S.F. EHRLICH
ASSOCIATES, INC.

August 15, 2017

Managing YOUR Money

STAN'S WORLD

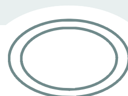
As you might imagine, John and I spend a lot of time reading both professional journals as well as more mainstream publications, such as the Wall Street Journal and Barron's. Thus, we're familiar with the current debate about robo-advisors and which investors might benefit from using them.

The term robo-advisor was coined to describe portfolio management with minimal human contact. For a relatively small fee, an investor can open an account, make a deposit, complete a suitability questionnaire, and have his/her money placed into a model portfolio for investment.

That type of model is probably most appropriate for younger investors who have relatively small portfolios. They don't need advice, are not interested in retirement planning, and have few issues that require interaction with a personal advisor. In fact, early robo-advisor programs were more like mutual funds; give the custodian your money to manage, sell when you want, and add as you see fit.

The prospect of managing more money (and collecting more fees) has led to a considerable expansion of robo services, and the big boys have entered the fray. Firms like Vanguard and even Schwab are now in the robo marketplace, and they are rolling out expanded services. But the question remains: are they merely putting lipstick on programs primarily focused on gathering assets to collect fees, or are they taking steps to supplant and replace financial advisors? Perhaps most importantly, whose interests do they have at heart?

Bloomberg News recently pointed out a potentially significant conflict of interest on some robo-advisor platforms. Specifically, the portfolio that a robo-advisor offers its clients may be influenced by payments made to the custodian by companies trying to put their mutual funds onto the robo-advisor platform. (A platform is the term used to describe the collection of mutual funds offered by a custodian.)



STAN'S WORLD (CONT'D)

If the collection of mutual funds is influenced by payments made to certain custodians, investors may be short-changed in terms of not being able to select from low cost, or appropriate, mutual and exchange-traded funds. If that sounds like a conflict of interest, let's just say that anyone who call himself a fiduciary would never be able to pick investments for clients based upon payments received from others.

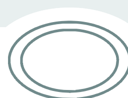
And then of course, there's the whole issue of competency. A few years ago, both Vanguard[1] and Morningstar[2] published studies that sought to measure how much a financial advisor can add to a clients' annual returns over the long-term. Their findings were significant, revealing that an advisor can add up to 3% per year to overall portfolio returns.

To be clear, adding up to 3% per year to portfolio returns doesn't necessarily mean selecting better mutual funds. It pertains to the sum of activities that in totality contribute to higher returns, such as: (1) behavioral coaching (i.e. keeping you in the market when you're ready to throw in the towel), or educating you as to why concentrating your assets into one sector could be detrimental to your long-term financial health; (2) asset placement, or assuring that your assets are properly placed in both taxable and qualified accounts to try to reduce current and future taxes; (3) periodic rebalancing to maintain the risk level appropriate for your long-term needs as well as your personality; (4) helping to determine an appropriate spending strategy through the multiple phases of retirement; and (5) suitable asset allocation (i.e. how much money you should put at risk in the stock market, bond market, etc).

In addition, if you hold accounts at multiple custodians, robo-advisors are unlikely to be interested in providing advice on assets that are held elsewhere. Even if they offer advice via an 800#, it's highly unlikely that the on-call representative will talk about investments in an investor's 401k plan, or help to calculate insurance needs; or speak with an accountant about tax planning; or coordinate with the family attorney on beneficiary designations; or help an investor's child buy a first home; etc, etc.

BY THE NUMBERS[4]

- The **findings of the Federal Reserve's "stress test"** completed on 34 large US banks were released on 6/22/17. The tests, created in 2009, showed the banks all passed for the third consecutive year. The banks were put through financial simulations to determine if they could survive a two-year economic slump that included a 10% national unemployment rate, 50% decline in stock values, 25% drop in home prices and 35% decline in commercial real estate prices.
- The **yield on the 10-year Treasury note** closed at 1.36% on 7/8/16, its lowest closing yield ever. 10-year notes have traded in the US since 1790. The current rate on the 10-year Treasury note is approximately 2.20%.
- Moody's estimates that the unfunded pension liability for the 5 **public pension systems** in Illinois is $250 billion, double the $127 billion estimate from the state's actuaries, a function of the state using more optimistic investment assumptions than used by Moody's.
- 31% of American workers surveyed have accumulated no **money for their retirement** on either a pre-tax or post-tax basis.
- In July 2009 there were 14.6 million **unemployed** Americans and 2.2 million job openings. In April 2017 there were 7.1 million unemployed Americans and 6.0 million job openings.



