FINANCIAL DESIGN STUDIO
DESIGNED FOR LIFE

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Left to Right: Michelle Smalenberger, Steve Smalenberger, Rob Stoll, Trevore Meyer

Nifty Fifty

Written By: ROB STOLL, CFP®, CFA

Big tech companies reported earnings the last week of July, handily beating analyst expectations. This sent their stocks soaring, with Apple, Amazon and Facebook surging to record highs. It's been an incredible run for the stock prices in America's biggest companies. So much so that the top 5 stocks in the S&P 500 Large Cap index make up 23% of the overall index, which is the highest percentage since 1972.

The concentration of the stock market harkens back to the Nifty Fifty Era of the late 60's and early 70's. Back then, it was names like Disney, IBM, McDonalds, and Xerox that were the heroes. Today it's Apple, Microsoft, Amazon, Facebook, and Google. The question is: does it mean anything to see markets this concentrated? While no two periods are the same, it's a good time to dust off the history books on the Nifty Fifty to see how that played out.

Warren Buffett calls it a career

In 1957, 27 year-old Warren Buffett launched Buffett Partnership Limited (BPL). Having been a student of Benjamin Graham – the father of fundamental investing - Buffett took what he learned about investing and decided to start his own fund. And what a start it was. From 1957 to 1968, BPL generated investment returns in excess of 25% per year compared to annual returns in the Dow Jones Industrial Average of 9%.

Despite the success, Buffett started turning cautious on the market in 1967. In his May 1968 partnership letter, he wrote, "We live in an investment world, populated not by those who must be logically persuaded to believe, but by the hopeful, credulous and greedy, grasping for an excuse to believe."

Suddenly, in May 1969 at the tender age of 38, Buffett announced that he was closing down BPL and would retire. By the end of the year the partnership was closed. Interestingly, his last investment recommendation was for his investors to buy tax-exempt bonds, which were yielding 7% at the time.

"I am not attuned to this market environment and I don't want to spoil a decent record by trying to play a game I don't understand just so I can go out a hero." Warren Buffett, May 1969 Partnership Letter.

We know that Buffett continued his investment career running Berkshire Hathaway, which he still does to this day. But it happened after the Nifty Fifty mania that drove him out of the market blew up, creating once-in-a-lifetime investment opportunities for him to invest in again.Buffett took a similar stand against the market mania in 1998 and 1999 during the Tech Bubble. That market was also concentrated.

