



# The THOUGHTFUL INVESTOR™

Advisor's Name and Credentials®

Company Name

Third Quarter 2016

## Waiting for the Recession

*Recession - a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters.*

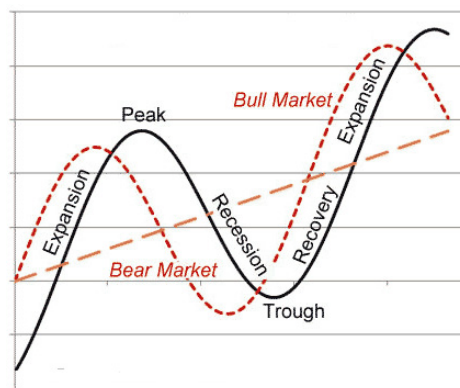
When it comes to investing, recessions matter. They matter a great deal. Major stock market declines have occurred during recessions. When recessions start with stocks at high valuations, the largest declines have followed. The best market performance has historically occurred in 1, 3 and 5 years following the end of a recession. There are exceptions to the outperformance, but they are the outliers.

In a normal business cycle, recessions occur on average every five years. It's part of the cyclical nature of life. We tend to swing from one extreme to the other and in the process, maintain a relative balance. The longest time the U.S. economy has gone without a recession is 10 years.

The United States went through its longest, and by most measures worst economic recession since the Great Depression between December 2007 and June 2009. Since then the recovery in terms of Gross Domestic Product (GDP), has been one of the weakest on record with average annual GDP growth of only 2.1%. First quarter 2016 came in at an anemic 0.8% annual rate.

And that presents the investor with a dilemma. The current recovery is seven years old. It's nearing nine years since the start of the recession. History tells us a recession may well

### The Business Cycle and Stock Market Cycle



Stock market prices tend to rise or fall in anticipation of changes in the economy.

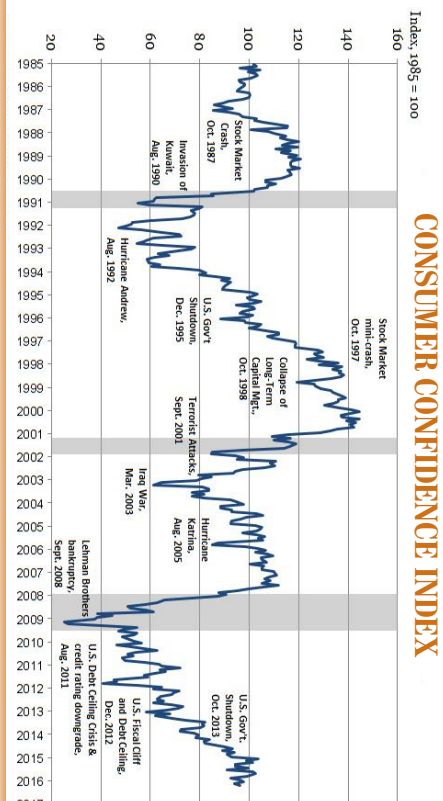
be overdue. At the same time, stock market valuations are definitely on the high side. Using Yale professor and Nobel laureate Robert Shiller's 10-year average of "real" (inflation-adjusted) earnings, the historic P/E10 average is 16.7. In February 2015, the ratio hit a new interim high of 27.0, before receding to 24.3 at the end of May.

Is the U.S. on the verge of a recession, in a recession or continuing a struggling recovery? Ironically, we will only know in hindsight. One of the best recession indicators has been an inverted yield curve when short-term interest rates exceed long-term rates. But the Fed's manipulation of interest rates over the last seven years has depressed short-term rates to well under 1%, sidelining the inverted yield curve's validity. Even when interest rates reflected actual market demand, economists at the National Bureau of Economic Research have been six to 12 months late in detecting a recession.

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## Missing the Good Old Days of 2000

The good news – Americans on the whole are feeling a lot more confident of their future than we were in 2009. For that matter, we are more confident than we have been for much of the last 30 years. But we are still a long way from the heady days of 2000, when the worries about Y2K were behind us, the market had minted hundreds of new millionaires and life was full of potential!



