Asset Management Group, Inc.

Planning Pays Off

Savings Rates Decline

DECEMBER 9, 2017 / ASSETMAN14 / LEAVE A COMMENT
by Bob Veres

You don't hear much about America's personal savings rate these days, and the reason may be because the news is discouraging: collectively, the percentage of our income that we save is trending downward again, and may be about to hit record lows. The Federal Reserve Bank of St. Louis tracks the U.S. personal savings rate, going back to the late 1950s, when when people were setting aside a thrifty 11% of what they made. Americans achieved a record 17% savings rate in the mid-1970s (see chart) before a long decline set in. In 2013, the rate briefly spiked again above 10%, but as you can see from the chart, Americans have become less thrifty since then. The most recent data point shows Americans saving just 3.6% of their income.

How does this compare to the rest of the world? A chart on the Trading Economics website shows that most countries fall in the 4.5% to 10% range, but with considerable fluctuation. For instance, Spain experienced a negative savings rate just last quarter, but this quarter reports a rate of more than 14%. Japan and Mexico seem to be consistently the thriftiest of the reporting nations, each with savings rates above 20%. (India's rate on the chart appears to be in error.)

Does any of this matter? Economists will tell you that when the savings rate is high, it cuts into consumption, which lowers economic activity. But at the same time, countries with high savings rates have more capital to invest in their future, and their citizens tend to be less vulnerable to economic downturns. On the whole, we should probably prefer more savings to less.

Sources:

https://tradingeconomics.com/united-states/personal-savings (https://tradingeconomics.com/united-states/personal-savings)

https://fred.stlouisfed.org/series/PSAVERT (https://fred.stlouisfed.org/series/PSAVERT)

Common Estate Planning Mistakes

DECEMBER 8, 2017 / ASSETMAN14 / LEAVE A COMMENT
by Bob Veres

The most common way to transfer assets to your heirs is also the messiest: to have a will that is so out of date that it doesn't relate to your property or estate, to have your records scattered all over the place, to have social media, banking and email accounts whose passwords only you can find—and basically to leave a big mess for others to clean up.

Is there a better way?

Recently, a group of estate planning experts were asked for their advice on a better process to handle the transfer of assets at your death, and to articulate common mistakes. The list of mistakes included the following:

Not regularly reviewing documents. What might have been a solid plan 15 or 20 years ago may not relate to your estate today. The experts recommended a full review every three to five years, to ensure that trustees, executors, guardians, beneficiaries and healthcare agents are all

up-to-date. You might also consider creating a master document which lists all your social media and online accounts and passwords, so that your heirs can access them and close them down.

Using a will instead of a revocable trust. This relates mostly to people who want to protect their privacy. When assets pass to heirs via a will, the transfer creates a record that anybody can access and read. A revocable trust can be titled in your name, and you can control the assets as you would with outright ownership, but the assets simply pass to your designated successor upon death.

Failing to fund the revocable trust. You've set up the trust, but now you and your team of professionals have to transfer title to your properties out of your name and into the trust, with you as the trustee. If you forget to do this, then the entire purpose of the trust is wasted.

Having assets titled in a way that conflicts with the will or trust. You should always pay close attention to the beneficiary designations, because they—not your will—determine who will receive your IRA assets. Meanwhile, assets (like a home) owned in joint tenancy with rights of survivorship will pass directly to the surviving joint tenant, no matter what the will or trust happens to say.

Not using the annual gift exemption. People can gift $14,000 a year tax-free to heirs without affecting the value of their $5.49 million lifetime gift exemption. That means a husband and wife with four children could theoretically gift the kids $112,000 a year tax-free. That can reduce the size of a large estate potentially below the gift exemption threshold, and in states where there is an estate tax, it can help there as well.