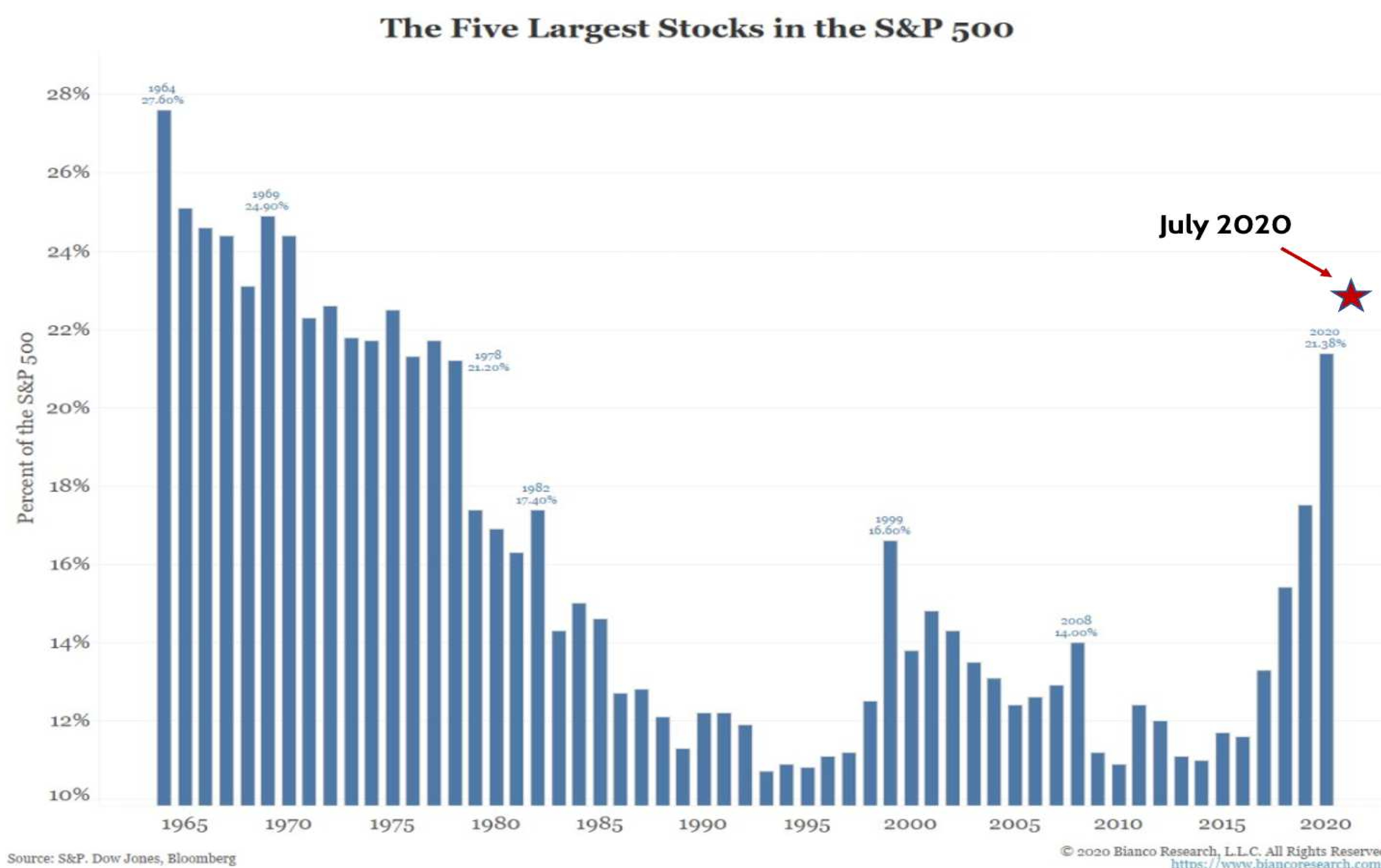
This time around, he didn't retire. But he refused to buy high-flying tech stocks. He caught a lot of flak for that stance at the time but ended up performing extremely well after the bubble eventually burst.

Why does this matter? We're witnessing another concentrated market and another moment when Buffett isn't following the herd. In the midst of the market panic we experienced this past March - when the S&P 500 dropped over 30% from its peak – Buffett was a net SELLER of stocks, not a buyer. This, despite the fact Berkshire has $137 billion of cash sitting on the sidelines!

"I will not abandon a previous approach whose logic I understand even though it may mean foregoing large and apparently easy, profits to embrace an approach which I don't fully understand, have not practiced successfully and which, possibly, could lead to substantial permanent loss of capital." Warren Buffett, 1967.

Market Concentration: Then and Now

Economist Jim Bianco of Bianco Research posted an interesting chart a few weeks ago looking at the concentration of the top 5 stocks in the S&P 500 going back 50 years.



After a 40-year period when the top 5 stocks in the S&P 500 averaged a combined weight of around 13%, concentration has surged. You can see that as of July (red star), just five stocks make up 23% of the index. Buffett noted in his letters in the late 60's that the number of attractive investment opportunities was rapidly diminishing. As that happens, investors invariably pile into the "winners," regardless of price.

We believe the current market concentration is a yellow "caution" flag for investors. Mr. Market is telling us that the investment opportunity set is becoming narrow. Everyone's money is going into the same, small group of perceived winners.

When the Levee Breaks

Nifty Fifty stocks reached their peak in the early 70's, around the time that Led Zeppelin released their fourth album, Led Zeppelin IV. Valuations for these stocks, as measured by their price/earnings ratio (P/E), surged to extremely high levels in 1972

To help you understand how high these P/Es got, consider that the average price/earnings ratio for the S&P 500 over the last 25 years is 16.0x. If a run-of-the-mill good company trades at a mid-teens P/E, a "growth stock" might normally trade at 20.0-30.0x their earnings.

Below, you can see that some of the biggest companies were trading at upwards of 60-80x P/Es. Any way you slice it, these stocks were very expensive!