Shaded areas represent periods of recession. Source: The Conference Board. Data from The Conference Board, Nielsen, TNS, NBER

# Financial Tool #1 – The Budget

*“Budgets are what separate the financially successful from the financially mediocre.”*

Mindy Crary

Think of a budget as a brake. To become financially successful, you have to spend less than you earn. To control our spending, most of us need some form of a brake, a reality check as to how much we actually have and how much we spend. Otherwise, it's very easy to rationalize away excess spending or not even realize why we live from paycheck to paycheck.

What is a budget? **It starts with a goal.** If you don't have a reason to budget, you won't stick with it. But finding a goal is as easy as saying I want sufficient resources to retire, or, I want to be able to buy a new car in two years. Since our lives tend to revolve around money, finding a reason to use it more efficiently is typically not the problem. Make certain your goal is **SMART - Specific, Measurable, Achievable, Relevant, and Time Framed.**

The next step is to answer **Where does my money come from and how much is my income?**

Now you need to know **where your money goes.** Basically, this is tracking your expenses. These typically fall into three categories. **Fixed Needs** might include rent, phone bill, loan payments such as for a house and/or car, insurance, etc. **Variable Needs** are necessary expenses that might vary from month to month such as food, gas, etc. **Wants** might include clothing, entertainment or personal possessions.

Add up your income, subtract your expenses and the resulting number is the amount you have left for saving to meet your goals. Now you can go back into your income and expenses and look at ways you can increase the amount of money you can put toward making your goal a reality.

While putting a budget together can be as simple as two columns of numbers on a page, to really understand and control your finances, it helps to be able to analyze your spending trends and to track expenses as painlessly as possible. Fortunately, technology offers a number of aids. An internet search for “personal finance software” or “best budgeting software”

will bring up a host of solutions. One top ranked program is MINT, which offers the advantages of ease of use, ability to import spending records directly from your accounts, and free. But there are a number of other solutions that may fit your needs better at relatively modest costs.

Unless you take the time to understand your income sources and how you spend your money, you can never truly control your finances. Without the solid information that comes from budgeting, you are just guessing. Make financial success, not financial mediocrity your goal and take control of your money.

