S.F. EHRLICH ASSOCIATES, INC.

May 15, 2022

Managing Your Money

STAN'S WORLD—HERE WE GO AGAIN

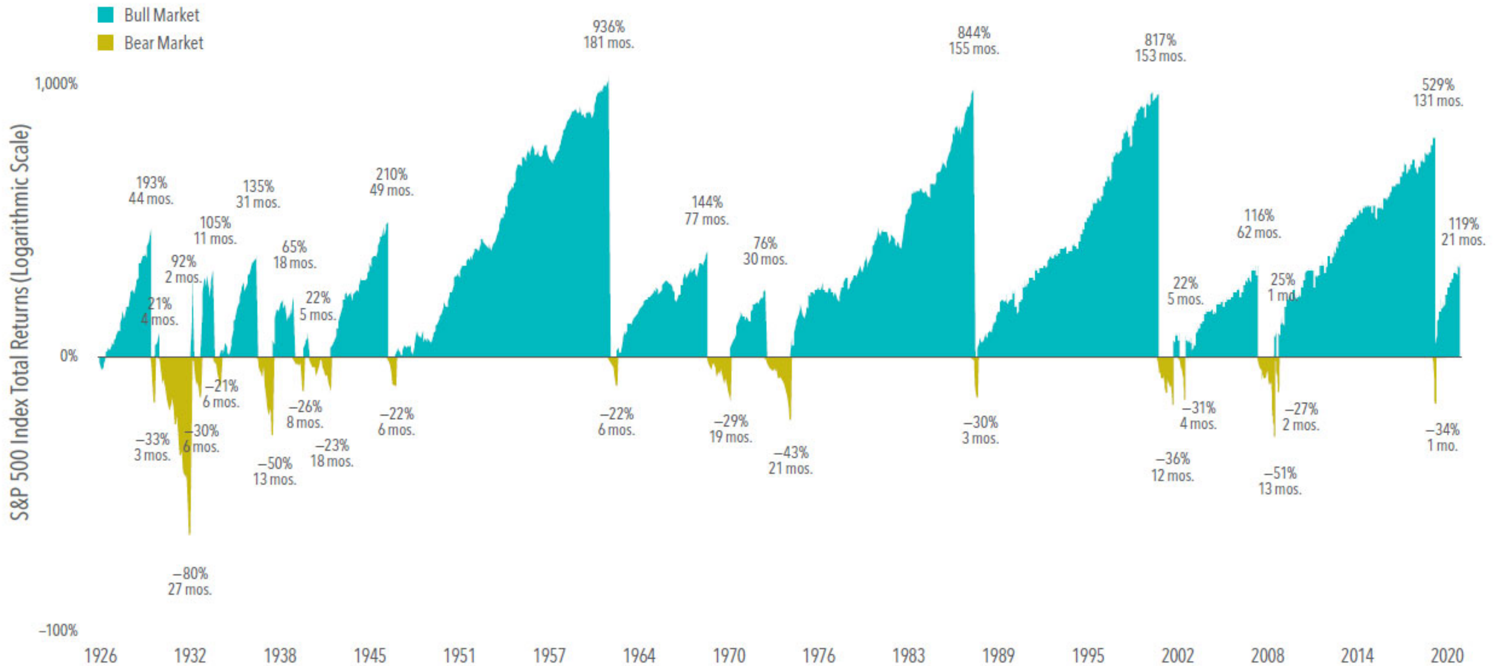
To long-time clients, let me start by saying: "Here we go again." To newer clients, I'll say: "Don't worry; this is normal." And to everyone else: "Buckle up for the ride." I am referring, of course, to the latest, and current, stock market correction.

Market corrections always cause some degree of uneasiness. Since opening the doors more than 26 years ago, I have yet to find an easy way to share disappointing portfolio performance news with people who trust you to take care of their finances. We know our clients: we know your faces, your stories, and often, we know about your struggles. Much like a roller coaster ride, the trip down can feel terrifying.