Not understanding the generation-skipping transfer tax. A husband and wife can each leave estate values of $5.49 million to any combination of individuals. But if there's anything left over, there's a 40% federal estate tax on those additional assets left to heirs in the next generation (the children), and an additional 40% on assets left to the generation after that (the grandchildren). Better to transfer $5.49 million out of the estate before death (tax-free, since this fills up the lifetime gift exemption) into a dynastic trust for the benefit of the grandchildren. You can also transfer that annual $14,000 to grandchildren.

Not taking action because of the possibility of estate tax repeal. Yes, the Republican leadership in Congress includes, on its wish list, the total repeal of those estate taxes. But what if there's no action, or a compromise scuttles the estate tax provisions at the last minute? Federal wealth transfer taxes have been enacted and repealed three times in U.S. history, so there's no reason to imagine that even if there is a repeal, the repeal will last forever. Meanwhile, dynastic trusts and other estate planning tactics provide tangible benefits even without the tax savings, including protecting assets from lawsuits and claims.

Leaving too much, too soon, to younger heirs. Nothing can harm emerging adult values quite like realizing, as they start their productive careers, that they actually never need to work a day in their lives. The alternative? Create a trust controlled by a trusted family member or a corporate trust company until the beneficiaries reach a more mature stage of their lives, perhaps 30-35 years old.

The Economic Myth-Destroyer gets his due

OCTOBER 13, 2017 / ASSETMAN14 / LEAVE A COMMENT
by Bob Veres

Imagine a person who always, in every circumstance, makes rational decisions with his money. He saves when he ought to and spends exactly as he should spend, in order to maximize the "utility" of whatever wealth he happens to possess. He defers gratification with ease. When he invests, he has instant and total access to all possible information related to every item in his, including the details of every company's financials and any impactful world events, even if they haven't reached the news media yet. If he found a $100 bill on the sidewalk, he would immediately go out and invest it in a steel mill.

Most of us have never met a person like that, but this is how most economists, when they build their models, assume that normal humans behave. All of us—and especially professional financial planners—know that these assumptions are far from what we see in the real world, which makes us question whatever economists tell us about group behavior like the financial and economic markets, laws and regulation, or what consumers will do next.

All of this is why a silent cheer went up around the professional investing world when University of Chicago economist Richard Thaler was awarded the 2017 Nobel Prize in Economics by the Royal Swedish Academy of Sciences. Thaler spent his entire career exploring the differences between these unrealistically idealized economic assumptions and actual human behavior. He demonstrated that people take mental short-cuts—called "heuristics"—when they make what they believe to be logical decisions. He showed that in the real world, their decisions are often impulsive, and self-control is more of an aspiration than a reality.

Thaler also developed a theory of "mental accounting," which explained how people make financial decisions by creating separate accounts in their minds—one for college funding, say, and another for retirement, and still another for vacations or a new car. He explored those mental short-cuts

and found that people tend to expect more in the future of what they've recently experienced (recentcy bias) and uncomfortably often they believe themselves to have more knowledge about their decisions than they actually do.

An experiment with a lost ticket uncovered the "sunk cost" effect. Thaler found that if people purchased a $100 opera ticket and lost it on the way to the show, they would be unlikely to buy another ticket, reasoning that $200 was too much to pay. But if we were perfectly logical, the only choice upon approaching the ticket counter should be whether it was actually worth $100 to hear the opera, and we had already made that decision when we bought the first ticket.

This is actually the second time that the Nobel Prize in Economics has been awarded to behavioral theorists who strayed from the economic party line. Daniel Kahneman won the prize in 2002 for his work with fellow psychologist Amos Tversky on human behavioral biases and systematic irrational behaviors.

In the models that economists produced out of their assumptions of perfectly rational, all-knowing investors and consumers, we could never have market bubbles or market crashes, since every market price is right and fair at every moment. In that strange world, nobody would ever pay more than anybody else for a product or service. Thaler's prize—and Kahneman's before him—suggest that the world of economics is starting to catch on to the messy decision-making that actually goes on in the real world.

Tax Reform—or Not?

