameda is also bankrupt. Cryptocurrencies remaining at FTX are frozen due to the bankruptcy filing, and no one knows how much customers will get back or when.

Besides the money transferred to Alameda Research, which apparently lost most or all of it, FTX loaned Bankman-Fried $1 billion and another executive received a $500 million loan. Curious minds wonder - why does someone worth $26 billion need to borrow $1 billion? Despite being unable to account for billions of FTX customers' dollars, Mr. Bankman-Fried denies committing fraud or intentionally misusing customer funds. It has become apparent that, unlike Warren Buffett, this emperor has no clothes. The financial media, sports figures and celebrities who endorsed and popularized FTX were witless enablers of SBF's con job (pardon me, alleged con job).

The fraud at FTX caused one of the largest rapid destructions of wealth in financial history. Bankruptcy court filings state that FTX has $1 billion in liquid assets and $9 billion in liabilities. FTX's new CEO, John Ray, said that he believed gross negligence was involved and that a *"substantial portion"* of FTX customers' assets may be *"missing or stolen."* Additionally, FTX's collapse *"appears to stem from the absolute concentration of control in the hands of a very small group of grossly inexperienced and unsophisticated individuals."* Sam Bankman-Fried was arrested December 12th in the Bahamas after the U.S. filed criminal charges, and it is reported that the Securities and Exchange Commission plans to accuse Mr. Bankman-Fried of committing securities fraud.

Not since Bernie Madoff's Ponzi scheme have investment professionals been so criticized for failing to do basic due diligence. Bernie Madoff asserted that several banks and hedge funds were complicit in his Ponzi scheme. In his words, *"They had to know. But the attitude was, 'If you're doing something wrong, we don't want to know.'"* The prominent venture-capital firm, Sequoia Capital, Singapore's state-owned investment company Temasek, the Ontario Teachers' Pension Plan, SoftBank Group, and hedge funds Third Point and Tiger Global, somehow failed to discover that FTX never held board meetings, had no audited financial statements and could not produce an accurate list of its employees or bank accounts. Did the managers of these firms really believe that SBF was making billions by trading imaginary "coins"? They never envisioned that they were being duped by a supreme con artist (pardon me, alleged con artist). It's not the first time that Investment advisory firms seeking market beating performance have gotten in bed with the devil. And if you get in bed with the devil, don't be surprised if you wake up in the middle of the night with your jammies on fire.

Even after his fraud was exposed, SBF maintained a high media profile and he was treated as if he did nothing wrong. In a virtual interview with the New York Times from his luxury home in the Bahamas, SBF summarized his alleged con by saying, *"Look, I screwed up."* In another interview, he said he thinks he is down to $100,000 *"or something like that"* in his bank account. In an interview with the Wall Street Journal, SBF noted that he was never comfortable with fame: *"It's not even that I enjoyed it particularly…It opened a lot of opportunities and doors that seemed very exciting to be exploring. And my mind wandered, and I got really distracted."* Caught with your hand in the cookie jar? No problem. Just blame it on distractions.

Customers of unregulated crypto platforms lack safety nets such as deposit insurance that protects investors when traditional banks and brokerages fail. The task of cleaning up after FTX and other recent crypto failures has largely fallen to U.S. bankruptcy courts, which have only begun to answer how crypto customers should fare in an insolvency.

Nobody becomes a billionaire just by being smart. You also need to be lucky. It appears that SBF's fortune came from making big leveraged bets on crypto during its stratospheric rise. I've said it many times, when the left side of the chart looks like the left side of the Eiffel Tower, it won't be long before the right side of the chart looks like the right side of the Eiffel Tower. The rapid rise in the price of many cryptocurrencies that made some speculators temporarily wealthy had all the characteristics of a classical mania. Crypto may be the biggest "greater fool" investment in our lifetime, taking its place alongside the 17th century Dutch tulip bulb mania as one of the most notorious manias, bubbles and crashes in history. Time will tell.

Sam Bankman-Fried is just the latest con artist (pardon me, alleged con artist) who mesmerized investors with an exciting story that promised quick wealth with little or no effort. No one is going to get excited hearing that investing should be boring. That, over a 20-year period, they can expect to earn annualized average returns of 6% to 7% by owning a diversified portfolio of boring stock and bond index funds (and expecting losses one year out of four). Thus, every day people invest their hard-earned dollars in investments they don't understand, with promised returns too good to be true, on the advice of people they barely know, all the while hoping that they won't be cheated.

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Well, that's it for 2022. There's only one thing left to say - Merry Christmas to all, and to all a good night.

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