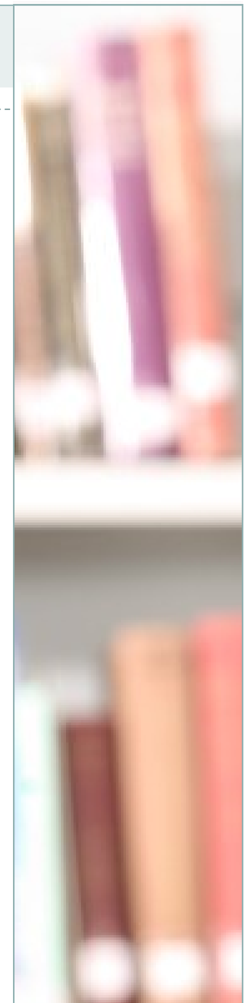

S.F. EHRLICH ASSOCIATES, INC.

February 15, 2018

Managing YOUR Money

STAN'S WORLD

Clients are sometimes surprised when we respond "no" when they ask if we saw a market drop coming. While we all may realize a market drop will eventually occur, we can never predict when that might happen. Though the volatility that returned to the stock market in early February was sudden and dramatic, it wasn't altogether unexpected considering the exceptional run this market has had.

Even if you've been around for more than a few years, you're probably not used to watching daily 1,000 point moves in the stock market. Then again, many of us who have been around for more than a few years are also not used to talking about a 26,616 Dow, the market's all-time high before a 10% correction that began on January 26. (For those keeping score at home, a correction is classified as a 10% drop in the stock market, whether it occurs over a few months or a few days. In terms of severity, a bear market is a drop of at least 20%.) As of this writing, the most recent correction saw a market drop of 10.58% over the period January 26 – February 6[1].

So how does one prepare for a correction? Frankly, there's little anyone can do to mentally prepare for a correction. Not only do we not see it coming, but we also don't know when it will end. Corrections are part of a historically repetitive cycle, a cycle that shows markets generally move higher, peak, fall, bottom, and then turn up. While that explanation may sound too simplistic, it's typically how markets move, and hopefully how markets will continue to move for eons to come.

What we can control during market cycles is periodic rebalancing - where appropriate, shifting dollars from over-achieving assets to under-achieving assets. As we don't try to time the market (i.e., predict when we think it might go up or down), rebalancing is a non-emotional response to market gains or losses. If equities drop, consider buying more; when equities go up, possibly prune back some of the winnings. While the changes we make are often subtle, research[2] shows they can enhance a portfolio's return over time. (Always remember those two operative words: 'over time.')

STAN'S WORLD (CONT'D)

By managing portfolios in line with risk tolerance, long-term goals, and short-term cash flow needs, we attempt to filter out a lot of the market noise. We don't assume that momentum will continue indefinitely, nor do we presume to know when the stock market will reach a peak (or a bottom).

Sometimes, depending upon the extent of the market downturn, we're able to harvest tax losses that can be used to offset capital gains. For us, rebalancing is a dispassionate response to whatever the markets do. It's not sexy, but it works.

So why did volatility return after such a calm (and rewarding) year in 2017?

A lot of what drives the momentum of a rising (or falling) stock market is consumer confidence. In a recent column in the New York Times[3] titled "Consumer Confidence Helps, Until It's Gone," Professor Robert Schiller (who achieved fame for calling the stock market crash that began in 2007) points out that consumer confidence has helped to drive this market since 2009, when the Great Recession came to an end.

Schiller also notes that exuberance "seems to be fueling the stock market, where prices have outstripped fundamental valuations. Real (inflation-corrected) corporate earnings per share for the Standard & Poor's 500-stock index were, for the third quarter of 2017, only 6 percent higher than they were in the second quarter of 2007, just before the financial crisis. In contrast, real stock market prices were 39 percent higher." Might that mean today's investors are also assuming that stock valuations will continue to grow?

