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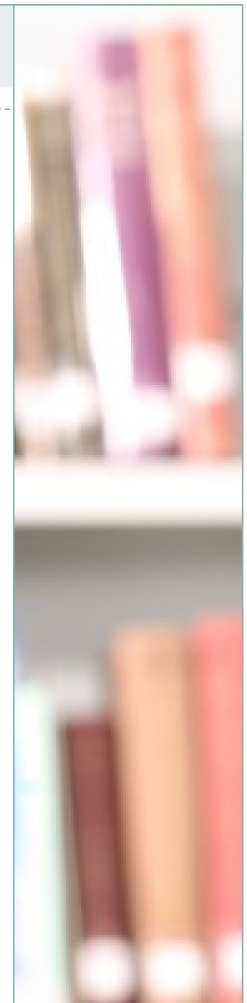


# Managing YOUR Money

## STAN'S WORLD

The on-going debate between actively managed and passively managed mutual funds has picked up steam recently. Actively managed funds are mutual funds with an investment team that seeks to buy the 'best' stocks for their portfolio. I have an image of the chief investment officer standing on a desk in the middle of that fund's trading floor screaming: "Buy only winners; sell all the losers. Your bonuses depend on it!" (Maybe I need to watch the movie Wall Street to see if they actually do that.)

Passively managed mutual funds follow an index, even if it comes with a slight twist. There are mutual funds, for example, that follow the S&P 500. They use sophisticated trading programs to ensure that the composition of their mutual fund follows the daily fluctuations of the S&P 500. Each day the program will dictate that they buy more of certain stocks while pruning positions in others. Presumably there's no yelling, and the people who write their trading software programs probably receive the biggest bonuses.

In recent years, active management has fallen out of favor, as many actively managed funds have failed to keep up with their passively managed brethren. It leads active managers to routinely declare that active management is better when markets go up, or active management is superior when markets go down. Or maybe they perform better when markets go sideways.

On more than a few occasions, I've been asked by clients if I know these winning managers, or at least a few of their winning stocks. (I don't know either.) I can only assume that some investors conclude that passive isn't sexy (i.e., not enough 'action') and therefore can't be the most profitable way to invest. To that I say, au contraire.

## STAN'S WORLD (CONT'D)

Dan Solin, author of The Smartest series of books (e.g., "The Smartest Investment Book You'll Ever Read," etc.) notes that over the past five years, almost 92% of large cap fund managers lagged the benchmark used to measure their fund's success (or lack of same). As actively managed mutual funds also have higher fees than passively managed funds, the result is high fees generated poor performance.

While Vanguard's index funds beat at least 61% of actively managed funds over the last 10-year period, the Dimensional Fund family performed even better. "On average, its funds outperformed 76% of actively managed funds over 10 years and 80% over 15 years." Since we use a number of Dimensional Funds, it was satisfying to read that statistic.

*Almost 92% of large cap fund managers lagged the benchmark used to measure their fund's success.*

The next time you think that passively managed funds are for sissies, think again. We invest in the equities and bond markets to be long-term winners, and if we can win by eliminating the risk of hiring the wrong mutual fund manager (which apparently is most of them) by going after 'average' returns, then that's a bet worth taking.

### BY THE NUMBERS

- Total **credit card debt** in the US dropped in January 2017 to $996 billion, the first month-over-month decrease since February 2016. The peak in credit card debt was $1.022 trillion in April 2008.
- Since 1950, there have been 58 different 10-year periods (i.e., the 10 years from 1950-1959, 1951-1960, etc.). The **S&P 500 produced an average annual total return** of less than +7% during 15 of the 58 decade-long periods (26% of the time). 19 of the 58 periods (33% of the time) resulted in an average annual total return of at least +14%. The S&P 500 has produced a positive total return in 56 of the 58 10-year periods, or 97% of the time.
- The **US exported** more goods and services in calendar year 2016 to the UK and Japan ($119 billion) than we exported to China ($116 billion). The population of China (1.39 billion) is 7 times the size of the 192 million people living in the UK and Japan combined.
- Earnings up to $127,200 in 2017 are subject to employee-paid payroll taxes of 6.2% that support **Social Security** benefits. An estimated 6% of American workers will make more than $127,200 in 2017.
- Ames, IA had the lowest **unemployment rate** (2.1%) while El Centro, CA had the highest (18.8%).