OCTOBER 9, 2017OCTOBER 9, 2017 / ASSETMAN14 / LEAVE A COMMENT
by Bob Veres

You can be forgiven if you're skeptical that Congress will be able to completely overhaul our tax system after failing to overhaul our health care system, but professional advisors are studying the newly-released nine-page proposal closely nonetheless. We only have the bare outlines of what the initial plan might look like before it goes through the Congressional sausage grinder:

We would see the current seven tax brackets for individuals reduced to three — a 12%, rate for lower-income people (up from 10% currently), 25% in the middle and a top bracket of 35%. The proposal doesn't include the income cutoffs for the three brackets, but if they end up as suggested in

President Trump's tax plan from the campaign, the 25% rate would start at $75,000 (for married couples), and joint filers would start paying 35% at $225,000 of income.

The dreaded alternative minimum tax, which was created to ensure that upper-income Americans would not be able to finesse away their tax obligations altogether, would be eliminated under the proposal. But there is a mysterious notation that Congress might impose an additional rate for the highest-income taxpayers, to ensure that wealthier Americans don't contribute a lower share than they pay today.

The initial proposal would nearly double the standard deduction to $12,000 for individuals and $24,000 for married couples, and increase the child tax credit, now set at $1,000 per child under age 17. (No actual figure was given.)

At the same time, the new tax plan promises to eliminate many itemized deductions, without telling us which ones other than a promise to keep deductions for home mortgage interest and charitable contributions. The plan mentions tax benefits that would encourage work, higher education and retirement savings, but gives no details of what might change in these areas.

The most interesting part of the proposal is a full repeal of the estate tax and generation-skipping estate tax, which affects only a small percentage of the population but results in an enormous amount of planning and calculations for those who ARE affected.

The plan would also limit the maximum tax rate for pass-through business entities like partnerships and LLCs to 25%, which might allow high-income business owners to take their gains through the entity rather than as income and avoid the highest personal brackets.

Finally, the tax plan would lower America's maximum corporate (C-Corp) tax rate from the current 35% to 20%. To encourage companies to repatriate profits held overseas, the proposal would introduce a 100% exemption for dividends from foreign subsidiaries in which the U.S. parent owns at least a 10% stake, and imposes a one-time "low" (not specified) tax rate on wealth already accumulated overseas.

What are the implications of this bare-bones proposal? The most obvious, and most remarked-upon, is the drop that many high-income taxpayers would experience, from the current 39.6% top tax rate to 35%. That, plus the elimination of the estate tax, plus the lowering of the corporate tax (leading to higher dividends) has been described as a huge relief for upper-income American investors, which could fuel the notion that the entire exercise is a big giveaway to large donors. But the mysterious "surcharge" on wealthier taxpayers might take away what the rest of the plan giveth.

But many Americans with S corporations, LLCs or partnership entities would potentially receive a much greater windfall, if they could choose to pay taxes on their corporate earnings at 25% rather than nearly 40%. (Note: The Trump organization is a pass-through entity.)

A huge unknown is which deductions would be eliminated in return for the higher standard deduction. Would the plan eliminate the deduction for state and local taxes, which is especially valuable to people in high-tax states such as New York, New Jersey and California, and in general to higher-income taxpayers who pay state taxes at the highest rate?

Currently, about one-third of the 145 million households filing a tax return — or roughly 48 million filers — claim this deduction. Among households with income of $100,000 or more, the average deduction for state and local taxes is around $12,300. Some economists have speculated that people earning between $100,000 and around $300,000 might wind up paying more in taxes under the proposal than they do now. Taxpayers with incomes above $730,000 would hypothetically see their after-tax income increase an average of 8.5 percent.

Big picture, economists are in the early stages of debating how much the plan might add to America's soaring $20 trillion national debt. One back-of-the-envelope estimate by a Washington budget watchdog estimated that the tax cuts might add $5.8 trillion to the debt load over the next 10 years. According to the Committee for a Responsible Federal Budget analysis, Republican economists has identified about $3.6 trillion in offsetting revenues (mostly an assumption of increased economic growth), so by the most conservative calculation the tax plan would cost the federal deficit somewhere in the $2.2 trillion range over the next decade.