STAN'S WORLD (CONT'D)

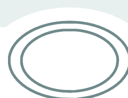
And in what may turn out to be the biggest point of all, robo-advisors (even those with 800#'s) haven't been tested in down markets. How will they, and their representatives respond, when their phone lines are deluged with callers during market drops of 20, 30, 40, or even 50%?

If I sound biased, it's because I am. I believe investors hire financial advisors because they want a positive financial outcome; and if they're confident that the advisor will partner with them through the myriad of ups and downs that life throws our way, then they'll be willing to pay the fee for the advisor's services. Once an advisor loses interest in a client, or no longer has the time to address that client's personal needs, then the advisor should be replaced by either another individual or a computer.

We keep an eye on the marketplace, so we'll continue to charge fees that are appropriate for the services that we render. A lot of our work has nothing to do with managing money, and we don't believe robo-advisors can compete with the non-financial tasks that we perform for our clients on a daily basis. An algorithm and an 800# only go so far; the studies by Vanguard and Morningstar show what we're really worth.

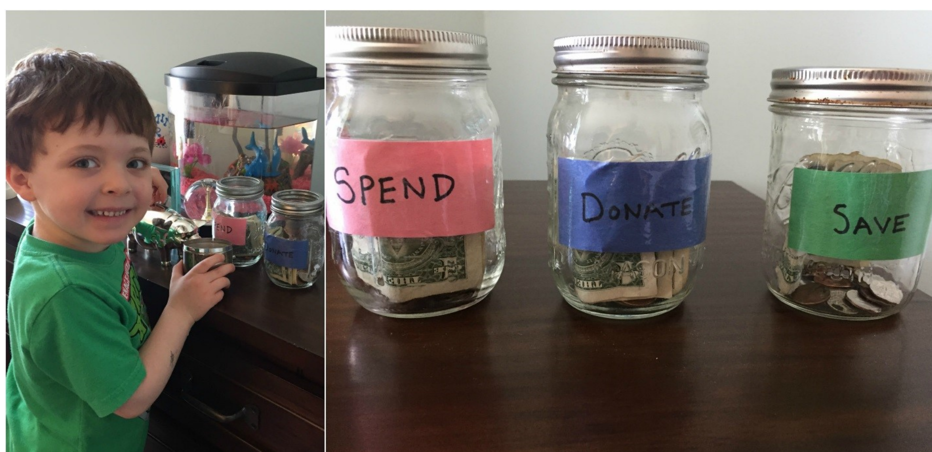
BY THE NUMBERS[4]

- **Permits for the construction** of 6.14 million single family homes were issued during the four years 2003-2006. Permits for the construction of 6.08 million single family homes were issued during the 10 years 2007-2016.
- One of every 24 individual **income tax returns** (4.2%) filed for tax year 2014 reported adjusted gross income of at least $200,000.
- There were 61 million Americans who received **Social Security** benefits (retirement or disability) in 2016, or 19% of the US population. Social Security's total income (payroll taxes collected plus interest earned) amounted to $957 billion last year, $35 billion more than the $922 billion of program expenditures and outlays. Social Security actuaries predict the program will have just 5 more years (2017-2021) where total income will exceed expenditures and outlays.
- An estimated 17% of American adults will provide some level of **care to their aging parents** (e.g. dressing, bathing, feeding or shopping) at some point in their lives.
- The **median square footage** of new single family homes built in the US in 2016 was 2,422 square feet, an increase of 532 square feet over the last 25 years. That's equivalent to a 23' x 23' addition to a new home today compared to a home constructed in 1991.



KIDS AND PERSONAL FINANCE: JOHN'S STORY OF STARTING 'EM EARLY

September is right around the corner, which means it's back-to-school time. No doubt that any parent with a child under the age of 18 is scrambling around, helping their kids pick up the necessary materials they need for a successful year. Just imagine the slate of courses primed for your child or grandchild: social studies, math, biology, art, personal finance...wait, what? No personal finance class, you say?

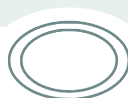


You're not alone. According to a 2016 study by the Council for Economic Education[3], only 20 states require students take a high school course in economics, with the number of states with standardized testing in economics dropping from 27 to 16 since 2002. Further, only 17 states require high school students to take courses in personal finance. In our neck of the woods, New York and New Jersey are two of those 17 states while Pennsylvania, Connecticut, and Delaware have yet to meet the standard for either economics or personal finance classes.

This is occurring as a) employers are transitioning the burden of saving for retirement from the employer to employee by eliminating employee provided pensions in favor of employee-funded 401(k)s, and b) college costs rise at such an astronomical rate that students frequently enter the work force saddled with loads of student debt. Lacking the appropriate tools to meet such challenges, these kids are going to be behind the eight ball right from the start.