While consumer confidence may not be shaken if the recent stock market correction bounces back, it will be a very different situation should the markets wane and consumer confidence drops along with them. As an example, Schiller points to the period 1990 – 2000, when the S&P 500 rose 256% while earnings only climbed 78%.

BY THE NUMBERS[7]

- In the 75 years from 1943-2017, the **S&P 500 had 28 declines** of at least 10% (but less than 20%), or once every 2.7 years.
- The last **10% correction** for the S&P 500 (a decline of more than 10% but less than 20%) was a 13.3% drop over the 3 months that ended 2/11/16, or approximately 2 years ago.
- The **national debt** increased 86% during George W. Bush's 8 years as president, and increased 88% during Barack Obama's 8 years as president.
- 90% of American adults at least age 25 have **graduated from high school.** 34% of American adults at least age 25 have a bachelor's degree from college. 13% of American adults at least age 25 have a master's degree.
- The **average price of gasoline** nationwide was $2,54 a gallon as of Friday 1/19/18. The average price of gasoline nationwide in 1968 was 34 cents. After adjusting for 50 years of inflation, the 34 cent price in 1968 is equivalent to $2.47 in 2018 dollars.
- The United States has added 8 new "**renter**" households in the last decade for every 1 new "owner" household, a total of 7.8 million new renters vs 965,000 new owners.
- As of 12/31/17, the 120.2 million households in the US were split between 77.2 million **owners** and 43.0 million **renters**.

STAN'S WORLD (CONT'D)

The crash in 2000-2002 demonstrated that investors were wrong about their expectations for higher earnings since stock prices fell before earnings caught up with them. Will it be different this time?

Other theories abound as to why the market got a little tipsy. Some point to a new Fed chair, an unknown entity until he begins taking actions that will impact the marketplace. (Markets truly dislike uncertainty, and a new Fed chair is a big deal.)

Concerns about inflation are widespread, especially in a tight job market. Will prices begin to rise? If yes, will that lead to increased inflation? If it does, might the Fed increase interest rates at a faster pace than they've already telegraphed to the market?

What about a growing US budget deficit that will require the US Treasury to go into the marketplace and borrow ever increasing amounts of money? Will that push interest rates higher, thus causing borrowing costs to rise for mortgages, car loans, credit cards, etc.? If so, might that cause the economy to slow and bring on the next recession?

A Dow at 26,000 means even 2 or 3% market moves will sound more ominous because it's 2 or 3% of a much larger Dow.

Whether it was one or a combination of the above that caused the status quo to change a few weeks ago, the point is that cycles make up markets. In terms of volatility, last year was a bit of an aberration. While we don't think the new normal is 1,000 point days, a Dow at 26,000 means even 2 or 3% market moves will sound more ominous because it's 2 or 3% of a much larger Dow.

Regardless of what happens next, stick around…this is how markets act.

BY THE NUMBERS[7]

- For every 2 families that moved into **Vermont** last year, just 1 family moved out, making Vermont the "top moving destination" state. For every 1 family that moved into Illinois last year, 2 families moved out, placing Illinois last on the same list.
- Since 1950, the **S&P 500** has been up 54% out of more than 17,000 trading days, 60% of 817 months, 66% of 272 quarters, and 74% of 68 years.
- The total return of **stocks** and the total return of **bonds** have not been negative in the same year over the last 40 years.
- The S&P 500 has gained an average of 10.1% per year (total return) over the last 50 years, despite suffering through 7 **bear markets** of at least a 20% decline each time.
- The **small-cap Russell 2000 stock** index has gained 10.2% per years over the last 35 years.
- 43% of the **Fortune 500 companies** were founded or co-founded by either an immigrant to the United States or by the child of an immigrant.
- The **life expectancy** of a baby born in the US in 2016 is 78.6 years, a decline of 0.1 year from 2015, the second straight year-over-year drop after 21 consecutive years of increase.