Nifty Fifty Era ('72-73)

Company	1972 Price/Earnings Ratio	'72-73 Peak to '74-75 Trough	Year Surpassed Nifty Fifty High
Avon Products	65.4	-86%	1991
Disney	81.6	-84%	1985
American Express	39.0	-74%	1981
McDonalds	85.7	-73%	1982
Xerox	48.8	-70%	1992

Tech Bubble Era ('99-00)

Company	99-00 Price/Earnings Ratio	99-00 Peak to '02-03 Trough	Year Surpassed Tech Bubble High
Amazon	Money Losing	-95%	2009
Cisco Systems	230.2	-88%	Never
Intel	59.5	-81%	2018
Microsoft	86.7	-65%	2014
General Electric	52.9	-61%	Never

It's always a mystery as to what pops a bubble, but you can see that once it does, it can get ugly for these big, popular companies. And it can take a long time for these stocks to regain the all-time highs they achieved in their respective bubbles.

One key investment lesson to learn from this table above is this: "Great companies can have long periods where they're terrible stocks." Other than Avon, General Electric, and Xerox, all of the companies above are alive, well, and thriving. They grow and dominate in their respective markets.

But that doesn't mean their stocks go up in a straight line. Amazon, Cisco, Intel and Microsoft continued to grow even after the Tech Bubble burst. But it still took 10-15 years for their stocks to fully recover. The same dynamic was seen with the Nifty Fifty (Amex, Disney, and McDonalds.)

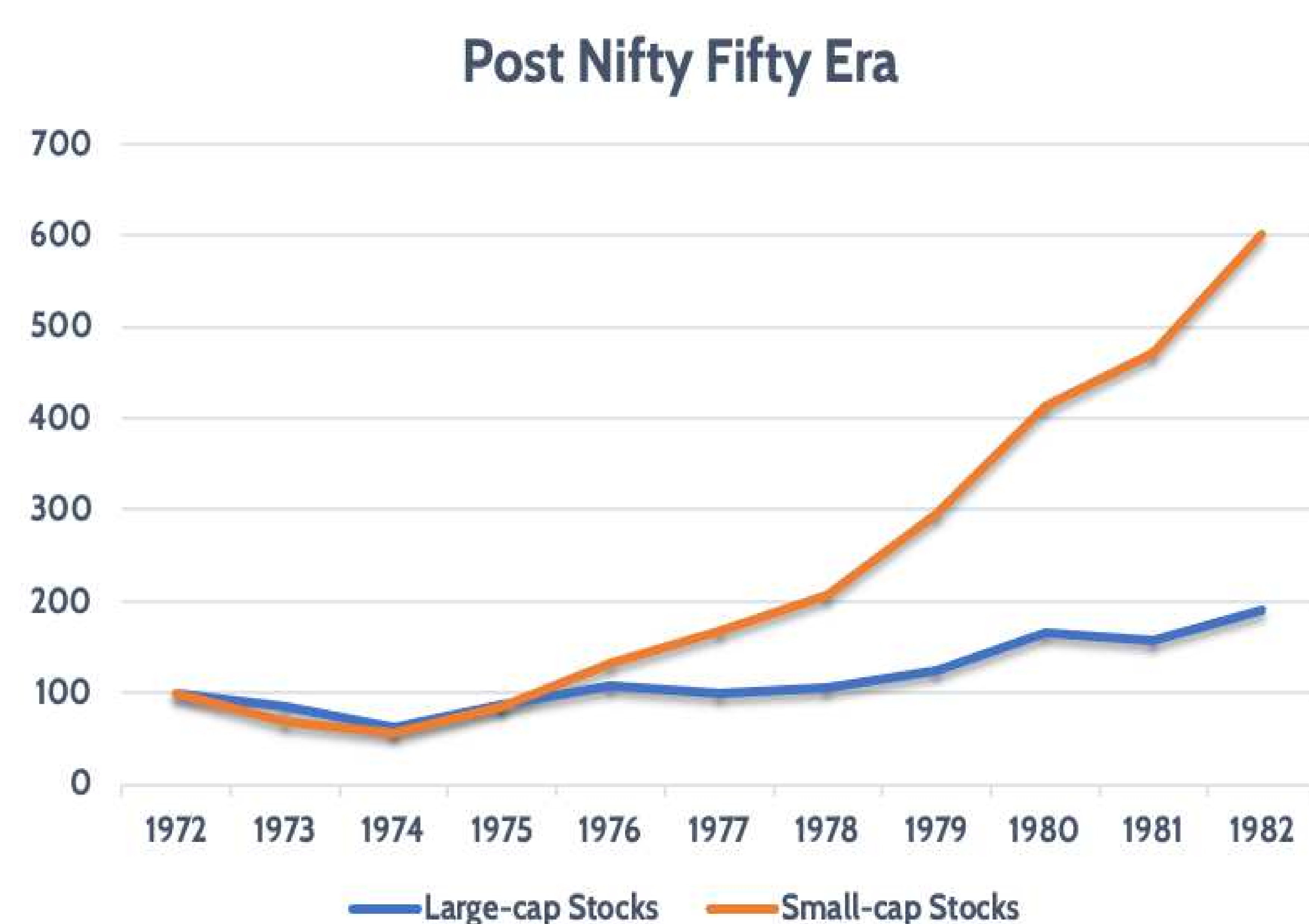
Of course, long-term investors like Warren Buffett would've been handsomely rewarded for holding these stocks through thick-and-thin. But given the nature of retirement time horizons, not everyone can take the attitude of "I'll just hold this stock forever." At some point, you're gonna need that money.

