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Resolute Connections

In this month's newsletter, *Cause for Alarm?* discusses today's lofty stock valuations, yes even after the recent drops, and whether there is cause for alarm. *"Smart" Investment Strategies?* summarizes how the "other half" manages its money, namely college endowments across the country, and whether all the high-priced talent hired by some of the world's largest investors may have outsmarted themselves when a simple investment approach, available to most of us, would have worked out better.

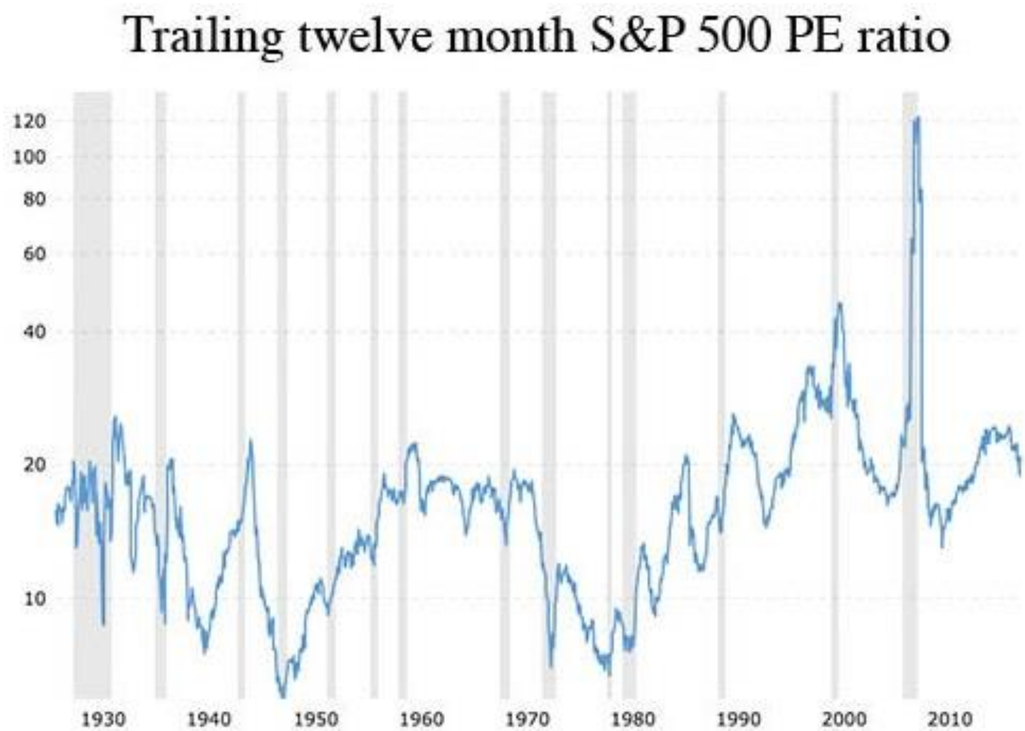
Managing Inversion concerns the inversion of the so-called yield curve, where short-term government bond returns are higher than long-term ones, which has gotten a lot attention lately, since it has in the past been such a good predictor of recessions. (*Un)Safe Deposit Boxes* concerns the troubling fact that safe deposit boxes may not be quite as safe as they appear.

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

Cause for Alarm?

Pundits like to point out that the current price/earnings (PE) ratio of the U.S. stock market is higher than historical averages, and well above their global counterparts. It's true that stocks cost more, relative to earnings, today than at times in the past. But the real question is: is there cause for alarm?

The accompanying graph shows one measure of the S&P 500's PE over the last 90 years. It tracks the trailing 12-month PE, defined as the aggregate share price divided by the aggregate one-year earnings over the past year. Some believe this measure is superior to PEs that use the forecasted earnings, because, well, we can't be sure the forecasts will turn out to be accurate. Trailing PEs have the huge advantage of being relatively indisputable.



What do you see? The runup to the dramatic 2008-2009 market downturn really stands out. It is clear in hindsight what was not always clear at the time: stock prices had gotten somewhat over their skis. Meanwhile, if you look all the way back to 1929, you can see that today's valuations—as has been famously repeated—are almost exactly what they were before the great stock market crash that led to the Great Depression.

