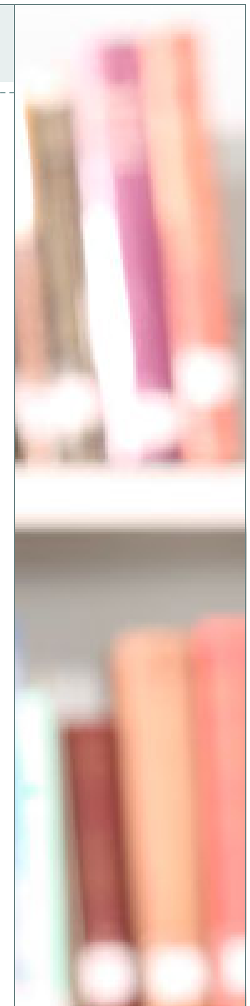
S.F. EHRLICH
ASSOCIATES, INC.

September 30, 2022



Managing Your Money

STAN'S WORLD—SOUND FAMILIAR?

You may wonder whether or not John and I recycle paragraphs from old memos when we write to clients every time there's a stock market downturn. We don't, but we understand the perception. If you've been a client through a few downturns, you may have observed that many of our communications repeat the same themes: try to stay calm; stay the course; market cycles repeat; and getting in and out of the market (a.k.a., market-timing) to try to avoid losses doesn't work. Frankly, there aren't a lot of ways to say the same things, hence the repetition.

This is admittedly a tough time to be an investor, and this is an especially tough time to be an investor determined to 'stay the course.' The drumbeat of bad news goes on with seemingly more bad news each day. While I concede it's difficult to stay positive, my personal optimism stems from knowing the next phase after a down market cycle is an upturn. While I don't know when it will get better, I know "better" is coming. And I also know that I want in from the beginning, because being out of the market and missing even a few incredible days during a momentous market rally could result in missing significant gains. To reiterate; I want in from the beginning, though I don't know the date that will occur.

Over the years, I've had hundreds of conversations with clients about trying to sidestep market downturns. My stock answer is it can't be done, and when it's attempted, it's not done well. Who knows the day (or month) of a market peak? Who knows the day (or month) of a market bottom? On top of that, taxable accounts often hold unrealized gains. When you sell positions with unrealized gains in an attempt to avoid future losses, you're going to incur capital gains that will generate tax bills.

Adding to the anxiety this year is that in 2008-2009 when the S&P 500 fell nearly 57% from its peak (yes, you read that correctly), interest rates held firm. With bond prices stable, losses on the equity side of the portfolio were offset.

STAN'S WORLD—SOUND FAMILIAR? (CONT'D)

During this downturn, interest rates have spiked, which has created historic losses in parts of the bond market. When even a short-term investment grade corporate bond fund falls almost 9% year-to-date, it speaks to the volatility in the bond market. With equities down, and bonds down, there aren't many places to hide.

So if the words we use in our memos sound familiar, it's because they are. If we tell you that markets recover and will ultimately reach even greater highs, it's because that's what markets have historically done. And that's where we get our conviction when encouraging you to stay the course.

LONG-TERM CARE INSURANCE—ARE YOU AT LEAST 40 YEARS OLD? KEEP READING

There used to be a time when people would think about buying long-term care insurance when they retired. There used to also be a time when insurance companies wrote policies for sixty-somethings. Then a funny thing happened: people started to live longer. Worse, at least from the perspective of an insurance carrier, the people who lived longer were people who were long-term care policyholders.

Insurance companies were always happy to write long-term care insurance because they made money from those policies, especially when policyholders died without ever requiring care. But when policyholders lived longer lives and collected on those policies, the insurance companies paid out far more in claims than they collected from premiums.

Recognizing that longer life means less profit, insurance companies have been feverishly raising premiums on policies they wrote years ago. They also tightened underwriting for these types of policies including no longer writing long-term care policies for people in their 60's (or even late 50's). In fact, some companies exited the business entirely. (Approximately 50,000 long-term care insurance policies are sold annually, down from 740,000 sold in the year 2000.[1]) For those still writing coverage, the goal is to collect higher and higher premiums for as many years as possible prior to a claim.

What's the risk of not having coverage?