David vs. Goliath

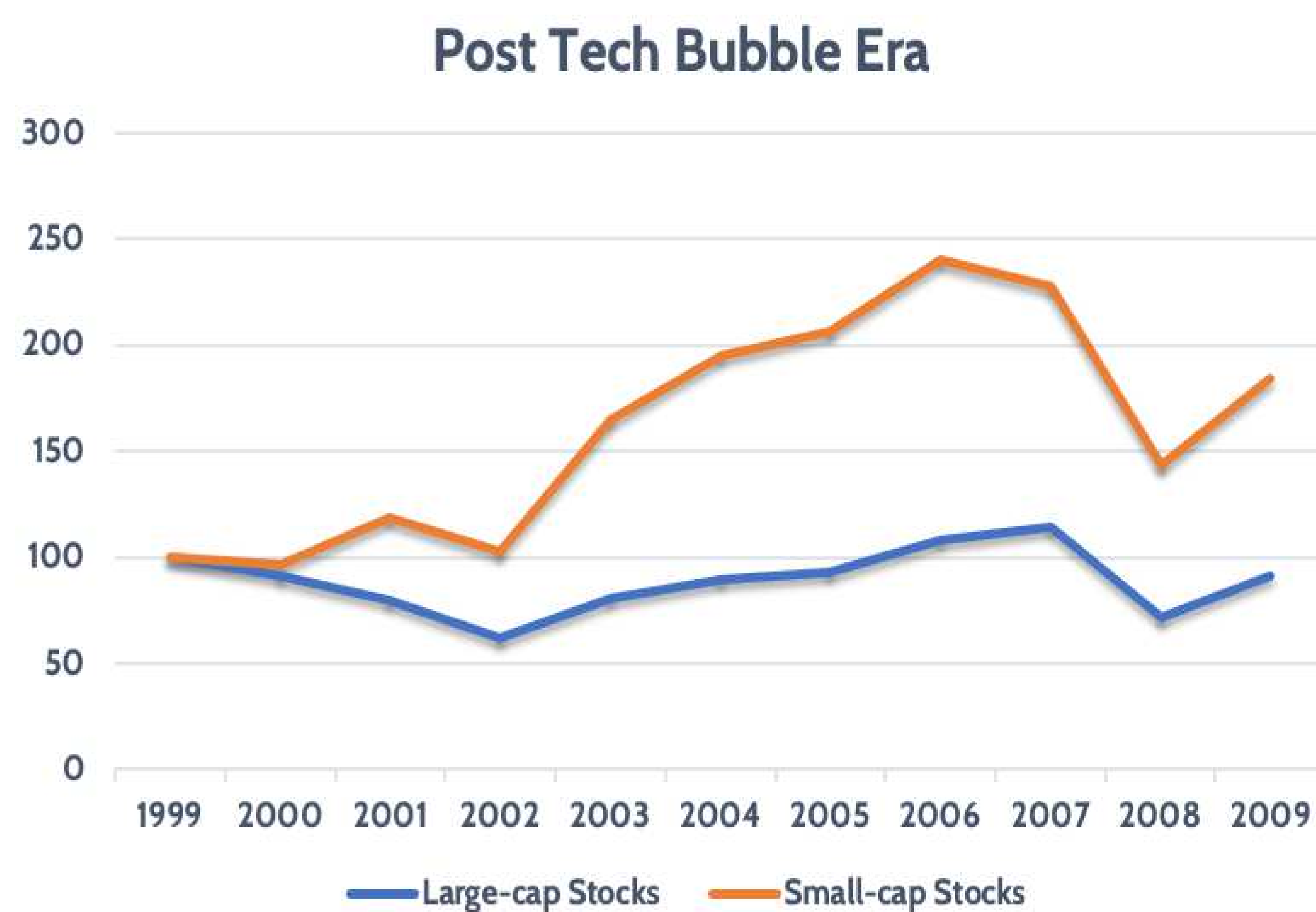
How should investors navigate these kinds of markets? We believe the key differentiator between successful and unsuccessful investors in times like these is maintaining discipline. Buffett quit in 1969 because the potential cost of abandoning his discipline was too high. Put another way, he didn't chase the fad just because it looked like easy money. And he was eventually proven right.