There are four stages to an economic cycle (expansion, peak, contraction, trough), and stock markets have similar cycles. The following chart[1] depicts bull and bear markets from 1926, to include total returns and duration for each. By definition, cycles are transitory in nature, though we never know how long each phase of the cycle will last.

(see chart on following page)

STAN'S WORLD—HERE WE GO AGAIN (CONT'D)



Source: Dimensional Funds

Even as we go through the current market correction, remember that the stock market is also a leading indicator. It often drops in anticipation of an economic slowdown, and then expands long before the economy appears to be turning around. What the market is telling us now is that company profits are under pressure from both inflation (higher costs for labor, material, and energy) and potentially slowing demand if a recession occurs. Markets go up when investors perceive value for their investment dollars, but markets are now falling because investors are uncertain as to the return on their investment over the near term.

We want clients to understand the fundamentals of economic cycles, so we write newsletters and memos throughout the year to share information we've learned. In fact, we build portfolios knowing there will be times like this. Still, when downturns occur, we know some clients will be unsettled.

While we may want to minimize your level of stress when markets get roiled, we also realize that all of our charts and empathy may not always assuage your feelings. We get it, even if you don't always share those feelings with us.

STAN'S WORLD—HERE WE GO AGAIN (CONT'D)

The beauty of having a financial plan is knowing it was built for good times as well as the more turbulent periods. If you need an update on where you stand, we're just a phone call or email away.

NOTE: If you have a friend or loved one who is troubled by stock market performance, please call us on their behalf. We'll share information that you can use to help them feel more confident or even speak to them directly. There's simply no need for people to be overly stressed by market performance.

PROTECTING AGAINST INFLATION—HOW ABOUT AN I BOND?

Inflation has been lifting prices lately, and with that comes a barrage of news articles, TV talk show segments, and social media posts about how best to beat inflation in your portfolio. One of the hottest tools on the market currently is Series I bonds. They're "hot" since they currently have a published rate of 9.62%. With a rate like that, who wouldn't want to invest?

First, a few facts on Series I bonds:

- What is a Series I bond? - I bonds are variable rate bonds issued by the Federal government that pay interest based on a) a fixed rate, determined by the Treasury and b) a variable rate that is reset every 6 months based on current levels of inflation. Per the TreasuryDirect website, I bonds are currently paying a fixed rate of 0% plus a variable rate of 9.62%. Series I bonds have 30-year maturities. During the time you own the bond, you don't receive interest payments; rather, the value of the bond goes up every 6 months by whatever inflation rate is assigned to the investment by the Treasury. At the end of the 30-year holding period (or if you sell prior), you receive what you initially paid plus whatever inflation occurred during the holding period.
- Each individual taxpayer is capped on annual purchases. If you file a joint return, you and your joint filer can purchase up to $20,000 per year (a single filer can purchase up to $10,000 per year). In addition to these caps, you can also elect to receive your Federal tax refund in the form of I bonds, up to $5,000 per filer.
- I bonds can only be purchased and held directly through TreasuryDirect's website.
- I bonds are subject to redemption penalties. They can only be cashed out after 1 year of ownership; at that point, you'll still incur a penalty of three months' interest if you try to sell the bond prior to owning it for five years.

PROTECTING AGAINST INFLATION—HOW ABOUT AN I BOND? (CONT'D)

A few thoughts on including I bonds in a portfolio:

- Purchase Limits: The cap on purchases makes it difficult to build a meaningful initial position. For example, if you have a $1 million portfolio, are joint tax filers, and purchase $20,000 of I bonds this year, you've established a 2% position. Repeat the same process next year, and you're up to 4%. During the time it takes to build this position, the variable inflation component of the bond can fall, which means you're no longer earning 9.62% interest. The primary driver of return on this investment is inflation expectations. After three to four years of diligently building an I bond position in your portfolio, inflation may no longer be an issue.
- Holding Period Requirements: As mentioned above, an investor needs to hold their I bond for at least a year before they can sell; and even then, there's a penalty of three months' interest if they try to sell before holding it for five years. By purchasing these bonds, you're not only committing to high inflation now but for an extended period of time. If that scenario plays out, there may be better ways to protect against inflation (leading to the next point).
- More efficient ways to combat inflation: By purchasing I bonds, you're investing solely in future inflation (i.e., if there's inflation, the investment has solid returns; if not, it doesn't). If you truly want to protect against inflation there might be better ways to do so:
    - *Within equities* - Over extended periods of time, equities have outperformed inflation. Companies have quite a bit of flexibility in passing cost increases along to customers (translating to higher revenues) while also managing rising costs of inputs, all resulting in stable and/or increasing profits down the road. Much of the downturn you see in the equity markets over the past several months is a function of the cost of capital going up and concerns over a coming recession. But if you stretch out the time horizon and compare an equity portfolio's ability to outpace inflation, the equity portfolio compares favorably.
    - *Within fixed income* - As we've seen play out on the bond side of the portfolio this year, one of the greatest threats to bond returns is inflation. If you purchase a bond today paying $200 per year for the next 10 years, rampant inflation can make that bond payment worth a lot less than $200 as you get closer to year 10 of the bond's life. When faced with potentially inflationary times, it's better to keep bond portfolio maturities short so that when bonds mature they can be reinvested at higher rates, which will eventually pay higher interest payments down the road.

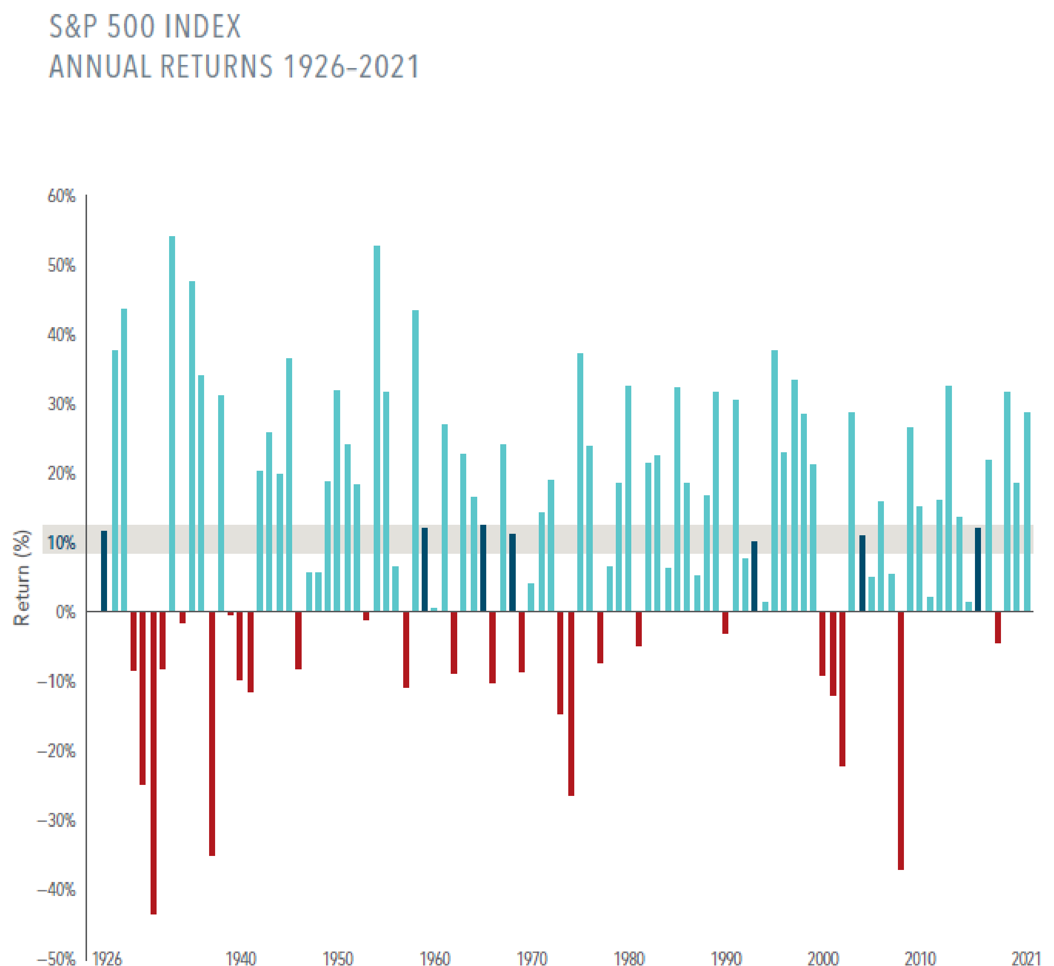
PROTECTING AGAINST INFLATION—HOW ABOUT AN I BOND? (CONT'D)