BITCOIN: OY, WHAT A RIDE!

By: John Zeltmann

You've probably noticed that Bitcoin has been in the news lately. While Bitcoin is not the only cryptocurrency (a cryptocurrency is a digital currency), it's the most well-known, and the hype around it may bring back memories of long lines to buy Beanie Babies. But more than a few people use cryptocurrencies to conduct transactions over the internet, with companies such as Microsoft, Expedia, and Intuit accepting cryptocurrency for payment.

For some investors, the potential for tantalizing returns may be enough to justify the gut-wrenching roller-coaster ride Bitcoin owners have experienced to date. From May 27, 2017, to December 16, 2017, Bitcoin rocketed up 818.3%, only to fall 64.3% from its peak through the market close on February 5, 2018[1].

For anyone considering an investment in Bitcoin or any other cryptocurrency, it's important to understand the risks involved:

- **Diversification**: There's no evidence cryptocurrencies provide any diversification benefit. The closest thing we can (reluctantly) compare them to are actual currencies. While currencies may offer small diversification benefits over short periods of time (i.e., 6-18 months), there is little diversification benefit as the time horizon is extended[4]. This phenomenon applies to currencies around the world, from the euro to the dollar to the yuan; no one knows how it will apply to the cryptocurrency landscape.
- **Who will come out on top?:** With more than 1,500 cryptocurrencies[5] out there, think back to the Dot-com era of the late 1990s. Who among the cryptos is today's Amazon? Has that currency even been created yet? Google wasn't around in 1997; former players like Netscape, Prodigy, and AOL probably wish it had stayed that way.

BY THE NUMBERS[7]

- 46% of Americans have **no money invested in stocks** today, either through the ownership of individual stocks, equity mutual funds, or through holdings inside a pre-tax retirement plan.
- In July 2017, Dr. James Canton, CEO of the Institute of Global **Futures** in San Francisco, **predicted** the following 6 things will no longer exist within a decade: keys, parking meters, cash, brick and mortar banks, TVs, and telephones.
- The yield on the **10-year Treasury** note ended 2017 at 2.41%, just 0.03 percentage points lower than the 2.44% it finished as of 12/31/2016. The yield on the 10-year note was 2.57% on 8/5/11, the day Standard & Poor's downgraded the USA's AAA rating that it held for 70 years.
- The average interest rate nationwide on a **30-year fixed rate mortgage** was 3.99% at the end of 2017. The record low national average was 3.31% as of 11/22/12.
- The price of **oil** ended 2017 at $60.12 a barrel, up 12% from its 2016 close of $53.72. The $60.12 price was the first daily close above $60 a barrel since 6/24/15.
- If the **expansion** of the US economy (i.e. no recession), continues into May 2018, it will rank as the 2nd longest expansionary period in our history. Contraction and expansion have been traced since 1854.

BITCOIN: OY, WHAT A RIDE! (CONT'D)

- **Regulatory Issues:** Nobody currently regulates crypto-currencies. While the U.S. Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) are in the midst of coordinating a plan to increase oversight, that might add to trading costs while detracting from potential returns. In the meantime, the Bitcoin crew has decided that only 21 million coins will be created, though no one knows how long such a cap will remain in place. That 21 million cap has driven much of the price increase over the last 12 months, but what happens when "they" - whoever they are - decide to lift the cap?
- **Cybersecurity:** What happens to the cryptocurrency market the first time there's a significant hack into one of the coins? When a thief steals from your bank account through wire fraud, the next few steps those stolen dollars take are relatively easy to trace. With cryptocurrency, transactions are primarily conducted on an anonymous basis, making the forensics that much more difficult. While security is presented as an argument *for* cryptocurrencies, what better trophy for the hacker community than to be the first to crack the crypto code?
- **Currencies (crypto or otherwise) don't produce anything:** As with any other currency (and gold for that matter), cryptocurrencies are nothing more than a store of value. (Considering the price volatility we've seen over the past several months, it doesn't even adequately accomplish that task.) Additionally, unlike most companies, cryptocurrencies don't produce earnings, distribute dividends, etc. - their value is entirely derived from the whims of its investors.