The risk is that a carefully cultivated financial plan, implemented over decades, can easily fail if you or your partner requires extensive (read: expensive) care. It's a risk that many people are ill-prepared to address. For some reason, many don't even take the risk seriously.

LONG-TERM CARE INSURANCE—ARE YOU AT LEAST 40 YEARS OLD? KEEP READING (CONT'D)

An assisted living facility can easily cost $10,000 per month (or more). Medicare will pay zero, and Medicaid won't contribute until you (and your spouse) have expended all your funds. In blunt terms, the risk of not addressing potential long-term care needs is running out of funds long before you (and/or your spouse) run out of years.

The Center for Retirement Research at Boston College reports that for people age 65 and older: "…about one-fifth of retirees will need no long-term care support, and that one-quarter are likely to experience a severe need. In between these extremes, 22% will have low needs and 38% will have moderate risk."

Self-insurance is an option tied to your assets. Obviously, the more assets you have, the better the chance you'll be able to self-fund home-care aides or the cost for more extensive care. But if you don't have an excess of wealth, then funding an extra household (e.g., one spouse remains at home while the second moves to a community for care) is usually a burden most families can't afford. The dollars may work for a while, but at some point, assets are depleted. As noted above, Medicaid only starts to pay for assisted living and other residential care when the assets of both spouses are effectively depleted.

The latest iteration: Hybrid long-term care policies

In order to fill a growing void in the marketplace, insurance companies have developed a hybrid insurance product, which is a combination of life and long-term care insurance. While the policy often includes a significant up-front premium payment, some policies include large annual premiums for the first 10 years. In return, the policyholder typically receives a death benefit approximately equal to premiums paid along with a monthly benefit to cover long-term care.

One attractive feature of a hybrid policy is it addresses a years-old complaint that insurance companies keep all the premiums should a policyholder die without ever utilizing any benefits from his/her long-term care policy.

BOND MATH 101: WHY YOU SHOULD CHEER HIGHER INTEREST RATES

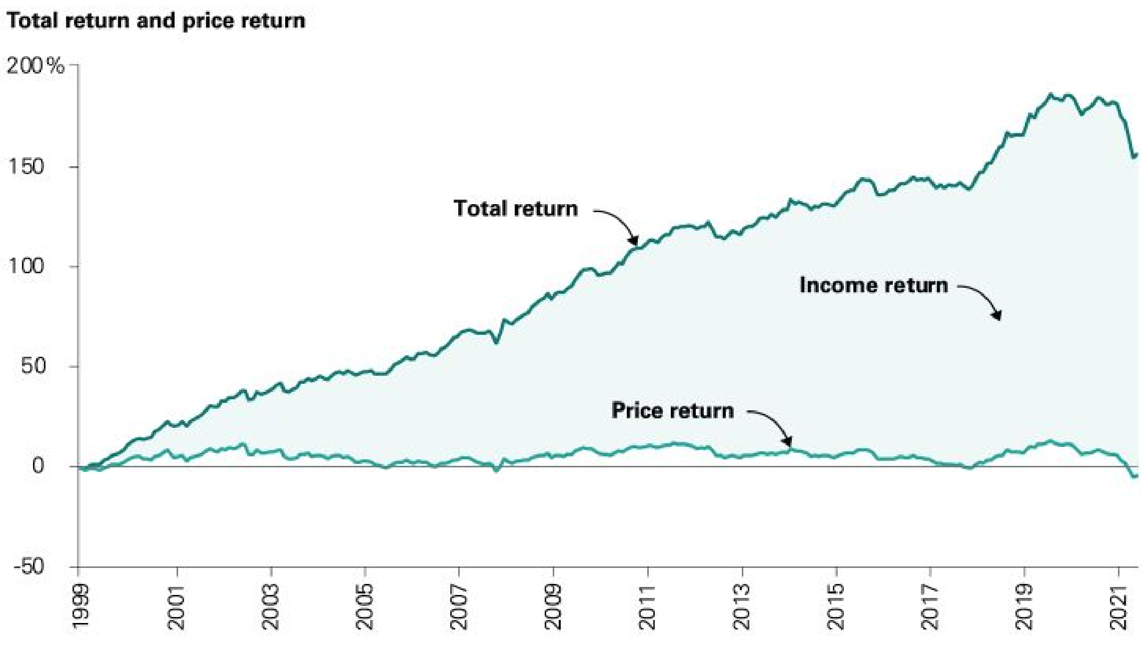
A recent paper by Vanguard[2] visually depicts why an increase in interest rates is so important to long-term bond returns and why more recent price volatility is not as much a concern as many investors fear.