- As a replacement for emergency funds?: For non-retirees, we typically recommend keeping anywhere from 6 to 12 months of monthly expenses in liquid cash for emergency savings in the event someone loses a job or suffers some other form of hardship. While having this cash stash can offer peace of mind, it can come at the cost of foregone investment earnings. Should I bonds be considered a place to park your emergency fund? Not quite. The emergency fund needs to be available at a moment's notice; cash in the I bond can't be accessed for at least a year from the initial purchase. Even then, it's subject to withdrawal penalties if not held in the I bond for more than 5 years.

Bond investing has changed considerably over the last 20 years. You used to be able to rely on bonds paying a solid 4-6% annually. Nowadays, we must be diligent and patient when investing in bonds. While a 9%+ rate of return is attractive, it's important to recognize it comes with potential pitfalls and unintended consequences, all of which should be understood prior to investing.

THE BUMPY ROAD TO THE MARKET'S LONG-TERM AVERAGE

The chart on the right from Dimensional Funds[2] depicts in graphic form how much the S&P 500 Index has gained (or lost) in every year since 1926. While the average annual return is approximately 10%, "it's important to remember that returns in any given year may be sky-high, extremely poor, or somewhere in between."



THE BUMPY ROAD TO THE MARKET'S LONG-TERM AVERAGE (CONT'D)

In fact, while the long-term average return may be approximately 10%, note that "Annual returns came within two percentage points of the market's long-term average…in just seven of the past 96 years." In other words, there's a lot more volatility than the 'smooth' annual returns one might envision. (When viewing the chart, the horizontal gray bar shows the market average plus or minus two percentage points. Notice the mere seven times the Index actually falls within that range.)

In terms of volatility, "Yearly returns have ranged as high as up 54% and as low as down 43%." (NOTE: This chart shows returns for calendar years only. Returns over other 12-consecutive month periods may be higher or lower.)

Finally, "Since 1926, annual returns have been positive 71 times and negative 25 times."

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.

S.F. Ehrlich Associates, Inc.
15 Alden Street, Suite 12
Cranford, NJ 07016
Fax: (908) 789-1115

Stanley F. Ehrlich
Phone: (908) 789-1100
stan@sfehrlich.com

John Zeltmann, CFP®, CFA
Phone: (908) 789-1944
jzeltmann@sfehrlich.com

[1] "Bulls, Bears, and Long-Term Benefits of Stock Investing." Dimensional Fund Advisors, April 2022.

[2] "The Bumpy Road to the Market's Long-Term Average." Dimensional Fund Advisors, February 2022.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by S.F. Ehrlich Associates, Inc. ("SFEA"), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from SFEA. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. SFEA is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of SFEA's current written disclosure Brochure discussing our advisory services and fees is available upon request. If you are a SFEA client, please remember to contact SFEA, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing, evaluating, or revising our previous recommendations and/or services, or if you've changed your permanent residence.