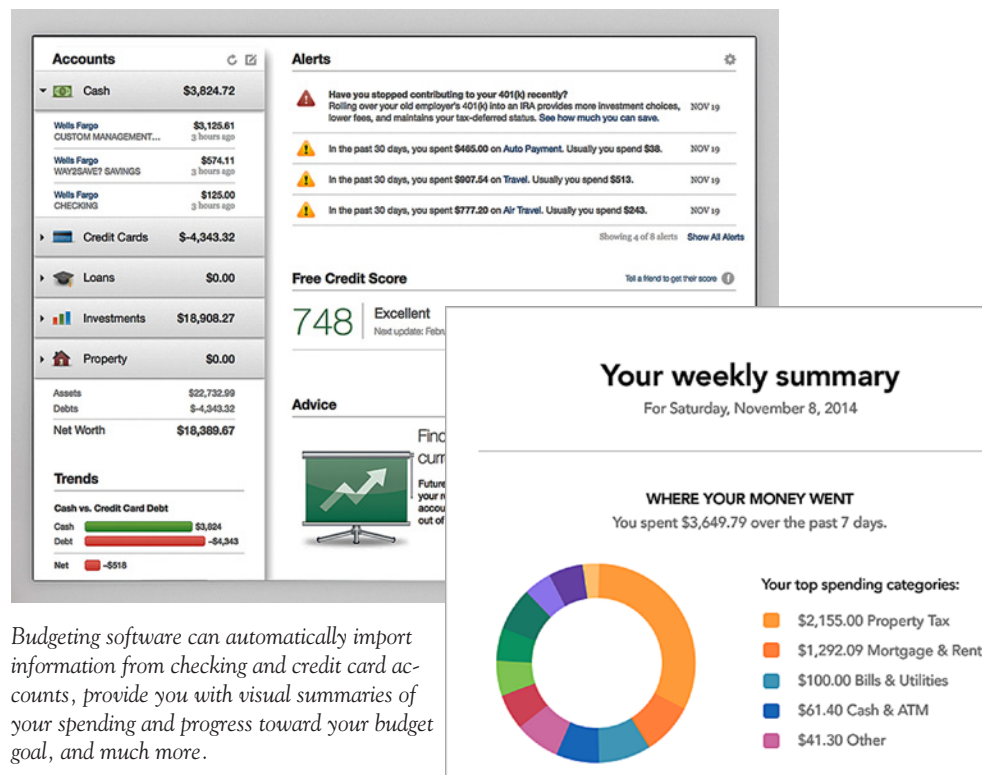
## Waiting for the Recession

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What we do know is that recessions are part of the normal business cycle. Government intervention may delay their onset, but this has its dangers. *“Stability leads to instability. The more stable things become and the longer things are stable, the more unstable they will be when the crisis hits,”* said American economist Hyman Minsky. We also know that the stock market is well above average valuations, a precursor for above average losses.

Which brings us back to another great truth of investing - *“Markets can remain irrational a lot longer than you and I can remain solvent,”* attributed to John Maynard Keynes. As students of the financial markets, we strive to understand and anticipate the market's trend, but not predict. We let the market tell us when it's time to move. This is not, however, the time to decide a passive index strategy is the way to invest.

**FOOTNOTE: MONEY IS ON THE MOVE**  
- For the week ended 05/25/2016 ExETFs - All equity funds reported net outflows totaling -\$4.927 billion. Net inflows were reported for all taxable bond funds of \$1.502 billion, bringing the rate of inflows for the \$2.238 trillion sector to \$1.762 billion/week. Money Market funds reported net inflows of \$7.257 billion. ExETFs - Municipal Bond funds report net inflows of \$0.840 billion. Source: Lipper U.S. Fund Flows Report



Budgeting software can automatically import information from checking and credit card accounts, provide you with visual summaries of your spending and progress toward your budget goal, and much more.



# Age is a Matter of Perception

*"Studies have shown that an ant can carry one hundred times its own weight, but there is no known limit to the lifting power of the average tiny eighty-year-old Spanish peasant grandmother."*

Terry Pratchett, *Reaper Man*

The odds are we are going to be around a lot longer than prior generations. The life expectancy for women is now 81, while men will reach an average age of 76. Keep in mind those are averages. At least half of us will live longer, some quite a bit longer. Now the trick is to make those years productive and enjoyable, and it turns out there is a relatively simple way to do so. Get rid of your negative stereotypes on aging!

The problem with getting old is that we expect to get...well, old. And old has some definite image problems. Old is too often characterized as the crabby curmudgeon, the physical wrecks, Alzheimer sufferers, and has-beens. Accept the negative stereotypes, and you may find that they can become a self-fulfilling prophecy.

How we think about getting older affects how we age. If we expect aging to bring physical decline and reduced thinking abilities, the odds are it will. Sometimes the problem is that we attribute to getting older symptoms that have a very different cause and fail to seek medical attention. Even the medical profession has a tendency to see problems in terms of age. A retired friend was diagnosed with early stage Alzheimer's due to her inability to remember details and think clearly. A year later, the diagnosis changed to sleep apnea. It turned out she was suffering sufficient oxygen and sleep deprivation that it was affecting her ability to remember and think clearly.

Approach aging with a positive outlook and you will be less prone to mental decline, less likely to develop coronary disease and more likely to lead a happier life. In fact, the Yale School of Public Health found that subliminally exposing older individuals to positive messages about aging

resulted in long-term improvements in their self image, strength and balance. In a study on older adults, those who exercised functioned physiologically similar to younger people. Even the feared onset of mental deterioration is greatly exaggerated and often encouraged by low expectations.

Five simple rules to making a longer life more worthwhile include:

1. Keep active
2. Stay social
3. Challenge yourself
4. Think positive
5. Don't write off problems to "old age"



Getting old and staying a vibrant, contributing part of society is actually a long tradition, contrary to any stereotypes of aging.

**Benjamin Franklin** was 77 when he served with the U.S. commission to complete negotiations and sign a peace treaty with England; invented bifocals at 78; at 81 served as the oldest delegate to the Constitutional Convention, and became president of the Pennsylvania Society for Promoting the Abolition of Slavery.