## RANSOMWARE: DO YOU EVER THINK YOU'RE BEING WATCHED?

It was Joseph Heller, the author of Catch-22, who pointed out: "Just because you're paranoid doesn't mean they aren't after you." As it turns out, that's especially true of your computer.

Ransomware is a relatively new term to the American lexicon. It pertains to a criminal event whereby a hacker places malware onto your computer and begins encrypting all of your data and files. Upon completion, you receive a ransom note, requiring you to make a payment to be able to access your files. If you fail to make the payment within a prescribed number of hours, you'll never receive the encryption code to retrieve your data.

You may be surprised to learn that there's honor among thieves. Ransomware is a business, and MONEY Magazine reports that once the ransom is paid (in bitcoin), the criminal entity will work with you to help you, to include providing on-line service agents. After all, they don't want to take your money and run; it's bad for business. (I think the pirates in Somalia share the same philosophy: release the hostages once the ransom is paid, so they'll pay it the next time knowing that you're an honest hostage-taker.)

To protect yourself from becoming the victim of ransomware, MONEY recommends you take the following steps:

- Get yourself some backup: Whether you use a hard drive or on-line service, be certain your files are backed-up on a continuous basis. In addition, even if you use an on-line service, such as Carbonite, you should also regularly back-up critical files onto a UBS drive or an external hard drive. (Even on-line services aren't immune from hacking.)
- Stay current: Make sure your computer's operating system, browsers, etc., are all current. Don't ignore notices that talk about upgrades and security patches. Older programs aren't safer; they're far more vulnerable to being hacked.
- Handle e-mail with care: Everyone used to fear those e-mails from Nigeria that promised lottery winnings. (I once even received a call from a friend to ask if it was legitimate. And no, she didn't respond. I hope.) Now, hackers use far more sinister ways to entice you to open attachments or upload your information to a website that you think is legitimate. NEVER open e-mail attachments, even from 'known' contacts, unless someone verbally tells you what they sent to you and when. And NEVER open a link on an e-mail, regardless of how legitimate it may look. All you're going to do is give hackers personal information and/or a way to get into your computer. And now you know what they're going to do next.

### BY THE NUMBERS

- There were **1.65 million existing homes for sale** nationwide as of 12/31/16, a total that has dropped 460,000 in the last 6 months. The 1.65 million homes for sale is the lowest level since that statistic began being recorded in 1999.
- The nation's **unemployment rate was 4.8%** as of January 2017. Adults age 25 and older with at least a bachelor's degree have just a 2.5% unemployment rate. (The lowest unemployment rate in US history was 2.5% in June 1953.)
- Only **36% of all jobs in the US require education beyond high school**, which means 64% of jobs require a high school diploma or less. 27% of jobs do not require any formal educational criteria.
- The **morning after closing at a bear market low of 677 on Monday, March 9, 2009**, John Authers (journalist for the Financial Times newspaper) wrote: "...perhaps the greatest reason for hope (for the US stock market) at present is that almost all hope seems to have been lost." At the time of Authers' forecast, the S&P 500 had fallen 57% over the previous 17 months.
- 40% of the 75 million **single family American homes** that are owner-occupied as of 12/31/16 were built before 1970.