Others, notably the Brookings Tax Policy Center (see graph) see the new proposals actually raising tax revenues for individuals (blue bars), while mostly reducing the flow to Uncle Sam from corporations.

These cost estimates have huge political implications for whether a tax bill will ever be passed. Under a prior agreement, the Senate can pass tax cuts with a simple majority of 51 votes — avoiding a filibuster that might sink the effort — only if the bill adds no more than $1.5 trillion to the national debt during the next decade.

That means compromise. To get the impact on the national debt below $1.5 trillion, Congressional Republicans might decide on a smaller cut to the corporate rate, to something closer to 25-28%, while giving typical families a smaller 1-percentage point tax cut. Under that scenario, multi-national corporations might be able to bring back $1 trillion or more in profit at unusually low tax rates, and most families might see a modest tax cut that will put a few hundred extra bucks in their pockets.

Alternatively, Congress could pass tax cuts of more than $1.5 trillion if the Republicans could flip enough Democratic Senators to get to 60 votes. The Democrats would almost certainly demand large tax cuts for lower and middle earners, potentially lower taxes on corporations and higher taxes on the wealthy. Would you bet on that sort of compromise?

The Challenges of Capturing Bull Market Returns

SEPTEMBER 24, 2017 / ASSETMAN14 / LEAVE A COMMENT
By Bob Veres

You probably didn't notice, but Monday, September 11 marked a milestone: the S&P 500 index's bull market became the second-longest and the second-best performing in the modern economic era. Stock prices are up 270% from their low point after the Great Recession in March 2009—up 340% if you include dividends. That beats the 267% gain that investors experienced from June 1949 to August 1956. (The raging bull that lasted from October 1990 to March 2000 is still the winningest ever, and may never be topped.)

With the benefit of hindsight, it's easy to think that the long eight-year ride was easy money; you just put your chips on the table when the market hit bottom and let them ride the long bull all the way to where we are today. We tend to forget that staying invested is actually pretty difficult, due to all the white noise that tries to distract us from sound investing principles.

Consider, for example, that initial decision to invest in stocks that March. We had just experienced the worst bear market (down 57.7% from the peak in October 2007) since the Great Depression, and were being told many plausible reasons why prices could go lower still. After all, corporate earnings were dropping from already-negative territory. Was that the time to buy, or should you respond by waiting out the next couple of years until a clear upward pattern emerged?

he following year, investors were spooked by the so-called "Flash Crash," which represented the worst single-day decline for the S&P 500 since April 2009. Then came 2011, two to three years into the bull, when the S&P 500 declined 20% from its peak in May through a low in October. The pundits and touts proclaimed that another recession was looming on the horizon, which would take stocks down still further. Surely THAT was a good time to take your winnings and retreat to the sidelines.

By the time 2012 rolled around, there was a new reason to take your chips off the table: the markets were hitting all-time highs. Of course, historically, all-time highs are not indicative of anything other than a market that has been going up. If you decided to take your gains and get out of the market when the S&P 500 hit its first all-time high in 2012, you would have missed an additional 98% gain.

The headline distraction in 2013 was rising interest rates, which were said to be the "death knell" of the bull market. Low rates [it was declared] were the "reason" for the incredible run-up from 2009-2012, so surely higher rates would have the opposite effect. (The "experts" were wrong. The S&P 500 would advance 32% in 2013, its best year since 1997.)

In 2014, the U.S. dollar index experienced a strong advance, as markets began to expect the U.S. Fed to end its QE program. A falling dollar and easy Fed money were said to be responsible for the "aging" bull market, so this surely meant that it was time to head for the exits. Instead, the index ended 2014 with a 13.7% gain.

