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ASSOCIATES, INC.

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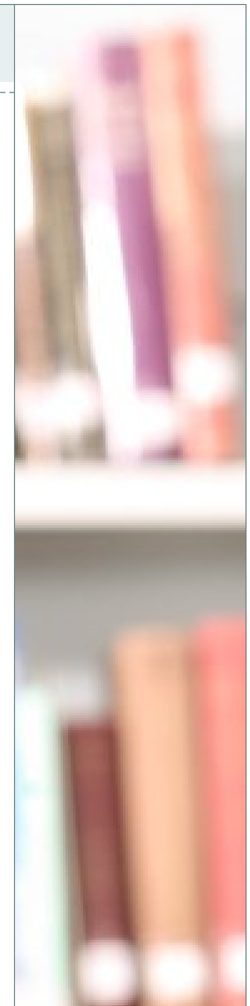


Managing Your Money

STAN'S WORLD—DOING GOOD CAN LEAD TO LIVING WELL

Recently, a friend and I engaged in a fairly profound conversation. He wondered what he was going to leave behind after he died. He asked me about his contribution to society and how to assess the good that he did. I told him the question is one I've heard before. Frankly, it's one I've periodically asked myself.

To quote my late mother, when you reach senior status, we're 'nearer than further,' with less time in front of us than we've already lived. Thus, it's obvious why a senior might ask a question of this nature. Religious beliefs may play a role in some self-assessments. For others, this type of moral accounting may be self-reflective, as they add up the pluses and minuses on their personal balance sheet.

Legacies aside, there actually is a significant reason why we all should be interested in doing good work. As heard on a recent podcast hosted by Christine Benz of Morningstar[1], Laura Carstensen, psychologist and director of the Stanford Center on Longevity, notes "one of the surprising contributors to life expectancy. . . has been purpose in life. Those people who feel like they matter to a cause or to other people, to their families, those people who have a real sense of strong purpose, live longer than people who don't….The people who say 'There's a reason for me being here,' are the ones who do better and live longer."

When it comes to living a long and healthy life, it's relatively easy to identify the most obvious do's and don'ts: routine exercise, no smoking, limited alcohol intake, reasonable diet, regular medical and dental care. Of note, genes play a relatively small role in our longevity, though we often point to elderly parents and centenarian aunts and uncles when calculating our own durability. Whenever I remark that my mom passed at 98, "You come from good genes" is a typical refrain. While that might be true, it doesn't mean I'm going to live to 98. (But if I do make it to 98, and I'm still writing Stan's World, the commentary should be interesting.)

STAN'S WORLD—DOING GOOD CAN LEAD TO LIVING WELL (CONT'D)

The idea of living a more purposeful life is one I've explored for years, and I've frequently shared my thoughts about charitable work in this newsletter. Little did I know that a byproduct of doing good is that we might also live longer.

Of course, there are some people who truly do not have time to do more than what life has already handed to them. To those I say you will be able to give to others at some point in the future. (And if you're already in a caretaker role, for example, there's no more to give.) To the rest of us, I say that having a purpose in life is more than being a responsible parent, loyal spouse, good friend, successful business owner, or hard-working employee. Finding time to matter to others – to matter to strangers – is incredibly fulfilling. The fact that you might even live longer is icing on the cake.

MARKET HIGHS AND INFLATION—THE RISK OF ASSUMPTION

If you're of a certain age, you may recall the classic TV show, *The Odd Couple*. The show focused on two friends who became roommates, played by Tony Randall (Felix Unger) and Jack Klugman (Oscar Madison). In one especially memorable episode, Felix used a blackboard in court to disassemble the word assume: "When one assumes, you make an ass of 'u' and 'me'."

And so it goes with investments. Assume you know what will happen next in the stock market, and think of Felix standing in front of you, pointing at the blackboard. The only difference is you won't be laughing.

Inflation: There is a widespread misperception that inflation always leads to poor stock market returns. A lot has been written on inflation over the past few months as inflationary numbers have hit multi-year highs. While we never know what the market will do next, history tells us that inflation alone is unlikely to shift the narrative. (There are notable exceptions, such as during the period of hyperinflation during the late 1970s and early 1980s.)

According to data published by Dimensional Funds[2,3], "A look at equity performance in the past three decades does not show any reliable connection between periods of high (or low) inflation and U.S. stock returns." (see charts from Dimensional on the next two pages)

