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August
2017

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Resolute Connections

Every day the media breathlessly reports on the gyrations of the Dow Jones Industrial Average based on the assumption it represents the US stock market. But does the Dow really represent today's tech driven stock market? This month's first article *Bad Barometer* makes the case the Dow might have been representative of the US market back in the days of the rotary phone, however now is a different story.

In *Measuring the Market* we present two different views on a topic our clients often bring up - the historically high U.S. stock market valuations. Investors have been willing to pay more, and more, for a dollar of corporate earnings. Does that make sense and what does that mean about future returns? Read on to find out.

The article *Aging Dilemma* questions whether today's 70-year-old American should be considered "old?" This is a timely topic with today's labor shortage, low birth rates, and fiscally strained retirement systems, as perhaps part of the solution to these issues is keeping workers in the 65 to 75 range in the workforce as the article suggest.

If you have any questions about anything we have covered in the articles below, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Bad Barometer

Chances are, the market barometer you most often hear about is the Dow Jones Industrial Average. Every evening, the Dow's ups or downs are soberly reported as if they reflect something important.

They don't.

A recent online article noted that the 100+ year-old index only reflects the performance of 30 U.S. multinational companies, and it doesn't

even reflect their average performance. The companies with higher share prices count more in the performance numbers, so that when a company's stock enjoys a price surge, it makes up a bigger part of the index.

This can make for some interesting differences between actual market performance and underlying valuation. The Goldman Sachs brokerage firm recently reported a \$224.41 share price, which accounted for 1,537 of the Dow's total points. By comparison, General Electric, which has a \$146 billion larger market cap, only accounted for 185 Dow points with its \$27.02 share price.

With only 30 stocks, the Dow doesn't come close to representing the U.S. business market. Based on its closing price on June 29, the total market capitalization of the companies in the index was about \$6.37 trillion, compared with \$21.8 trillion for the stocks that make up the S&P 500. The Dow has no representation in the utilities and real estate sectors. The Dow doesn't include Alphabet (parent company of Google) or Amazon.com, Facebook, Berkshire Hathaway or Alibaba Group. With the S&P 500 you get a more realistic look at what's happening across the entire spectrum of the U.S. marketplace.

In terms of how it reflects the market, the Dow was an extremely important index in the days of the rotary phone. In today's digital age, it has become a historic novelty. It's time to proclaim the S&P 500 as the market barometer for larger American companies.

Measuring the Market

Have you ever wondered what stock market professionals and equity analysts talk about in their spare time? Recently, the Bloomberg website featured a debate about something that is getting a lot of attention recently: the historically high, and still-rising U.S. stock market valuations. People have been willing to pay more, and more, and more for a dollar of corporate earnings. What does that mean about future returns?

Let's look over the shoulders and see how two professionals approach the question of how to look at today's markets.

Bloomberg Gadfly columnist Nir Kaissar starts by noting that the Standard & Poor's 500 Index has beaten both the MSCI EAFE Index -- a collection of developed market stocks outside the U.S. -- and the MSCI Emerging Markets Index by 6 percentage points a year since March 2009, when the market hit bottom. No matter how you

measure market prices U.S. stocks are now more expensive than their foreign counterparts. To Kaissar, that suggests that investors should consider moving at least some of their money out of American companies and into companies domiciled elsewhere.

Bloomberg View columnist Barry Ritholtz countered that valuation is largely driven by psychology. We are experiencing a bull market in American stocks, which can be defined (in psychological terms) as a period when investors become willing to pay more and more for a dollar of earnings. Eventually this will turn around, and the regional performance gap between the U.S. and Europe will reverse.

But for Ritholtz, the important issue is timing. You could have used Kaissar's argument four or five years ago, gotten out of U.S. equities, and you would have missed a nice runup while foreign stocks were going nowhere. Is it possible that the same will be true over the next few years? (Hint: it is definitely possible.)

Kaissar responded with a definition of risk vs. valuations—the idea that investors are generally willing to pay more for less risky stocks. So can we make an argument that the S&P 500—with a price-to-book ratio about twice as high as the EAFE basket of stocks—is half as risky as stocks trading in the rest of the world? He doesn't think so, and the conclusion is that American stocks are mispriced.

