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Oct.
2019

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Resolute Connections

In this month's newsletter, *Impeachment Economics* reviews the how the stock market performed during the previous two recent impeachment processes - that of Richard Nixon and Bill Clinton. Should you be concerned about the direction your portfolio might take, or is there a portfolio change that should be undertaken now? Read on to find out. *A Recession On Our Minds* touches on how one might invest in a down market based on the most recent 2008-2009 recession.

Post-Death Planning takes on the cheerful topic of what happens to one's unpaid bills post death, for any couple and heirs this can be an important issue. And *Straight Thinking About ETFs* concerns a persistent worry in the investment community about the popularity of passive investment vehicles like index funds and exchange traded funds, and what would happen if the majority of investor dollars were to roll into these types of investments.

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.

Impeachment Economics

As the impeachment process gets underway in the House of Representatives, President Trump has famously tweeted that the U.S. stock market will experience a severe decline if the process goes much further. This has led many money managers and financial planners to take a hard look at history.

There is no guarantee that history will repeat itself, of course, so this may be a futile

exercise. And in modern times there have only been two impeachment processes (Bill Clinton and Richard Nixon), which is hardly a large sample size or significant track record.

To make matters more complicated, the two impeachments produced very different market outcomes.

Let's start with the impeachment of President Clinton in starting in December 1998. The Senate acquitted Clinton in February of 1999. Stocks fell in anticipation of the release of the Starr report which detailed the case against the President; from July 17 through September 9, the S&P 500 dropped 19.4%. After that, however, during the actual trial, there was a significant rally. The entire decline had been recovered by November 28, 1998. In all, from the date the House voted to start impeachment proceedings on October 8, 1998 to the Senate's acquittal on February 12, 1999, the S&P 500 posted a remarkable 28% gain.

So impeachments are great for the market, right? Not necessarily. The downfall of Richard Nixon took the markets in the opposite direction. From the date that the newspapers reported the Watergate break-in on June 17, 1972 until the President's resignation on August 8, 1974, the S&P 500 tumbled 23.7%.

It can be persuasively argued that economic conditions had more to do with the upturn and downturn than the political process of impeachment. In the 1973-4 period, the global monetary system was falling apart as the U.S. left the gold standard. Oil prices were spiking, leading to stagflation. Heading into the Clinton impeachment, meanwhile, the U.S. economy was booming and the market was flying high amid the tech boom, the advent of the Internet and a balanced federal budget.

President Trump may believe that the stock market is all about him, and previous Presidents may have thought so too. But the reality is that economic forces have much more influence on stock movements than the winds of politics.

A Recession On Our Minds

How should you invest in a down market? If you want a guidepost, let's look back to

the terrible, traumatic down market of 2008-2009. You're going through relentless, daily and weekly losses (remember that?), and the feeling at the time was that the global economy had suffered a mortal blow. So you get to the bottom in March of 2009, and what do you have to look forward to?

Ben Carlson, of Ritholtz Wealth Management in New York, has recently helped us with this trip down memory lane. You are looking forward to the longest-running economic expansion in modern U.S. history, with a stock market that has quadrupled. Inflation is basically non-existent despite unprecedented monetary policy actions from the Fed, and the unemployment rate has fallen from a scary 10% down to 3.7%.

The period following the Great Recession, when the future looked so gloomy, was actually pretty bright.

Of course, you're worried about the next recession and major market downturn—as are we all. But history so far has rewarded investors who are willing to remain invested through the declines. Recessions come and go, but they don't typically last as long as our memories might lead us to think. The economy has been in a recession roughly 15% of the years since the last world war, and in expansion 85% of the time. If we spend 85% of our time focusing on events that happen 15% of the time, instead of the other way around, it can lead to terrible investment behavior. Investing under the assumption that the next recession or downturn is right around the corner means you will always be positioned too defensively.

Post-Death Planning

Have you ever wondered what happens to your unpaid bills after you die? You might be surprised to know that it depends on what kind of debt is still outstanding.

In most cases, your estate will have enough assets to pay off all bills—assuming you have a positive net worth at the time of death. But understand that life insurance proceeds, retirement and annuity accounts and brokerage accounts are left outside the estate—and therefore cannot be forced to pay off debts. Your estate's actual net worth may not be as great as you think it is.