**Florence Nightingale** contracted Crimean Fever visiting hospitals during the Crimean War when she was 35 and was periodically chronically ill for years afterwards. But she went on to consult with the British army on improvements to the military hospital system, founded nursing programs, wrote, advised and mentored into her 80s. She was appointed a Lady of Grace of the Order of St John at 84; became the first woman to be awarded the Order of Merit in 1907 at age 87,

was given the Honorary Freedom of the City of London at 88 and at age 90 was presented with the badge of honor of the Norwegian Red Cross Society.

In more recent times:

**Dorothy Davenhill Hirsch** of 89 years and 109 days visited the North Pole while aboard the Russian Nuclear Ice Breaker Yamal.

**Simon Murray**, 63 years 309 days old trekked the 1,200 km journey from the Hercules Inlet on the Zumbege Coast, Antarctica to the South Pole; a journey that took him 2 months to complete. Murray became the oldest man to reach the South Pole unsupported.

**Smoky Dawson** was an Australian country music performer who at the age 92 years and 156 days released a collection of original songs in an album entitled "Homestead of My Dreams" making him the oldest person to release a new album.

**Dr. Leila Denmark** was an American pediatrician who earned the title of "oldest practicing pediatrician" until her retirement at the age of 103.

**Gladys Burrill** at 92 years old became the Guinness Book of World Records' Oldest Female Marathon Finisher.

**Tamae Watanabe** became the then oldest woman to climb Mount Everest at age 63. Ten years later, in May 2012, she broke her own record, when she, now at the age of 73, again scaled Mount Everest.

The oldest person to be awarded a doctorate is Emeritus Professor **Dr Heinz Wenderoth** (Germany), who was awarded the degree of Doctor of Science by the Gottfried Wilhelm Leibniz University of Hannover at the age of 97. The subject of his dissertation was "Cell Biological Studies in the Morphology and Physiology of primitive marine Placozoons Trichoplax Adhaerens".

We have the ability and tools to live longer, healthier lives than ever. Add a positive attitude and getting older becomes a lot more fun and a lot more productive.



Contact information

Disclosure

## A Mind Is a Hard Thing to Change

**C**an you trust your mind? Maybe. Maybe not. It really depends.

Our natural inclination is to cling to our beliefs, particularly if recent experience has reinforced them. The problem is that when we run into something that contradicts our beliefs, our mind works to reject the conflicting information even when we know it's true. Scientists call this cognitive dissonance. MRI studies have shown that the reasoning side of the brain can actually shut down when presented with information that conflicts with an established belief. But in refusing to recognize a truth, we may also be missing opportunity.

How can you be more open to new ideas? It starts with understanding the power of beliefs and accepting that we may not always be right.

Like so many things in the nature of mankind, cognitive dissonance actually has some survival benefits. It keeps us from continually second guessing decisions, and suffering pangs of regret. It helps us sleep better at night and simplifies decisions. But it can also block our ability to see our own errors, much less correct them.

Being more open to change starts with understanding that our minds predispose us to the status quo. Unless we deliberately turn on our thinking circuits, our mind will shortcut to existing beliefs. Charles Darwin maintained that when he came up against a fact that



contradicted something he believed, he had to write it down within 30 minutes. If he waited longer than that, his mind would reject the information.

It is often most difficult to change our minds when critical to do so. Unhappy with your life or feeling threatened by changes around you? These emotions actually make it more likely that you will cling to existing beliefs even if they are the cause

of your misery. Happiness facilitates change. People who feel good about themselves are more likely to be open-minded. We are also more willing to consider new ideas if we are feeling secure. *"The more threatened we feel, by economic uncertainty, or threats of terrorism, or environmental doom and gloom, the more we circle the wagons of our opinions to keep the tribe together and keep ourselves safe...and the more fierce grow the inflexible 'Culture War' polarities that impede compromise and progress."*<sup>1</sup>

The problem with sticking with our beliefs and not asking whether or not we are right is that when you think you're right, you don't go looking. Overconfidence and complacency are the investor's greatest liabilities, leading to missed opportunities and the failure to see market dangers.

The fact is that everyone wants something to change when what they're currently trying to do isn't working. We *want* change when it fixes *our* problem but unless a deliberate effort is made to change the way we think, old patterns tend to dominate.

<sup>1</sup> [How Risky Is It, Really? Why Our Fears Don't Match the Facts](#), by David Ropeik