Ritholtz says that rather than trying to time which part of the world is going to do better or worse, it's better to own it all. Instead of U.S. stocks vs. world stocks, own a portfolio that includes all of them in proportion.

Aha! says Kaissar. U.S. investors commonly allocate 70 percent to 80 percent of their stocks to the U.S., even though U.S. stocks represent only 50 percent of global market capitalization. He says that if you believe in true diversification, it would make more sense to create portfolios with a U.S. stock allocation that's closer to 45 percent, tilting slightly toward the global stocks that are currently trading on sale.

Ritholtz makes a final argument, saying that sometimes cheap stocks get cheaper and continue to fall; other times expensive stocks get more expensive and keep going up. He doesn't want to abandon U.S. equities, but he finds common ground with Kaissar when he recommends that people with U.S.-heavy portfolios consider diversifying into MSCI EAFE and MSCI EM indexes—not for timing purposes, but because it's prudent diversification. You can see exactly how boring the cocktail conversations of stock analysts can be by

viewing the entire discussion here:

<https://www.bloomberg.com/view/articles/2017-06-26/how-to-know-when-stocks-are-properly-valued-a-debate#596235f3a911d>

Aging Dilemma

Should today's 70-year-old American be considered "old?" How do you define that term these days? Statistically, your average 70-year-old has just a 2% chance of dying within a year. The estimated upper limits of average life expectancy is now 97, and a rapidly growing number of 70-year-olds will live past age 100.

Perhaps more importantly, today's 70-year-olds are in much better shape than their grandparents were at the same age. In most developed countries, healthy life expectancy from age 50 is growing faster than life expectancy itself, suggesting that the period of diminished vigor and ill health towards the end of life is being compressed.

A recent series of articles in the *Economist* magazine suggest that we need a new term for people age 65 to 85, who are generally hale and hearty, capable of knowledge-based work on an equal footing with 25-year-olds, and who are increasingly being shunted out of the workforce as if they were invalids or, well, "old." Indeed, the article suggests that if this cohort does NOT start returning to the workplace, the impact could be catastrophic on society as a whole.

Globally, a combination of falling birth rates and increasing lifespans threaten to increase the "old-age dependency ratio" (the ratio of retired people to active workers) from 13% in 2015 to 38% by the end of the century. That, in turn, could lead to huge fiscal strains on our pension and Social Security systems, because fewer workers would be paying for retirement benefits for more retirees.

What to do? The article notes that, in the past, whenever a new life stage was identified, deep societal and economic changes followed in the wake. A new focus on childhood in the 19th century paved the way for child-protection laws, mandatory schooling and a host of new businesses, from toymaking to children's books. When teenagers were first singled out as a distinct demographic in America in the 1940s, they turned out to be a great source of economic value, thanks to their willingness to work part-time and spend their income freely on new goods and services.

The next most logical shift in our thinking could be separating out people age 65-80 from the traditional “old” and “retiree” category—and calling them something different. (The article doesn’t offer a suggested name.) They might continue at their desks, or downshift into the kinds of part-time work that emphasize knowledge and relationships. Many who experienced mandatory retirement retired to the so-called gig economy. Though gigging is usually seen as something that young people do, in many ways it suits older people better. They are often content to work part-time, are not looking for career progression and are better able to deal with the precariousness of such jobs. The article notes that a quarter of drivers for Uber are over 50.

More broadly, a quarter of all Americans who say they work in the “sharing economy” are over 55. Businesses that offer on-demand lawyers, accountants, teachers and personal assistants are finding plenty of recruits among older people.

Still others are preparing for life beyond traditional retirement by becoming entrepreneurs. In America people between 55 and 65 are now 65% more likely to startup companies than those between 20 and 34. In Britain 40% of new founders are over 50, and almost 60% of the over-70s who are still working are self-employed.

One large economic contribution made by older people that does not show up in the numbers is unpaid work. In Italy and Portugal around one grandmother in five provides daily care for a grandchild, estimates Karen Glaser from King’s College London. That frees parents to go out to work, saving huge sums on child care.

All of these changes represent societal adjustments to a reality that isn’t well-publicized: that the traditional retirement age increasingly makes no sense in terms of health, longevity and the ability to contribute. The sooner we find a label for healthy people age 65 to 80, the faster we can start recognizing their potential to contribute.

Sources: Bob Veres Inside Edition Newsletter.

For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.

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