## RANSOMWARE: DO YOU EVER THINK YOU'RE BEING WATCHED? (CONT'D)

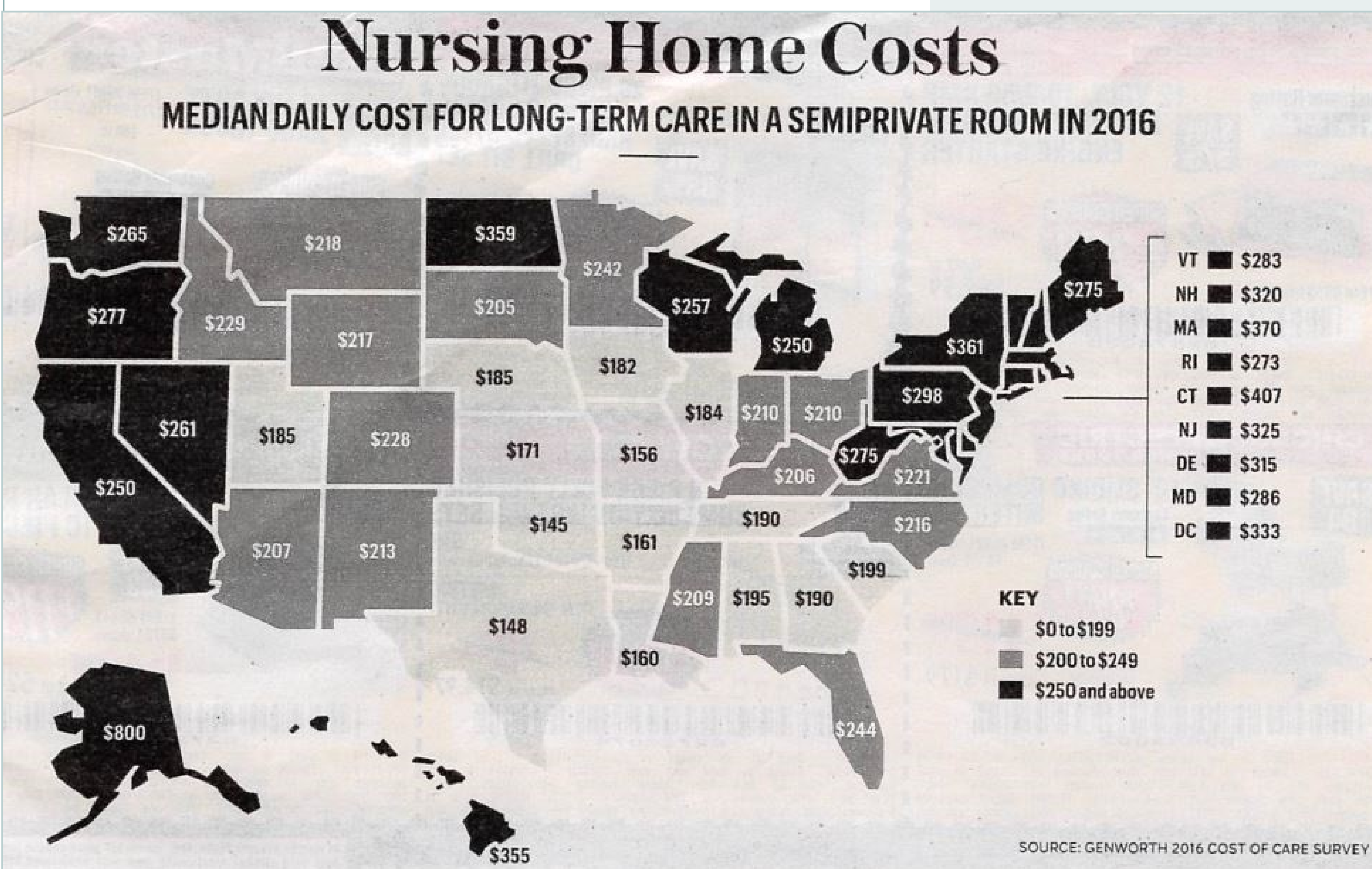
- Inoculate against viruses: While anti-virus programs aren't fool-proof, they do add another layer of protection. Make sure a program is loaded on your computer, and confirm that it automatically downloads upgrades as soon as they are available.

## NEED LONG-TERM CARE? HEAD SOUTH, OR WEST (BUT NOT TOO FAR WEST!)

Quoting the Genworth 2016 Cost-of-Care Survey, AARP estimated the median daily cost for long-term care in a semi-private room in 2016. The results are surprising, though possibly depressing, depending upon where you reside. The chart is repeated below:

## BY THE NUMBERS

- 43% of American adults that have **health insurance** coverage in force today have difficulty affording their deductible.
- 63% of American adults do not have $500 in a savings account to cover an **emergency expense**.
- There were 404 **operating oil rigs** in the US (on land and offshore) as of 5/27/16. There were 809 operating oil rigs in the US as of 3/24/17. Thus, the number of oil rigs has doubled in the last 10 months.