One of the key strategies that we employ at FDS is maintaining well-diversified portfolios. That means you own stocks in large companies, small companies, international companies, and emerging market companies. On the bond side that means owning safe U.S. Treasuries and higher-yielding bonds.

What catches my eye the most from looking at the post-Nifty Fifty/Tech Bubble periods is that small stocks tended to do well after the big guys eventually blew up. The Davids stood up to Goliaths.



Source: Ibbotson Associates Total Returns Data



Source: Ibbotson Associates Total Returns Data

This dynamic was pronounced in both periods. After the Nifty Fifty blew up, large stocks generated gains of 6.7% per year over the next 10 years, while small stocks gained an average of 19.7%. After the Tech Bubble burst, large-cap stocks actually LOST money over the next 10 years, losing an average of 0.9% per year. Meanwhile, small-cap stocks posted respectable gains of 6.3% over the same period.

If an investor had gone "all-in" on these Goliaths at the wrong time, they were setting themselves up for years of disappointment. Remember, the money you're stashing away will eventually be needed in retirement. So having a bad 10 years can make quite a difference in the kind of retirement you enjoy. A diversified investor, by contrast, did better. Sure, they still had some of their money in lagging large-cap stocks. But because they were diversified, they also had money in small-cap stocks, which did better.

Staying the Course

Maintaining the discipline to stay diversified when one part of the market goes up like crazy can get the best of us. "If only I had put all my money in Apple, then I'd be retiring in Tahiti!" But Mr. Market has shown us time and time again that what's popular today doesn't stay popular forever. Things change. And stocks in great companies can go through long periods of terrible performance.

That doesn't mean you should get out of the market and invest in muni bonds like Buffett did 51 years ago. With rates near 0%, that can turn into a costly exercise. It simply means that diversification will work to your benefit over time if you stay patient with it.

We always advise clients to remain focused on their time horizon when investing. Unless you're planning on living off of Social Security alone, there's going to be a day when you'll be drawing down your investments so you can buy food, pay taxes, and fund your medical expenses. Staying disciplined and diversified with your investments not only makes sense financially, but also reduces stress and uncertainty as you get closer to your goal.

How To Grow Your Finances [A Gardening Analogy]

Written By: MICHELLE SMALENBERGER, CFP®

This summer we decided to plant a garden. Now that our daughter is a little bit older she can help with the planting, pulling weeds, watering and the other fun things that come along. It's been fun because she can start to see the process of where our food comes from as we're working together but she also eats things before they even make it inside.

One vegetable we like to grow is corn. I noticed as I was watering that something had bit off the top of some of the corn plants that had started to grow. The same day we planted our garden we saw a deer walk through our yard. It was a reminder that since our garden is growing we now need to get our fence up to protect the plants.

This was such a great analogy on how to grow finances. There is a natural order of how things get taken care of. It is really a process to show that different stages accomplish different things.

Creating A "Garden" With Your Finances

1. **Plant:** Get started by depositing money or choosing what account to save in.
2. **Sun/Water:** Continue to add money or pay down debt to make progress.
3. **Protect:** Adding estate planning documents and insurance policies
4. **Weeds:** Amending documents, changing the amount of insurance, changing the savings amounts, or saving to different types of accounts.
5. **Harvest:** Reaching a goal!

If we don't take care of these **WEEDS** it can start to crowd out all of the good things that were already started before. It's important that over time you're taking care of these little things step by step. Because in the end, we really want to **HARVEST** and grow your finances! It's fun to see accomplishments in various areas of life. Which reminds me we have to get our fence up before something comes to eat our corn.