BY THE NUMBERS[4]

- 27% of the 12.4 million **manufacturing jobs** in the US today are held by employees who are at least age 55.
- The top two states in the US for "**road quality**" are Nebraska and Tennessee. The bottom two states are Connecticut and Wisconsin.
- 8/5/17 was the 6-year anniversary since **Standard & Poor's downgraded the US** from its AAA credit rating. Since then, the yield on the 10-year Treasury note has fallen from 2.57% to 2.20% and the S&P 500 has gained more than 130%.
- If you selected any single month at random to invest in **the S&P 500 during the 25-years ending 6/30/17**, you achieved a positive return for that month 66% of the time. If you extend your time horizon to just one year from the date of investment, you achieved a positive return 81% of the time. If your time horizon was two years, you achieved a positive total return 80% of the time.
- There are 2.8 workers paying **payroll taxes** for every **Social Security** beneficiary in 2017. There will be an estimated 2.2 workers for every Social Security beneficiary in 2035.
- Of 1,828 Americans surveyed, 31% said they did not **attend college** because it was too expensive.
- 95% of the companies in the S&P 500 have **underfunded pension plans**.

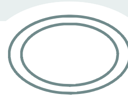


KIDS AND PERSONAL FINANCE: JOHN'S STORY OF STARTING 'EM EARLY (CONT'D)

Other than e-mailing your local politician, there are other steps you can take to help combat the dearth in financial literacy. If you're not familiar with the butterfly effect, it's the idea that small actions (e.g. a butterfly flapping its wings today) can result in large effects in the future (e.g. a tornado several weeks later). Hoping there's something to the butterfly effect, my wife and I decided it was time to start giving our 5-year-old son, Ben, a weekly allowance. Rather than the traditional model of giving him a weekly payment (in our case, $3), we decided to give him three clear glass jars to use as repositories for his weekly stipend.

Each glass jar has a distinct goal (which sounds like one of our financial plans): Spend, Donate, and Save. For each $3 payment, Ben has to save $1 to each bucket. As dollars accumulate, he can use those funds to spend towards each goal, with the "Spend" jar obviously being the most popular. (This savings tool is obviously best used for someone Ben's age, with 4-8 years old probably the optimal age range.) From both a parent's and a financial planner's perspective, this approach accomplishes a few very important goals:

- **He can see his savings grow:** Rather than saving money to a piggy bank that's typically opaque or solid, saving to a glass jar allows Ben to visually see his weekly savings accumulate. If we're out at a restaurant or the grocery store and I get some extra loose change, I'll give it to him, and he'll rush home to put it in one of the jars of his choice, only to see the volume of money in the jar increase as more is added to it. Children at that age are visual learners - take advantage of it. An open jar also allows him the ability to count money whenever he wants, which develops math skills.
- **He's learning to associate money with distinct goals:** Ben currently has three financial buckets he's saving towards - Spend (toys), Donate (gifts to charity), and Save (savings for the future). He currently only sees the immediate benefit of the Spend jar but soon will at least be able to experience the process of donating to charity. He may not yet be old enough to appreciate the magnitude of giving to charity, but we would rather err on the side of exposing him to such acts sooner vs. later so that when he's ready to appreciate it, it won't be completely foreign to him.
- **Stuff costs money!** As early as possible, teaching your child about the exchange of money for items can be extremely valuable. This concept is one of the fundamental building blocks of understanding money. Despite Ben wishing otherwise, Matchbox cars don't grow on trees!



KIDS AND PERSONAL FINANCE: JOHN'S STORY OF STARTING 'EM EARLY (CONT'D)

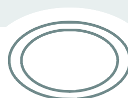
What should you do when the amounts in each jar get too large to leave around the house? Either utilize the cash for its intended goal (i.e. buy that Star Wars X-wing, or donate to a local charity of the child's choosing) or open a savings account that the child can eventually administer on his or her own when they get old enough (or to use to purchase a big-ticket item).

At an early age, there's tremendous value in allowing children to watch their account balances as they grow. Might you know anyone (i.e., kids or grandkids) who might benefit from such a savings mechanism?

And there are the older kids, especially those in college who are about to enter the working world. They face such challenges as paying off student debt, managing their own cash flow, and making decisions around employer-provided 401(k) plans once they start their first job. Feel free to send them our way. Some of our most gratifying personal finance conversations have been with 20- and 30-somethings who are not sure where to start when it comes to getting their financial house in order. These small strategies can be put in place today and can pay huge dividends down the road. But it all starts with three glass jars.