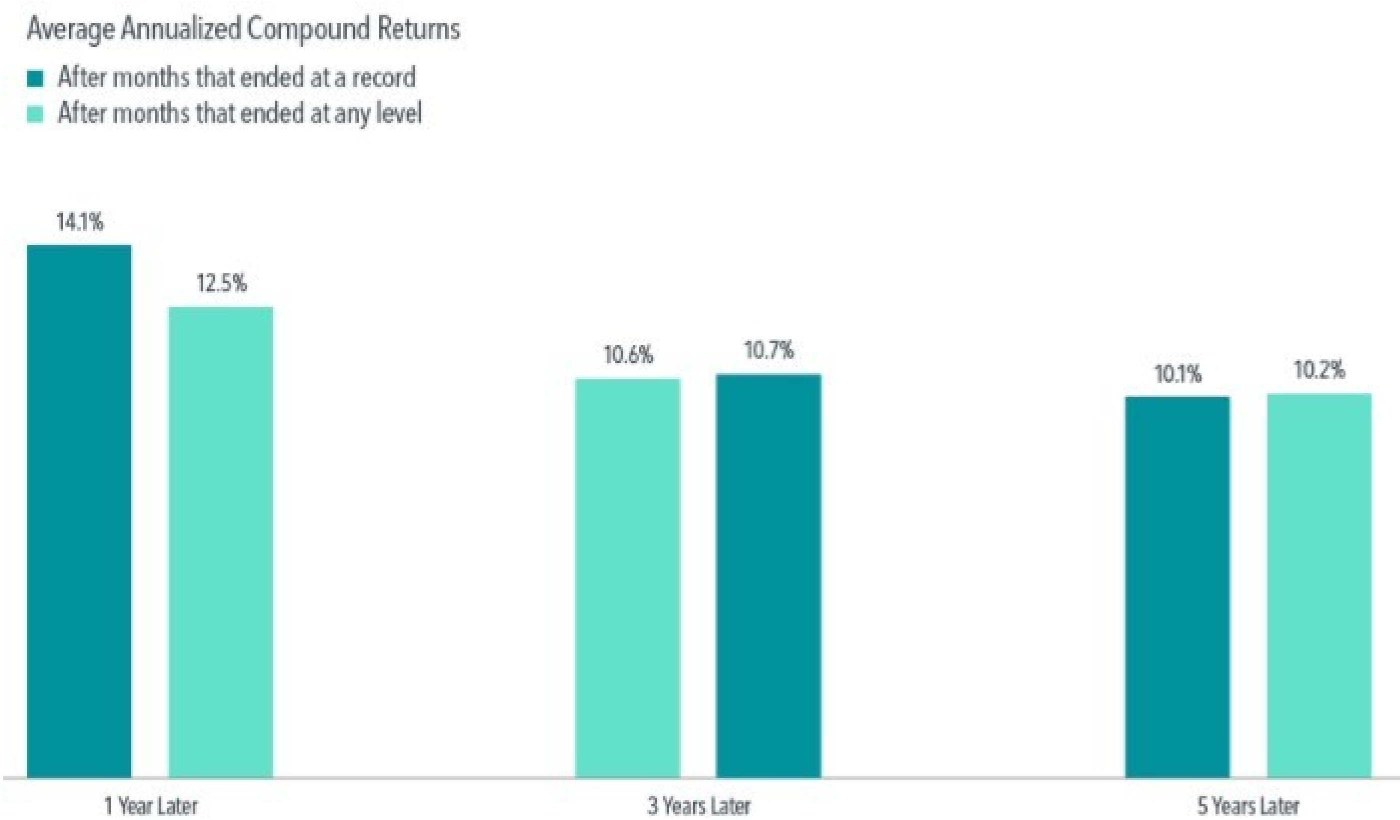
MARKET HIGHS AND INFLATION—THE RISK OF ASSUMPTION (CONT'D)

"Over the period charted, the S&P 500 posted an average annualized return of 8.1% after adjusting for inflation. Going all the way back to 1926, the annualized inflation adjusted return on stocks was 7.3%.

"History shows that stocks tend to outpace inflation over the long term – a valuable reminder for investors concerned that today's rising prices will make it harder to reach their financial goals."

MARKET HIGHS AND INFLATION—THE RISK OF ASSUMPTION (CONT'D)

Market Highs: "Many investors may think a market high is a signal stocks are overvalued or have reached a ceiling. But they may be surprised to find out that the average returns for the S&P 500 Index one, three, and five years after a new market high are similar to the average returns for the index over any one-, three-, or five-year period."



"In looking at all 1,000-plus monthly closing levels between 1926 and 2020 for the S&P 500 Index, 30% of the monthly observations were new market highs. After those highs, the average annualized compound returns ranged from nearly 14% one year later to just under 10% five years later. Those results were close to average returns over any given period of the same length. When viewed in terms of the index simply having risen or fallen, the S&P 500 was higher a year after notching a record 82% of the time, and 78% of the time after five years."

WHY IS IT SO HARD FOR PEOPLE TO MANAGE THEIR OWN MONEY?

During bull markets, it may appear as if anything an investor buys will go higher. For individual investors, up is up, and they may even be more emboldened when hearing of others who have made a lot of money. It's hard not to want in on the party. (How hard can it be? Even so-and-so is getting rich.) Unfortunately, there's a lot that can go wrong when discipline is lost.

In recent years, there has been considerable material published by behavioral economists on investor behavior. Using research by behavioral economist Jay Mooreland to explain how biases impact decision-making processes and behavior, Schwab[4] recently published an article on the topic. While the biases may be easy to identify, they're quite hard to overcome. (We took the liberty of adding one or two that we have observed over the years.)