BY THE NUMBERS[7]

- As of the end of 2017, there are more **Millennials** (83 million) than there are Baby Boomers (75 million). Millennials were born between 1981-97 and were age 20-36 in 2017, while the Baby Boomers were born between 1946-64 and were age 53-71 in 2017.
- The 1.48 million existing **homes that were on the market** for resale as of December 2017 is down 10% in the last year, down 19% in the last 5 years, and down 63% in the last 10 years.

BITCOIN: OY, WHAT A RIDE! (CONT'D)

- **Concentrated ownership:** According to studies[6] conducted by Credit-Suisse, about 4% of Bitcoin owners own approximately 97% of the outstanding Bitcoin value. Other cryptocurrencies have similar ownership distributions. The price of a cryptocurrency is highly dependent on the decisions by a handful of owners, yet another factor driving prices that isn't tied to some fundamental underlying value.

Cryptocurrency as a concept could be a worthwhile investment at some point in the future. In a digital world where transactions need greater security, cryptocurrency might even be the answer. Before making an investment, however, it's important to understand what you're walking into.

PRO BONO: AN UPDATE

By: Stanley F. Ehrlich

I am pleased to report that our first experience working in the Farmer's Market sponsored by the food bank* where we've volunteered for years was positive and fulfilling. We'll be returning for more. (*Community Soup Kitchen and Outreach Center, Morristown, NJ.)

In brief, in addition to providing daily meals (breakfast and lunch) seven days a week, and a wide variety of social services, the Community Soup Kitchen partners with a few area supermarkets to collect produce, meats, and a range of other products which are nearing their expiration dates. On Mondays and Fridays, volunteers pick up the food, sort the products, and then oversee their distribution to clients of the soup kitchen.

As the clients come down the 'line' moving from station to station, volunteers at each station (e.g., desserts, meats, produce) explain the foods in their bins and then hand each client one requested item (e.g., a loaf of bread, or a bag of oranges, etc.). There's a brief exchange (i.e., "This is good, you should try it") and then clients move on to the next station.

My first experience found me, appropriately enough, assigned to the dessert station. During my stint, one exchange with a client humanized one of the many problems faced by the homeless and those less fortunate.

As a man walked over to my station, I asked if he'd like a selection from the dessert bins. He replied: "I'd rather have a job, but I'll take a dessert." That's one of the reasons the Community Soup Kitchen changed its name and added Outreach Center. Hopefully, they'll be able to help him.

In addition to numerous opportunities to volunteer in soup kitchens, a client told us about the need for volunteers to work in animal shelters. If you like working with animals, call your local animal shelter and see if they could use a hand.

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.

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 (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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[1] Calculations available upon request.

[2] Daryanani, Gobind. "Opportunistic Rebalancing: A New Paradigm for Wealth Managers." *Journal of Financial Planning*, Jan. 2008.

[3] Shiller, Robert J. "Consumer Confidence Helps, Until It's Gone." *The New York Times*, 26 Jan. 2018.

[4] LaBarge, Karin Peterson, et al. "To Hedge or Not to Hedge? Evaluating Currency Exposure in Global Equity Portfolios." Vanguard Research, Sept. 2014.

[5] "Cryptocurrency Market Capitalizations." All Cryptocurrencies | CoinMarketCap, 15 Feb. 2018, coinmarketcap.com/all/views/all/.

[6] Chaparro, Frank. "97% Of All Bitcoins Are Held by 4% of Addresses." *Business Insider*, 11 Jan. 2018.

[7] "By The Numbers." Direxion ETFs & Funds, 2 Jan. 2018 through 5 Feb. 2018.