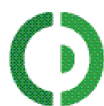


CONLON DART
wealth management

Volume XV, Issue I First Quarter 2018

> **"The less investors are braced for unexpected news, the less it takes to scare them."**
>
> *James Mackintosh, Wall Street Journal*

Musings on Bubbles, Melt-Ups and More

I've been plying the investment trade for over three decades now, but only recently have I heard the term "melt-up" tossed about freely in daily investment conversations. So I pulled up Investopedia and learned this:

A dramatic and unexpected improvement in the investment performance of an asset class driven partly by a stampede of investors who don't want to miss out on its rise rather than by fundamental improvements in the economy. Gains created by a melt up are considered an unreliable indication of the direction the market is ultimately headed, and melt ups often precede melt downs.

I'm not here to make the case for a market melt-up (and subsequent meltdown), but I would caution investors to be wary and combat the fear that they are somehow missing out on the action.

It seems not everyone agrees with me. In January alone, exchange traded funds (ETFs) gathered a net $75 billion in new investment, all but $8 billion going towards U.S. and international stock funds.

Moreover, the Wall Street Journal reported a recent surge in retail investor activity, particularly from younger investors using discount brokers such as TD Ameritrade and Charles Schwab. Ameritrade reports a 72% jump in new business from millennials, aided in part by offering customers access to bitcoin futures. Most millennials were too young to participate in the dotcom bust, yet their increased activity today is mildly reminiscent of that era. Hopefully, we aren't nearing the dreaded "fear of missing out" stage of the market cycle.

In a recent talk, Mohamed El-Erian, Chief Economist at Allianz (the parent company of Pimco), discussed the large wedge between market fundamentals and stock prices, suggesting that valuations have recently run up while fundamentals (corporate earnings) have not. He noted that "the wedge can last years at a time, but ultimately, the convergence will happen. The question is, will it happen from above or below?" In other words, will equity prices slide down commensurate with market fundamentals, or will fundamentals improve to match the current, mildly rich valuations?

Time will tell. On the plus side is a global economy growing in sync for the first time since the world crawled out of the Great Recession.

(continued on page 3)

The Joys of Navigating Medicare

Baby boomers are reaching their senior years at a record clip. Each year from now to 2021, a larger number of them will reach age 65. That means a lot of folks will be weighing their Medicare choices over the next several years.

Spoiler alert: Navigating Medicare choices for the first time is not a terribly fun process to go through. With that in mind, we offer this simple primer.

The Basics

Medicare benefits become available to all U.S. citizens (and qualified permanent residents) upon reaching age 65.

Coverage is divided into three core components: Part A (hospitalization), Part B (doctor visits), and Part D (prescription drugs). Elective coverage includes a Medigap supplemental policy, which covers gaps in deductibles, copayments, coinsurance, etc.

Medicare Part A is "free" for all eligible participants. Medicare Part B requires a standard premium ($134 per

(continued on page 4)

False Visions of the Future

"In all, out of six 'sure things' that the gurus predicted, just two actually happened."

The financial experts know a lot more about the markets and how the markets will perform in the future than the ordinary rest of us. Right?

As it turns out, the predictions made by financial experts are no better than those made by gypsies looking into crystal balls, soothsayers gazing at the entrails of a sacrificed animal or wizards with tall caps who gaze into space. In fact, the financial experts might even be LESS reliable than those other charlatans.

The reason we don't know this is that we all read the annual predictions made by so-called market experts, but nobody ever goes back to see if those predictions ever came true. Well, almost nobody. Larry Swedroe, an economist and director of research for Buckingham Strategic Wealth, spent much of 2017 compiling predictions that were made with a great deal of certainty, and recently gave what might be called a "guru scorecard" of results.

One popular prediction was that bond rates would rise dramatically in 2017, causing bond investors to book significant losses. Actual result: the Vanguard Long-Term Treasury Index returned 8.6% for the year, and the Vanguard Intermediate-Term Treasury Index gained 1.7%.

Another popular prediction: that the inflation rate would rise significantly—which also didn't happen in 2017. Swedroe notes that economists expected stocks to provide moderate single-digit returns, the dollar to strengthen and emerging markets to get socked by the potential for trade wars. None of these predictions actually came to fruition.