BY THE NUMBERS[4]

- Lenders **foreclosed** on 169,124 homes in the first six months of 2017, down 14.3% from the first half of 2016. The peak of bank repossessions in the last decade was in 2010 when more than one million homes were taken back by lenders.
- There are 75.7 million homeowners in the US. Of the 75.7 million, 30.6 million homeowners have no **housing debt** (i.e. they are mortgage-debt free). Of the 45.1 million homeowners that have debt on their home, just 1.8 million homeowners have mortgage debt that exceeds the value of their homes. The number of 'underwater' homeowners peaked at 15.1 million in 2010.
- Of the 524 **bank failures** that have occurred in the US during the 10 year period ending 6/30/17, more than half have occurred in 4 states: Georgia, Florida, Illinois, and California. Nine US states had zero bank failures.
- 95% of new households in the US in the last 10 years were comprised of families that are **renting** (i.e. 8.13 million new renter households out of 8.56 million new households).



WATCH OUT FOR FRAUDULENT EMAILS THAT LOOK LIKE THEY'RE COMING FROM CHARLES SCHWAB

A client forwarded an e-mail that had all the trademarks of a communication from Charles Schwab. Fortunately, our client was savvy enough to realize it was not sent by Schwab, but by someone seeking his log-in credentials. He forwarded it to me, and I sent it on to Schwab's security team.

It's called 'phishing', and it involves an attempt by criminals to get you to respond to their e-mail by thinking it's legitimate correspondence from your custodian, bank, or credit card company. When you log-in, they record your key strokes, and can in turn log into your account. With any luck and a bit of skill, they can transfer funds out before you (or the institution) realize the money is gone.

Should you ever receive any suspicious e-mail, start by looking at the return address. Does it say Schwab.com? When in doubt, or always, Google the 800# of the bank or custodian (NEVER call the 800# on the e-mail, as the 'representative' on the line may be a Ukrainian speaking heavily accented English) and call to inquire as to the origin of the correspondence.

If the questionable e-mail is from Schwab, start by calling us, and then forward us the e-mail. When in doubt, contact the Schwab Alliance Team: 800 515-2157.

INTRODUCING OUR NEW CHIEF COMPLIANCE OFFICER

John has added a new title at S.F. Ehrlich, and it's Chief Compliance Officer. In that capacity, John will make sure we're current with the myriad of rules and regulations we have to follow, and will be happy to answer any questions you may have on that subject.

BY THE UMBERS[4]

- The **longest bull** market for the S&P 500 since 1950 lasted 3,452 calendar days (i.e. the 9.5 year period from 10/11/90 to 3/24/00). The current bull market for the S&P 500 is a little under 3,100 calendar days, or approximately 8.5 years since 3/9/09. The current bull market would have to last until 8/22/18 to reach 3,453 calendar days.
- 48 million Americans are at least **age 65** today, representing 15% of the 326 million citizens in the US. The number of age 65+ seniors is projected to increase by a net of 4,700 per day over the next 18 years. (A net increase is the number of seniors turning age 65 each day minus the number of deaths in the 65+ age group.)
- Halfway through calendar year 2017, 5,300 **retail stores** have closed, equal to more than 200 per week.

S.F. EHRLICH ASSOCIATES, INC.

S.F. Ehrlich Associates, Inc. has been providing financial advice on a fee-only, independent basis for over 20 years.

Did we mention? *If you have a friend or family member who you think might benefit from a discussion with John or Stan about financial planning and asset management, please pass along our phone number and e-mail address. Long-term growth is not only important to portfolios, it's also critical to a business.*

*If you have a friend, co-worker, or relative who's in need of financial advice due to a pending or actual job loss, please give them our contact information. We're always glad to speak **pro bono** with people who need a hand.*

CLIENTS: *Please remember to contact S.F. Ehrlich (a) if there are any changes in your financial situation or investment objectives, (b) if you wish to impose, add or modify any reasonable restrictions to our investment management services, or (c) if you've changed your permanent residence.*

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Footnotes:
[1] Kinniry, Francis M., et al. "Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha®." Vanguard Research, 31 Dec. 2015.
[2] Blanchett, David, and Paul Kaplan. "Alpha, Beta, and ... More Gamma." Morningstar Advisor, Morningstar, Inc., 9 June 2017.
[3] "Survey of the States: Economic and Personal Finance Education in Our Nation's Schools." Council for Economic Research, 2016.
[4] "By The Numbers." Direxion ETFs & Funds, 9 Jul. 2017 through 14 Aug. 2017.

S.F. Ehrlich Associates is a fee-only financial planning and asset management firm. Managing YOUR Money is compiled entirely by Stanley F Ehrlich and John Zeltmann. Questions or comments are always welcome (and encouraged!) and should be sent to stan@sfehrlich.com.

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