- **Recency or representative bias**: While short-term results are entirely unpredictable (there's almost an even chance that the stock market will either go up or down each day), investors may believe they can distinguish patterns. One can assume, wrongly or otherwise, that a market (or stock) that goes down 10 days in a row will go up the 11th day. But that's gambling, not investing. The patterns that an investor sees may really just be the randomness one observes when flipping a coin or spinning a roulette wheel.
- **Outcome bias**: It's easy to look at short-term performance and assume, usually wrongly, that a specific investment was a mistake. Investors may view what happens over the next 60, 90, or 180 days as predictive of how the investment will act over the next five years. Patience is a virtue and, left to their own devices, it's very difficult for individual investors to let an investment strategy evolve over time as it's intended to do.
- **Anchoring bias**: When we hear a number, we tend to anchor, or adopt that number. If you read that the stock market returned 10%, you adopt 10% as 'your' number. If you fail to reach that number, you may do something more aggressive in the hope that you will achieve that return. Yes, the S&P 500 may have returned an average of 10% per year over the past 100 years, but that isn't necessarily the return on a broadly diversified portfolio. Unfortunately, anchoring bias causes investors to chase the anchor number and to forget how far the anchor may drop when things go terribly wrong.
- **Availability bias**: We tend to make judgments based upon the information that is available to us. Listen to a commentator who predicts the stock market will fall or that coffee beans will soar in price, and you're likely to do two things: sell out of the stock market and stock up on coffee. If you took the time, however, to research both comments, you might discover the opinion of the commentator is in the minority, and that most every prediction he/she has ever made has been wrong.

WHY IS IT SO HARD FOR PEOPLE TO MANAGE THEIR OWN MONEY? (CONT"D)

Radio and TV channels have to fill time, and it's not necessarily true that the people they hire to occupy hours are the smartest at what they do. Further, when they're wrong, it's viewed as yesterday's news. No one cares, except for those who listened to and acted on incorrect advice.

- **Hindsight bias**: It's human nature to assume that if a stock soared last year, it will continue to soar the next year. We all have investments we shoulda, coulda, bought, and that mindset can lead us to (wrongly) assume we can pick the next Apple or Amazon. Perhaps that will occur, or perhaps you'll pick stocks that never fly high.

And to include some additional biases we think could have been included in Schwab's article:

- **Home or domestic bias**: Why bother investing in anything except the U.S. stock market? Or domestic large cap growth stocks? Or mega cap stocks? Or only tech stocks? We often invest in things that we know, which is comparable to an employee of a publicly owned company investing all of his/her 401k plan into company stock. But just because company management talks a good game doesn't mean the stock is the best investment your money can buy. (Think Enron, Lehman, Lucent or even long floundering companies like General Electric). Similarly, just because you read and hear news about U.S. markets doesn't mean there aren't other opportunities around the world. There are, and foreign markets are just as equipped to outperform U.S. market performance.
- **Emotional bias**: It's very difficult for any investor not to be impacted by a roaring or crashing stock market. There can be elation when a portfolio grows and sadness when it sinks. Those swings in emotion can cause an investor to take inappropriate steps at exactly the wrong time, such as going all in when the market is soaring or cashing out when the opposite occurs. The idea of methodically rebalancing is foreign to many, if not most investors, because they're not familiar with the research demonstrating that slow and steady really does win the race. The last thing investors need during good or bad times is to make decisions based upon their euphoria or sorrow. Either can cloud decision-making, just when clear-headedness is needed the most.

Investing for the long-term is hard. If you add various predispositions and prejudices to the mix, it makes trying to achieve one's long-term goals that much harder.

S.F. EHRLICH ASSOCIATES, INC.

S.F. Ehrlich Associates, Inc. has been providing financial advice on a fee-only, independent basis for over 25 years.

Managing Your Money is compiled entirely by Stanley F. Ehrlich and John Zeltmann.

Questions or comments are always welcome (and encouraged!).

Did we mention? If you have a friend or family member who you think might benefit from a discussion with us about financial planning and asset management, please pass along our phone number and email address. Long-term growth is not only crucial 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 if: a) there are any changes in your financial situation or investment objectives, b) you wish to impose, add or modify any reasonable restrictions to our investment management services, or c) you've changed your permanent residence.

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[1] Benz, Christine. *The Long View: Laura Carstensen: "I'm Suggesting We Change the Way We Work"*. Morningstar. September 14, 2021.

[2] "Will Infation Hurt Stock Returns? Not Necessarily." *Dimensional Fund Advisors*, 16, Sept. 2021.

[3] "Why a Stock Peak Isn't a Cliff." *Dimensional Fund Advisors*, 17 Dec. 2021.

[4] Schwab.com. "Behind the Biases: 5 Tips for Coaching Investors toward Better Decisions." Schwab Brokerage, https://advisorservices.schwab.com/insights-hub/perspectives/financial-planning-and-behavioral-biases.