But you might also notice that prices have been higher than that many times since, sometimes for sustained periods (see: 1990s). And while the market has gone up dramatically since 2009, PEs haven't risen nearly so high.

Nothing about this graph tells us that stocks are cheap in today's market. But you can see that some of the scary messages in the press might be somewhat overblown. The chart doesn't show anything like the unsustainable price runup to 2008, or for that matter the runup to the 2000-2001 market drop. The tea leaves don't really seem to be telling us much of anything, when you look at the valuations over a long enough time frame. That's not quite as dramatic as saying that the valuations are as high as they were in 1929, but it's a truer picture of what's really happening as the indices ascend to new record prices.

"Smart" Investment Strategies?

If you want to see how the "other half" manages its money, turn to the National Association of College and University Business Officers, which surveys college endowments across the country. These portfolios tend to be a bit larger than yours and mine: Harvard University's 2018 endowment, the largest in the country, came out to more than $38 billion. In second place, the University of Texas is managing an endowment portfolio of just under $31 billion.

You can see on the chart the 40 largest university endowments. In all, the survey uncovered $616 billion managed by 104 American colleges and universities, and the top ten accounted for one-third of the total.

The 40 largest American university endowment funds

Rank	Institution	State/ Province	FY18 Endowment Funds ($000s)
1	Harvard University	MA	38,303,383
2	The University of Texas System	TX	30,886,018
3	Yale University	CT	29,351,100
4	Stanford University	CA	26,464,912
5	Princeton University	NJ	25,917,199
6	Massachusetts Institute of Technology	MA	16,529,432
7	University of Pennsylvania	PA	13,777,441
8	The Texas A&M University System and Foundations[i]	TX	13,524,947
9	University of Michigan	MI	11,901,760
10	Northwestern University	IL	11,087,659
11	The University of California	CA	11,008,035
12	Columbia University	NY	10,869,245
13	University of Notre Dame	IN	10,727,653
14	Duke University (DUMAC, Inc.)	NC	8,524,846
15	The University of Chicago	IL	7,928,485
16	Washington University in St. Louis	MO	7,594,159
17	Emory University	GA	7,292,165
18	Cornell University	NY	7,230,291
19	The University of Virginia	VA	6,953,380
20	Rice University	TX	6,277,506
21	University of Southern California	CA	5,544,267
22	Dartmouth College	NH	5,494,203
23	The Ohio State University	OH	5,211,434
24	The Vanderbilt University	TN	4,608,461
25	Johns Hopkins University	MD	4,325,020
26	New York University[ii]	NY	4,266,000
27	The Pennsylvania State University	PA	4,264,222
28	University of Pittsburgh	PA	4,200,206
29	University of Minnesota & Foundations[iii]	MN	3,717,476
30	Brown University	RI	3,603,848
31	University of North Carolina at Chapel Hill & Foundations	NC	3,432,911
32	University of Wisconsin Foundation	WI	2,985,251
33	Michigan State University	MI	2,907,967
34	California Institute of Technology	CA	2,879,493
35	University of Washington	WA	2,764,166
36	The President and Trustees of Williams College	MA	2,749,653

How do these institutions invest their assets? U.S. stocks made up just 13% of the largest endowments, foreign stocks made up 19%, and bonds added another 7% of the total. Three percent was allocated to cash, and a whopping 58% were devoted to "alternative strategies"—meaning private equity, hedge funds, derivatives, venture capital, investment real estate, timber farms and distressed debt. Looking over all public institutions, these alternative strategies made up 46% of the universities' total investments.

Of course, the reason that universities invest in those alternative strategies is that they have enough scale (total dollars) and enough money to hire smart investment managers who know how to make real money there—right? Interestingly, the average return for all the endowments ranged from 5.6% to 6.1% a year over the last ten years.

That's considerably lower than the colleges and universities would have gotten if they'd simply put all their money in the S&P 500 index—which was up 10.2% a year over the same time period.

The lesson here may be that all the high-priced talent hired by some of the world's largest investors may have outsmarted themselves when a simple investment approach would have worked out better. Additionally, one might ask why many of these institutions have been routinely increasing tuition at twice the rate of inflation while having billions in endowments?