Bond prices may not matter as much as you might think they do:

“While swift price declines can be upsetting, it’s important to remain focused on the long-term benefits of higher interest rates.

“Bond total returns have two main components: price return and return from income. Changes to interest rates cause these two components to move in opposite directions. As a medium- to long-term investor, you should care more about bond total returns instead of the negative short-term impact on bond prices. In fact, as we show in the chart, the long-term performance of bond investments has come mostly from income return, not price returns.”

Price return and total return for U.S. aggregate bonds



Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Notes: Monthly data are from December 31, 1999, to May 31, 2022. U.S. aggregate bonds are represented by the Bloomberg U.S. Aggregate Bond Index in USD. All bond income is assumed to be reinvested. Income return is the reinvestment of coupons and compound interest on the reinvestment.

Source: Bloomberg.

BOND MATH 101: WHY YOU SHOULD CHEER HIGHER INTEREST RATES (CONT'D)

Why bond bear markets are fundamentally different from stock bear markets

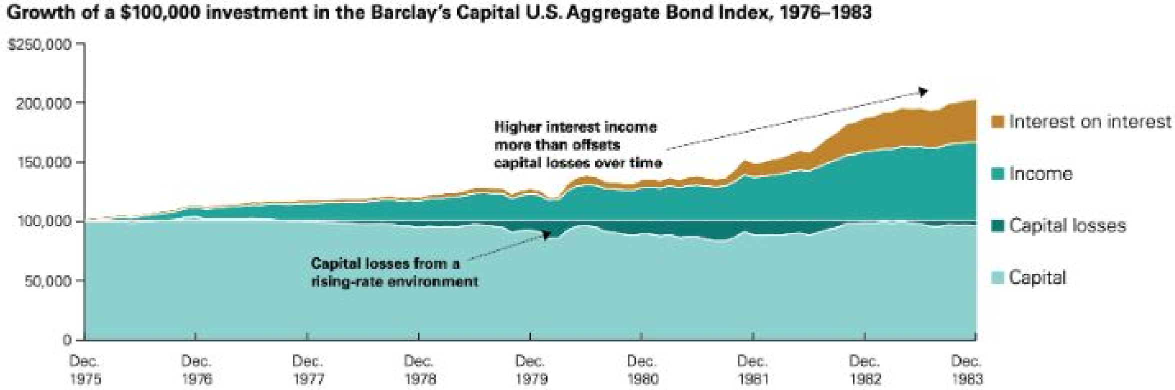
"For bond investors, the price return component's effect on total return decreases as time extends. For stock investors, the price return component of total return is much more significant. "The Lost Decade" is a great example of this: From January 2000 through December 2009, the total annualized return for the S&P 500 was -0.95%, inclusive of the reinvestment of dividends. The negative price returns caused by the bear markets of 2000-2002 and 2007-2009 had an immense impact on long-term returns.

"Now take the bond bear market of the 1970s, which was seen as a terrible time to have been invested in bonds as both inflation and interest rates were soaring. But consider this: Long-term bond investors who reinvested their income returns and remained patient as compounding took hold nearly doubled their capital from 1976-1983. Over the longer term, bond total returns are driven much more by reinvestment of interest income and compounding than by price returns. So try to look beyond the immediate pain of any losses appearing in your quarterly bond portfolio statements and instead focus on the longer-term upside of rising interest rates."

Interest income and reinvestment account for the largest portion of total return in bond funds

Bond investing in the 1970s and early 1980s

Growth of a $100,000 investment in the Barclay's Capital U.S. Aggregate Bond Index, 1976–1983



Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Notes: For this example, we assume that an investor fully funded a $100,000 investment in the Barclay's Capital U.S. Aggregate Bond Index (now Bloomberg U.S. Aggregate Bond Index) on January 1, 1976. We do not account for any expenses or taxes. Interest-on-interest return is calculated as the remainder after subtracting both income and capital returns from the total return.