Data Security Overview

Written by: TREVORE MEYER, CFP®, CKA

We live in an ever increasing technology driven world. We have data here, data there, and it is always going up here and it is going down there. Half the time we don't know what it is doing and where it is going, but it is important for us to know how best we can secure ourselves in this type of world.

Today as the resident techie for Financial Design Studio, I wanted to spend a little bit of time going through some of the best practices we do and how we can provide those to you to make sure your data is safe and secure throughout all of your online experiences. This is something I really put a lot of time and effort into making sure we do the best job that we can from a data security stand point for our clients.

Lock Down Your Passwords

The first thing to mention would be simply locking down your passwords. It's quite tempting to use the same three or four passwords for each online account we log in to. If you do this, just know you're not alone! That said, I would highly encourage you to consider using a dedicated password manager. These tools can not only keep track of your passwords, but they can auto-fill them to each website when you visit that page. Better still is that they can generate random and more secure passwords and even let you share them with friends and family if needed.

Update Your Router Settings

The next thing we would recommend that you do is update your router settings. When setting up your internet service you'll be offered the choice of either renting equipment from your Internet Service Provider (ISP) or purchasing your own. Either way, the device that you use will come with a default username and password to log into the router management interface. Nowadays, these credentials can be found on a sticker on the side of your device, but in years past, it wasn't uncommon to simply have **admin** and **password** as the default credentials. Yikes!

Either way. I would still recommend that you login to your router settings and update these credentials to something that you decide. Plus you can even store them in your new password manager! Reason being is that if someone gained access to your network and was able to determine the default credentials for your router, they could then login to the router management themselves and make changes without you knowing. While the likelihood of this type of breach may be small, knowing that it can be prevented with simply 15 minutes of setup time is peace of mind well earned.

Protect Yourself on Public Wifi

Finally, as we are often out and about, I fully understand that the free wifi at Starbucks or the airport can be really tempting to use to "just check one thing!" I'm not saying that you simply shouldn't use it, but simply to use it safely. The way we do that is to use what is called a VPN service, or a Virtual Private Network.

A VPN service essentially acts like a locked down tunnel. Any internet traffic passing through that tunnel is protected by encryption between your device and the VPN provider's servers. This means that if anyone were perhaps snooping or monitoring the traffic on that free wifi hotspot, any traffic related to your devices would simply be a garbled mess because of the encryption. This is especially important if we were to log in to any financial accounts, medical records websites, and even our email as any shred of information that a person may pick up could be used for potential identity theft.

If you have questions about your own data security or maybe you'd have a quick run through of your setup, please let us know, and we'd be happy to arrange a call to do so.