The following year, a sharp decline in crude oil prices was said to be evidence of a weakening global economy. The first Fed rate hike (in December 2015) since 2006 led many institutional investors to sell their stocks in the worst sell-off to start a year in market history. The 52-week lows in January and February were said to be extremely bearish; the market, we were told, was going much lower. Instead, the S&P 500 ended 2016 up 12%.

Today, you'll hear that the bull market is "running out of steam," and is "long in the tooth." New record highs mean that there is nowhere to go but down. In other words, you are, at this moment, subject to the same noise—in the form of extreme forecasts, groundless predictions, prophesies and extrapolation from yesterday's headlines—that has bombarded us throughout the second-longest market upturn in history.

This is not to say that those dire predictions won't someday come true; there is definitely a bear market in our future, and several more after that. But investors who tune out the noise generally fare much better, and capture more of the returns that the market gives us, than the hyperactive traders who jump out of stocks every time there's a scary headline. As we look back, let's recognize that holding tight through big market advances and allowing your investments to compound is never easy. But it can be extremely profitable in the long run.

What does it mean when your portfolio is up 10%?

JUNE 23, 2017 / ASSETMAN14 / LEAVE A COMMENT
By Bob Veres

You receive portfolio performance reports every three months—a form of transparency that financial planning professionals introduced at a time when the typical brokerage statement was impossible to decipher. But it might surprise you to know that most professionals think there is actually little value to any quarterly performance information, other than to reassure you that you actually do own a diversified portfolio of investments. It's very difficult to know if you're staying abreast of the market, and for most of us, that's not really relevant anyway.

Why?

The only way to know if your investments are "beating the market" is to compare their performance to "the market," which is not easy. You can compare your return to the Dow Jones Industrial Average, but that index represents only 30 stocks, all of them large companies. Most peoples' investment portfolios include a much larger variety of assets: U.S. stocks and bonds, foreign stocks and bonds, both including stocks of large companies (large cap), companies that are medium-sized (mid cap) and smaller firms (small cap). There may be stocks from companies in emerging market countries like Sri Lanka and Mexico. There may be real estate investments in the form of REITs and investment exposure to shifting commodities prices, like wheat, gold, oil and pork bellies.

In order to know for sure that your particular batch of investments outperformed or under performed "the market," you would need to assemble a "benchmark" portfolio made up of index funds in each of these asset categories, in the exact mix that is in your own portfolio. Even if you could do that precisely, daily, weekly and monthly market movements would distort the original portfolio mix by causing some of your investments to gain value (and become larger pieces of the overall mix) and others to lose value (and become smaller pieces), and those movements could be different from the movements inside the benchmark. After a month, your portfolio would be less comparable to the benchmark you so painstakingly created.

Many professionals believe that there are several keys to evaluating portfolio performance in a meaningful way—and the result is very different from comparing your returns with the Dow's.

1) Take a long view. What your investments did last month or last quarter is purely the result of random movements in the market, what professionals call "white noise." But you might be surprised to know that even one-year returns fall into the "white noise" category. It's better to look at your performance over five years or more; better still to evaluate through a full market cycle, from, say, the start of a bull market to the start

of a new bull market. However, you should remember that there are no clear markers on the roadside that say: *"This line marks the start of a new bull market."*

2) Compare your performance to your goals. Your financial plan indicated that your investments needed to generate (let's suppose) 5% returns above inflation in order for you to have a great chance of affording a long, comfortable retirement. If that's your goal, then chances are, your portfolio is not designed to beat the market; it represents a best guess as to what investments have the best chance of achieving that target return, through all the inevitable market ups and downs between now and your retirement date. If your returns are negative over three to five years, that means you're probably falling behind on your goals—and you might be taking too much risk in your portfolio.