Your executor will review the assets and debts in your estate and prioritize the debts according to some fairly straightforward rules. Certain creditors, like those who issue medical or mortgage bills, must be paid first. A probate court will decide which remaining debts go in which priority, unless there are clear directions in your will.

Mortgage debt normally passes to the spouse or partner whose name is also on the loan documents, but if there is no joint mortgage holder, and the estate has insufficient funds to pay the mortgage, whoever inherits the home can usually move in and resume making the mortgage payments. The rules are different with home equity loans; with these, the bank can demand that whoever inherits the home (and the loan) immediately repay the outstanding balance. However, this is not required of the lender; in many cases, the bank will agree to let the heir continue to make the loan repayments on schedule.

Auto loans work similarly to mortgages; the estate handles payments if the money is available. If not, whoever inherits the car has the option to continue making payments or selling the vehicle to cover the cost of the auto loan.

What about credit cards? Any joint account holder is liable for the debts after the co-account holder dies. But if you're the sole account holder, the credit card cannot go after any unpaid debts from your estate when you die. Spouses who live in community property states may or may not be liable for the outstanding debt.

Student loans are typically paid out of the estate, but if those funds are not available, the loan provider cannot force anyone to pay off the loans, since they are unsecured. However, if there is a co-signer for the loan, that person is liable for repaying the debt. Once again, however, a spouse in a community property estate may be liable for student loans incurred during the marriage.

Many financial planners will recommend a term life insurance policy for a specified time for people who are still building their financial lives, to avoid burdening the family with debt in the event of a premature death. And of course everybody should have a will, and the will should clarify where the existing financial accounts reside, and how to access them. A little upfront planning can save having to deal with a mess later on.

Straight Thinking About ETFs

You probably know that index funds and index ETFs are no longer just popular with financial planners and other insiders. Word has gotten out to the investment public about how difficult it is to beat the market, and how many index funds beat the majority of actively-managed funds—especially the expensive ones.

But there's a persistent worry in the investment community about what would happen if the majority of investor dollars were to roll into index funds and ETFs. These funds don't research the underlying fundamentals of the companies they invest in; their charter is simply to hold each stock in the same percentage as the index. If that's where most of the money is, who is left to determine what is and is not a bargain, what stock is over- and undervalued—a process called 'price discovery?' With all the fund flows into passive investments recently, is it possible that we already don't know the real value of the stocks in our portfolios?

A recent interview with Alex Bryan, the director of passive strategies research for the Morningstar organization, puts some of these worries into perspective. He acknowledges that if the markets are not efficiently priced, investors could end up owning big stakes in stocks that are overvalued—something that actually happened in the late 1990s, when tech stocks suddenly made up 40% of the S&P 500 solely due to their high share prices.

But Bryan notes that today, although index funds have about a 40% share of investor dollars in the U.S., they make up a very small part of the overall trading volume of stocks in the marketplace—because of their low turnover. That means that most of the trades, which is where 'price discovery' happens, are still being made by active fund managers and individual investors.

There are, however, disruptions when an index "reconstitutes," meaning that some stocks drop out of the index and others take their place. These changes are announced in advance, which basically means telling the world that the index funds and ETFs which mimic that index are going to have to sell certain stocks and buy others. Because these sales are basically forced, it means that investors know that the

stocks going into the index are going to get a bump in price, and they invest ahead of the purchases—which actually raises the price a bit further, and makes the index fund less efficient. The same thing happens with the stocks that have to be sold, but in reverse.

One solution is to own a total market index, which buys the whole market and, therefore, doesn't have any forced purchases or sales. The index funds and ETFs, themselves, are addressing this problem by applying a wider buffer zone. So if a company fits the definition of a small cap stock, and then has a good day on the market and trades at a higher price that would bump it up into the midcap space, a midcap fund might decide to wait to add it to its holdings. If the stock bounces back down into the small cap range, there is no trading activity.

Bryan's overall conclusion is that we are not in dangerous territory—at least not yet—regarding index ownership of stocks. How would we know when we cross that invisible line? If the markets suddenly become less good about valuing companies (and, therefore, their stocks), then the smaller number of active fund managers who are left in the marketplace will have a field day identifying misplaced securities, selling those that are overpriced and buying stocks that are trading significantly below their real market value. The result would show up in a resurgence in active managers beating passive indices, who would attract flow of dollars from investors, and the problem would correct itself.

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.

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