In all, out of six "sure things" that the gurus predicted, just two actually happened: small cap stocks did indeed underperform large-cap stocks in 2017, and the U.S. economic growth did strengthen in 2017 over 2016—albeit modestly.

Swedroe has been keeping track of "sure things" that pundits have predicted, and whether they actually turned out to be true, since 2010. The results have been dismal. Of the 62 significant predictions in that time period, 43 turned out to be wrong.

If you're looking for more evidence, consider consensus predictions of where 10-year bond rates will go each year since January 1, 2008. Over that ten year period, the consensus forecast from the U.S. Federal Reserve Board's Quarterly Survey of Professional Forecasters predicted that bond rates would go up significantly during the course of the upcoming year. With the exception of one year, they actually fell significantly short of the predictions.

All of this is worth remembering next time you hear a pundit or market guru make a confident prediction about what's going to happen in the markets. Based on past history, you could have done better if you'd relied instead on a gypsy fortune teller.

Source: Robert Veres, Inside Information

Melt-ups...

(continued from page 1)

Until recently, Japan, Brazil, and much of Western Europe were merely sporadic participants in the economic recovery. Not so anymore. Domestically, the new tax plan has also offered a boost, although we would caution that the plan alone won't guarantee 3% annual GDP growth, as many have suggested.

On a cautionary note, it's reasonable to assume that simple demographics will play a part in economic growth over the next several years. Between now and 2023, the number of peak earners and spenders aged 45 to 54 will decline from 13% to 12% of the population. Meanwhile, the population over age 70, which experiences the largest decline in spending, will increase from 10.5% to 12.5%. This shift will have an indeterminate impact on economic growth, but it will be felt.

Meanwhile, the upward path for stocks has been remarkably smooth. It won't remain that way indefinitely. Last year was the second-least volatile year on record (as measured by market drawdowns) since 1945. Only 1995 proved less volatile. Moreover, in mid-January, the S&P 500 reached its 300th day of trading within 3% of an all-time high—another record. Interestingly, volatility has been picking up in 2018. There have been a few notable down days, and others where the markets opened strong, only to drift down by the close. This behavior is normal. Last year's wasn't.

Tempering Expectations

We often talk with clients about investment returns as they relate to long-term financial planning projections. We assume different returns for different asset classes, and in many instances, we model projections over decades. We also consider historical returns and arbitrarily give them a "haircut," particularly for bond investments. For example, we currently assume a 3.9% annual return for bonds, far lower than the 7.35% result sported by the Barclays US Aggregate Bond index over the last forty years.

With that background, it was instructive—okay, alarming—to read a recent column by Jason Zweig discussing how pension fund managers view future returns for their own portfolios. Zweig referred to a new study from Erasmus University Rotterdam and Stanford that looked at expected long-term returns for 230 public pension plans. Let's just say the average pension fund manager isn't big on giving "haircuts" to their return assumptions.

On average, Zweig noted, "they expect cash to return an average of 3.2% annually over the long run; bonds, 4.9%; "real" assets such as commodities and real estate, 7.7%; hedge funds, 6.9%; publicly traded stocks, 8.7%; private-equity funds, 10.3%."

Perhaps the most striking fact was that the average pension fund assumes a 3.2% estimate for cash holdings. For perspective, a 10-year Treasury note only pays 2.8%, and a three-month Treasury bill, 1.4%. The fund managers' bond projections were also quite rosy. From here, we would need an enormous rise in bond yields to get annualized rates anywhere close to 4.9%. Most other return assumptions seem reasonable, although many forecasters argue that expected stock market returns should be ratcheted down over the coming decades.

Remember, pension managers are considered the "smart money." In other words, this cohort is generally a disciplined bunch that doesn't often fall victim to "fear of missing out" or other behavioral investing errors often attributed to "less smart" retail investors.

So why the high assumptions? For starters, most pension funds demand high returns in order to meet payout requirements for their retired employees. Aggressive projections are in pension fund managers' DNA. The good news—at least for them—is that they will be long retired and not held accountable if their projections prove short of their targets.