## ARE WE IN A STOCK MARKET BUBBLE?

The market's recent gains since the presidential election have led some investors to conclude that we must be approaching a market bubble. Mark Hulbert, writing in Barron's, says "Not so fast."

A recent academic paper defines a bubble "as a price increase of at least 100% over a two-year period followed within the subsequent two years by a drop of at least 40%." By that definition, there have only been two bubbles in our history: the market that peaked in 1929, and the dot-com bubble that peaked in 2000.

When the researchers broadened their definition to industries (i.e., the coal industry), they found 40 occasions since 1928 in which an industry rose 100% over a two-year period and then collapsed by at least 40% over the following two years. But even using criteria used for an industry bubble (i.e., volatility), there are no flashing warning signs.

None of this means that the markets won't fall over the next month/year/years, only that there's a significant difference between a bear market and the bursting of a bubble. Says Hulbert: "And on that score, at least, it appears that investors can breathe more easily."

So are the good times here to stay?  "Humans are hardwired to believe they can rely on the recent past to predict the future. As investors celebrate the eighth birthday of a bull market, that's a dangerous tendency."  The remainder of the article in FORTUNE, titled "Beware of Happy Memories", cautions investors against recency bias, which occurs when investors believe the recent performance of the market will continue into the future.

Of course, we all know the good times may continue, but just because something has happened doesn't mean it will continue to occur. Every day is a new day in the stock market, with only a slightly better chance that the market will go up that day as opposed to going down. But the fact that we've had an eight year run doesn't mean that run is unencumbered. Citing the oft-used expression, 'trees don't grow to the sky', this bull will end; we just don't know when.

### BY THE NUMBERS

- The US has kept records on **economic expansions and contractions** since 1854. The current expansion, which began in July 2009 is in its 93rd month. It is the third longest expansion in history, trailing only expansions that ran from 1991-2001 and from 1961-1969.
- The **world consumes 98 million barrels of oil per day**. 40% of the world's oil supply is produced from less than 2% of the world's largest operating oil fields.

## MIGHT I BE IMPACTED BY FUTURE CHANGES TO SOCIAL SECURITY?

With concern about the Social Security trust fund's solvency and speculation rampant that the system is bankrupt (which it actually isn't), many people wonder whether potential future changes will be directed at their retirement benefits.

The short answer is generally, "Yes, if you're under 50." I acknowledge that 50 is an arbitrary age, only used to make the point that I strongly believe that people nearing retirement don't have much to worry about when it comes to their benefits being materially altered by potential legislative changes made to save the Social Security system.

Why am I so confident? Anecdotally, I don't believe that folks in Washington will aim to make a change targeting the folks on Main Street who have paid into the system for so long and feel fully entitled (arguably so) to the benefit they've earned over the years.

Not into conclusions driven by my anecdotes? Then I'll use history. One of the more recent major overhauls of the Social Security system came in 1983, when the Federal government was faced with similar trust fund insolvency issues. Among several other resolutions passed in the bill, one of the major revisions included was a gradual increase in the age of eligibility for full retirement benefits from age 65 to age 66 in 2009 and age 67 in 2027. Simply put, they effectively changed the Full Retirement Age from 65 to 67 and did so over a transition period of 44 years!

But what about the recent legislative changes made in late 2015, eliminating the popular File & Suspend strategy as well as the Claim-Now, Claim-More-Later strategy (via the restricted application)? Those changes impacted people who were at or near collecting, right? Indeed they did. However, the number of people impacted was marginal - as we've written in other blog posts, approximately 90% of folks claim at or before Full Retirement Age (and the majority of those folks are claiming at age 62), so while the changes in 2015 made for good headlines, it impacted the small number of claimants who are actually taking advantage of the open loopholes. In fact, it did little to extend the currently projected trust fund extinction date of 2034.

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.*

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