3) Recognize that some of your investments will go down even in strong bull markets. The concept of diversification means that some of your holdings will inevitably move in opposite directions, return-wise, from others. Ideally, the overall trend will be upward—the investments are participating in the growth of the global economy, but not at the same rate and with a variety of setbacks along the way. If you see some negative returns, understand that those are the investments you're counting on to give you positive returns if/when other parts of your investment mix are suddenly, probably unexpectedly, turning downward.

That doesn't mean you shouldn't look at your portfolio statement when it comes out. Make sure the investments listed are what you expected them to be, and let your eye drift toward the longer time periods. Notice which investments rose the most and which were down and you'll have an indication of the overall economic climate. And if your overall portfolio beat the Dow this quarter, or over longer periods of time, well, that probably only represents white noise.

Not "If;" "When"

JANUARY 31, 2017 / ASSETMAN14 / LEAVE A COMMENT
By Bob Veres

You're starting to hear people talk about "if" there's a bear market during the Trump Administration, when the real truth is they should be talking about "when." And it won't necessarily be triggered by a poorly-worded tweet, a global-trade-stopping new tariff regime or tax and entitlement reform. Every presidential cycle has its share of market draw downs, seemingly regardless of presidential policies.

You don't believe it? The accompanying chart shows the worst stock market draw downs for every president since Herbert Hoover in the 1930s, and you can see that good president or bad, Republican or Democrat, they all eventually experienced significant down markets. Some might be surprised to see Ronald Reagan's 25% and 33% drop from high to low, or the nearly 52% draw down experienced during George W. Bush's presidency. Weren't these pro-business Presidents?

President	Inaguration Date	End of Term	Worst Stock Market Drawdown
Herbert Hoover	Mar. 4, 1929	Mar. 3, 1933	-86.19%
Franklin Roosevelt*	Mar. 4, 1933	Jan. 19, 1937	-33.93%
	Jan. 20, 1937	Jan. 19, 1941	-54.47%
	Jan. 20, 1941	Apr. 11, 1945	-28.79%
Harry Truman	Apr. 12, 1945	Jan. 19, 1949	-28.47%
	Jan. 20, 1949	Jan. 19, 1953	-14.02%
Dwight Eisenhower	Jan. 20, 1953	Jan. 20, 1957	-14.43%
	Jan. 21, 1957	Jan. 19, 1961	-20.66%
John F. Kennedy*	Jan. 20, 1961	Jan. 19, 1965	-27.97%
Lyndon Johnson	Jan. 20, 1965	Jan. 19, 1969	-22.18%
Richard Nixon**	Jan. 20, 1969	Jan. 19, 1973	-34.73%
	Jan. 20, 1973	Jan. 19, 1977	-47.32%
Jimmy Carter	Jan. 20, 1977	Jan. 19, 1981	-17.07%
Ronald Reagan	Jan. 20, 1981	Jan. 20, 1985	-25.30%
	Jan. 21, 1985	Jan. 19, 1989	-33.51%
George Bush	Jan. 20, 1989	Jan. 19, 1993	-19.92%
Bill Clinton	Jan. 20, 1993	Jan. 19, 1997	-8.94%
	Jan. 20, 1997	Jan. 19, 2001	-19.34%
George W. Bush	Jan. 20, 2001	Jan. 19, 2005	-43.46%
	Jan. 20, 2005	Jan. 19, 2009	-51.93%
Barack Obama	Jan. 20, 2009	Jan. 19, 2013	-22.60%
	Jan. 21, 2013	Jan. 19, 2017	-14.16%
Donald Trump	Jan. 20, 2017	???	???

*Lyndon Johnson sworn in Nov. 22. 1963

**Gerald Ford sworn in Aug. 9, 1974

What the chart doesn't show, but you know already, is that after every single one of these scary drops, the markets recovered to post new highs, which we're experiencing today. So don't listen to anybody who talks about "if" the markets are eventually going to go down sometime in the next four years. We're going to experience a bear market—time, date, duration and extent unknown. And then, if history is any indication, we'll see new highs again eventually.

Asset Management Group, Inc.