- Mitch Conlon

Stat Bank

104...Number of consecutive months the US economy has been expanding, the 2nd longest expansionary period on record.

(National Bureau of Economic Research)

8...Number of "renter" households added in the US over the last decade for every 1 new "owner" household.

(Census Bureau)

327...US population in millions as of Jan 1, 2018, 4.4% of the world's population.

(Census Bureau)

46...Percent of Americans who have no money invested in stocks today, including mutual funds.

(Gallup)

Medicare…

(continued from page 1)

month in 2018 for those who meet income requirements described below). Medicare Part D premiums vary, as they are set by private insurers, but costs averaged about $43 per month this year. Medigap plans include many different options and vary by region, but expect to pay around $200 per month, on average.

Many folks go a different route, electing Medicare Advantage instead. Otherwise known as Medicare Part C, Medicare Advantage plans replace the combination of Part A, Part B, Part D, and supplemental Medigap coverage with a single managed care plan. Many folks opt for Medicare Advantage plans because they typically cost less than traditional Medicare. The tradeoff is a more limited care network, not unlike the pre-Medicare HMO model. Access to a specialist usually requires a referral. More importantly, provider networks vary by plan and region. This model might be problematic for those in smaller markets or rural areas.

Dates to Remember

Upon reaching age 65, eligible participants enter the Initial Enrollment Period to sign up for Parts A and B. If you have not begun taking Social Security benefits, the Initial Enrollment Period begins three months before your 65th birthday month and last for three months afterwards. For those who elected to take Social Security prior to age 65, enrollment for Part A is automatic, as is Part B, unless you choose to opt out. In either case, Medicare Part D requires voluntary enrollment.

Neglecting to sign up during the Initial Enrollment Period can be an expensive mistake resulting in a lifetime increase in premiums.

Once coverage begins, ensuing renewal periods run from October 15th through December 7th in what is called the Open Enrollment Period. That's a good time for Medicare Advantage participants to review coverage, and for all Medicare participants to review their Part D coverage.

What does it cost?

Assuming you are covered for Parts A, B, and D, purchasing maximum coverage (including Medigap) will cost over $4,500 in 2018, or above $9,000 for a couple. Additionally, higher income individuals have to pay an "Income-Related Monthly Adjustment Amount" (IRMAA) surcharge on Medicare Parts B and D. As the law currently stands (the rules have changed a lot in recent years), Medicare Part B and D or Medicare Advantage recipients whose modified adjusted gross income exceeds $85,000 for individuals or $170,000 for married couples must pay the IRMAA surcharge. The total surcharge will vary by income and filing status, but can be as high as $369 monthly.

Medicare or Medicare Advantage?

On average, Medicare Advantage plans cost far less than "maximum" Medicare coverage, but the extent of the savings varies dramatically from state to state. Apples-to-apples comparisons are difficult because a particular Medicare Part C plan may offer significantly lower benefits than a competing plan with robust Part D (prescription drug) and Medigap coverage. In short, the trade-off for lower premiums is more often than not less benefit flexibility.

That said, roughly a third of all Medicare enrollees opt for Medicare Advantage plans, given their more cost-effective structure.

In any event, be sure to do your homework before choosing a plan. It's worth the investment.

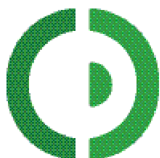
- Mitch Conlon

Finding Clarity in the Complex.

Conlon & Dart LLC
720 Olive Way
Suite 1850
Seattle, WA 98101

Phone: 888-777-4015
Fax: 206-728-1255
info@conlondart.com

www.conlondart.com



The information contained in this newsletter is for general use and while we believe all information to be reliable and accurate, it is important to remember individual situations may be entirely different. Therefore, information should be relied upon only when coordinated with professional tax and finance advice. The publisher is not engaged in rendering legal or accounting advice. Neither the information presented nor any opinion expressed constitutes a representation by us or a solicitation of the purchase or sale of any securities. This newsletter is published by CONLON & DART LLC, SEATTLE, WA, COPYRIGHT 2018.