Managing Inversion

The inversion of the so-called yield curve, where short-term government bond returns are higher than long-term ones, has gotten some attention lately, since it has in the past been such a good predictor of recessions. In March of this year, the two-year Treasury yield briefly touched above the yield on 10-year Treasuries, triggering headlines across the financial marketplace.

Inverted yield curves are not ideal for economic growth. They can discourage banks from longer-term lending, and they discourage investors from committing their capital to lending longer-term. (Why accept lower rates on riskier long-term investments when you can get a higher rate on a less-risky short-term one?) And this current yield curve inversion may be telling us what we already know: that a recession is coming, sooner or later. In the past, the U.S. economy has experienced a recession around one in every five years; the current 9-year economic expansion is already overdue to end.

The one entity that can put back some steepness in the yield curve is the Federal Reserve Board, which has expressed concern about the situation already, and which acted by cutting the Fed Funds Rate by 0.25%. That action, and at least one other rate cut expected this year, would bring down the yield of short-term bonds and end the inversion. It would also encourage corporations to borrow to finance long-term projects, giving the economy a bit of a boost—and (though this is not guaranteed) reduce the depth of the inevitable next recession.

(Un)Safe Deposit Boxes

When people want to protect important papers like their wills and trust documents, or valuables like rare coins or precious jewelry, they understand that it's not generally wise to keep them laying around the house. Much better—so goes the conventional wisdom—to put those items in one of the 25 million safe deposit boxes at local bank branch offices around the U.S. There, they'll be protected by a foot-thick steel door and a system with two keys, one kept by the customer, one by the bank.

Alas, it appears that safe deposit boxes are not quite as safe as they appear. A recent article in the New York Times highlights the case of an international expert in rare watches who stored some of his merchandise, 92 watches in all, plus rare coins, in a safe deposit box at a Wells Fargo bank branch in New Jersey. In a later reconstruction of events, it was discovered that Wells Fargo had tried to evict another customer for not keeping up with payments, and had drilled open the wrong safe deposit box. The customer returned to find that his "safe" deposit box was empty, missing millions of dollars worth of merchandise, and went to the management for an explanation. Wells Fargo executives looked around for the lost items in its storage, and found some but not all of the merchandise stored away in a separate location, shrugged their shoulders and told him that the loss had nothing to do with them. Oddly, they also offered the customer five watches that didn't belong to him, which had never appeared on the bank's own inventory of valuables in the box.

You would think that the contents would be insured or guaranteed by the bank, or that there would be laws that protect the customers who trustingly store their most precious valuables in safe deposit boxes. But apparently these "safe" repositories of peoples' most valuable possessions are far from foolproof. Worse, they exist in a kind of legal gray zone. If you carefully read the leases, you discover that you, the renter, assume all risks of leaving property in the box. Wells Fargo's safe deposit box contract caps the bank's liability at $500. Citigroup limits it to 500 times the box's annual rent. JPMorgan Chase has a $25,000 ceiling on its liability.

Meanwhile, the losses are quietly mounting up. In the last five years, there have been 44 safe deposit-related robberies, and uncounted number of bank errors, where boxes were mistakenly relocated, evicted or misplaced. In Maryland, a large bank closed several branches and lost hundreds of safe deposit boxes, costing one customer $500,000 worth of lost gold and gems. In each case, banks vigorously fight any requirement to make their customers whole, and bank regulators seem uninterested in getting involved, since (this might surprise you) no provision of federal banking law regulates safe deposit boxes.

The Wells Fargo case seemed cut-and-dried: the bank's own inventory listed 92 watches in the safe deposit box, and only 85 were recovered. The bank freely admitted in court that its employees had mistakenly drilled into and terminated the box. One of the lost watches had an estimated value near $1 million, and there were missing gold coins. Yet after years of litigation and appeals, Wells Fargo has offered no restitution. The bank is apparently free, by law, to fight not to protect the assets in its "safe" deposit boxes.

Is there a better place to keep your valuables, power of attorney and other documents? Consider a sturdy, fire-proof home safe, and make sure that the combination is available to more than one person, in case the owner is somehow incapacitated.

Source:
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.