Source: Vanguard calculations based on capital, income, and total return data reported by Barclay's Capital.

BOND MATH 101: WHY YOU SHOULD CHEER HIGHER INTEREST RATES (CONT'D)

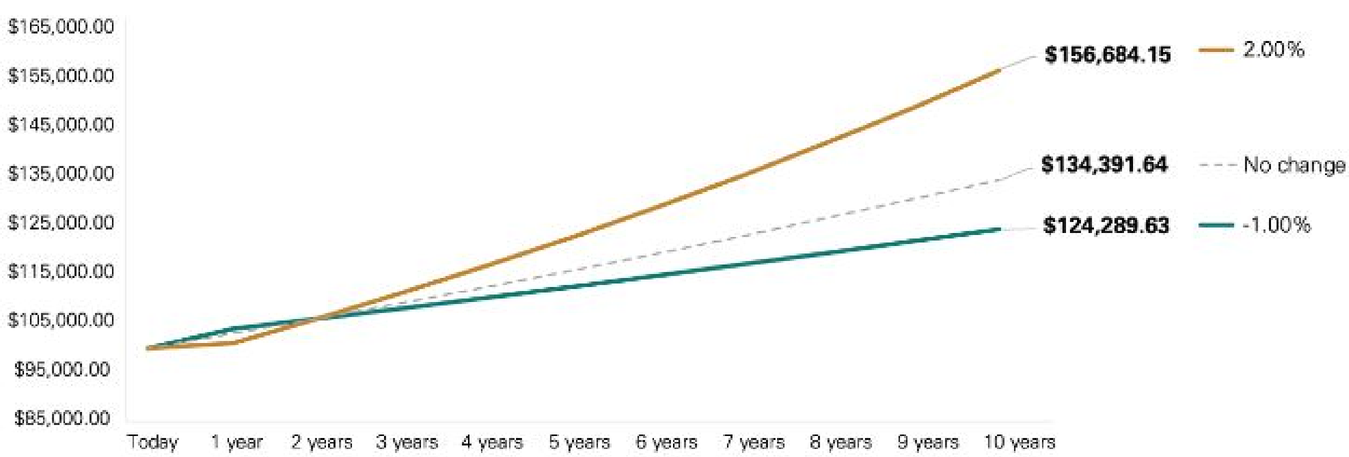
Bond math holds up even during fixed income shocks

"Consider short-term Treasuries: interest-rate-sensitive securities whose total returns are extremely sensitive to central bank policy changes. As interest rates on the short end of the Treasury curve have risen due to expectations of further Federal Reserve policy adjustments, so too has the weighted average yield to maturity for funds that invest in these securities. That provides a better foundation to help you weather further rate shocks as starting yields are now much higher. Even if rates were to rise an additional 200 basis points (bps) from here, you would now recoup any lost principal within a year and then benefit from higher yields moving forward – ultimately increasing the long-term value of your bond portfolios (see chart).

"That means the time it takes to recoup your capital from an interest rate shock depends on your starting yield. A 200 bp rate shock from a 50 bp starting yield will take longer to break even when compared to a 200 bp rate shock from a 250 bp starting yield. The bottom line … is that as rates move higher, bonds are more attractive, not less."

The silver lining in rising rates

Hypothetical impact of changes in interest rates



Notes: This hypothetical example begins with a portfolio value of $100,000 and does not represent the return on any particular investment. "No change" yields are based on a starting yield of 3%. For simplicity, duration was assumed to remain at two years, but in practice, as yields change, duration also changes. Such a dramatic change in yields, as this example assumes, would likely constitute a rather significant adjustment to a portfolio's weighted average duration. For purposes of illustration, we assumed no change to yields in subsequent years. Yields are not guaranteed.

Source: Vanguard.

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] Miller, Mark. "Long-Term Care Coverage Is Trending in the Wrong Direction." Wealth Planning, June/July 2022, pp. 24–25.

[2] "Why you shouldn't abandon bonds." Vanguard, 25 July 2022.