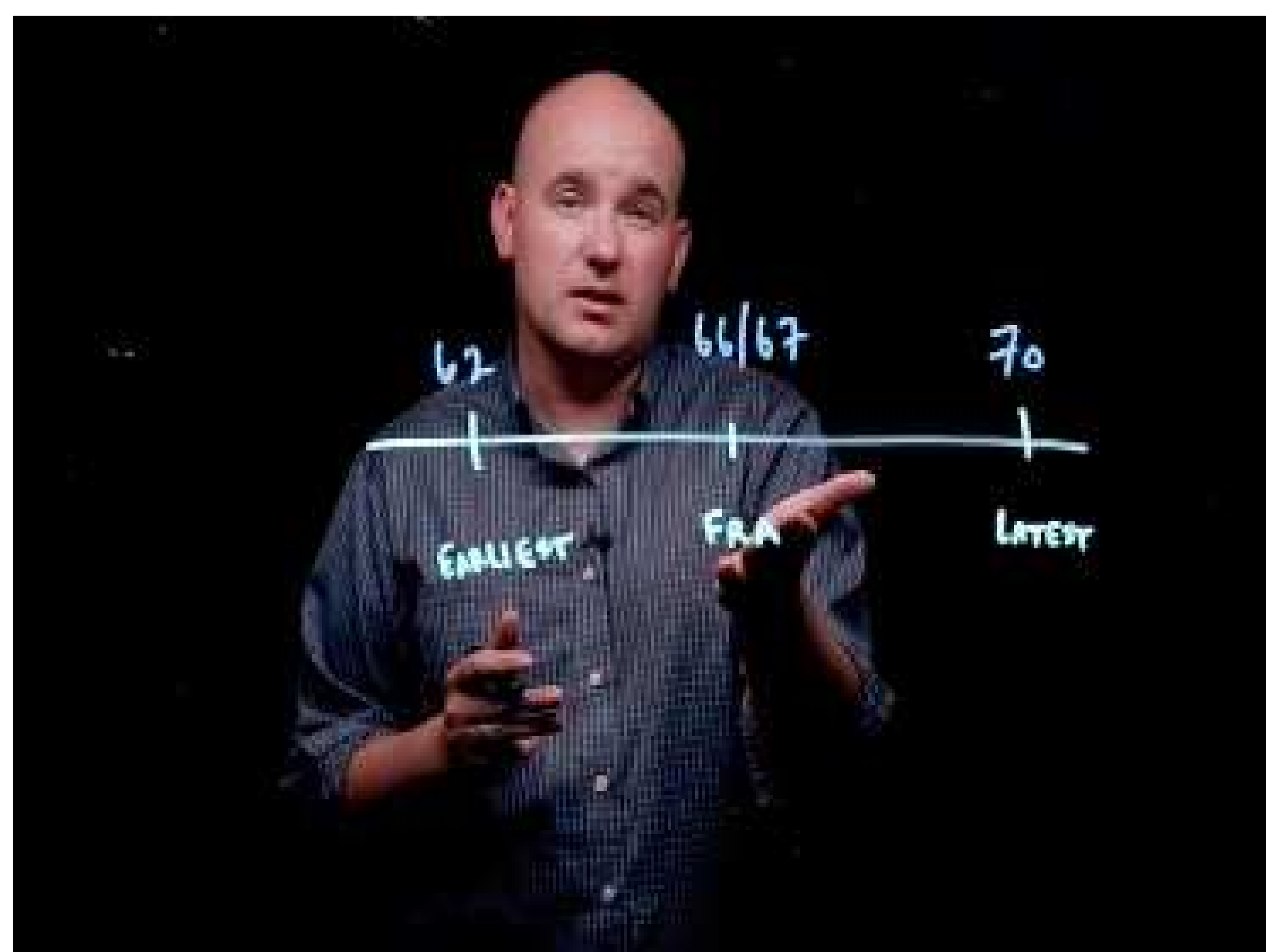
What Are The Basics of Social Security?

Written By: STEPHEN SMALENBERGER, EA

Social Security is a topic that becomes important especially when someone is considering retirement or is already retired. When does it make the most sense to start collecting? That really depends upon your specific situation. In order to start receiving the full value of the benefits that you've accumulated over your working career, you will need to wait until age 66 or 67, based upon your actual date of birth.

The earliest that anyone can start receiving your own benefits would be age 62. It could also be 63, 64 or 65. However, the amount of the benefit will be reduced since it started prior to reaching Full Retirement Age (FRA). The Social Security Administration has created a calculator to help in determining your FRA.

If you wait until after Full Retirement Age (FRA), the monthly benefit increases at a rate of 8% per year for each year that the benefit is delayed. The latest that it can be postponed until is age 70.



By default, most people will start collecting at their respective Full Retirement Age. Yet, there are some planning reasons to either start early or delay depending upon:

- Life Expectancy
- Health Condition
- Cash Flow Needs
- Spouse

These are just a few of several discussion points that we will have with you. It is important especially since not only does your decision impact your own benefits, but it may impact a spouse's future benefits as well.

This is one "asset" or source of income that you are not able to pass on to heirs in addition to their own benefit... so we need to get this right! Therefore, it makes sense to take the time, do the math and planning in order to make an educated decision.

As always, there are many considerations and details not addressed in this post. It is meant to be general and educational in nature. However, if this raised a question or prompted curiosity on how various planning strategies could potentially be applied to your particular situation... please let us know. We are happy to help!

Disclosure footnote:
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Frequently Asked Questions (FAQs)

Are you a Fiduciary?

Yes, we are! This means we have a **duty** to act in **your** best interest. A person acting in a **fiduciary** capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client.

You're Fee-Only: What does that mean?

We have chosen to be a fee-only advisory firm. This means we do not accept any fees or compensation based on product sales. While we know our clients need products like insurance we do not receive any benefit from any source when you buy a product.

How does Financial Planning Work Virtually?

It's amazing how many of our clients move away as we work together. After all, that was part of your goal! We are able to share everything we do in person, virtually. We simply use screen sharing and video software so we can see you and look at the same documents, together.

Are you taking on new clients?

Yes! We are happy to work with friends or relatives that you think would benefit from a Financial Advisor relationship. A quick phone call is all it takes to see if they are a great fit.

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