FINANCIAL DESIGN STUDIO

DESIGNED FOR LIFE

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

Are We in a Bubble?

Written By: ROB STOLL, CFP®, CFA

There's been a lot of talk lately that the stock market is in a bubble. Stocks are nearing all-time highs despite being in the midst of a sharp economic slowdown due to COVID, confounding market experts. Famed British investor, Jeremy Grantham, gave a CNBC interview recently where he said the stock market has now entered its 4th bubble in his long career.

Unfortunately, the only way to know whether we're in a bubble is through the rear-view mirror after it has already popped. What might seem like a "bubble" may have more substance to it than many experts want to give it credit for. For example, many bond investors have spent the last 20 years talking about a bubble in bonds. Yet it persists.

While we can't know for sure whether we're in a bubble or not, we can look for some clues. And as we look at it, there seem to be more clues today than there were prior to the COVID epidemic.

Lessons from the Tech Bubble

A number of the clues we'll see aren't new or different from what we've seen in past bubbles. I started my investment career in late 1997. At that point the Internet Tech bubble was just entering its craziest phase. Everyone was making money.

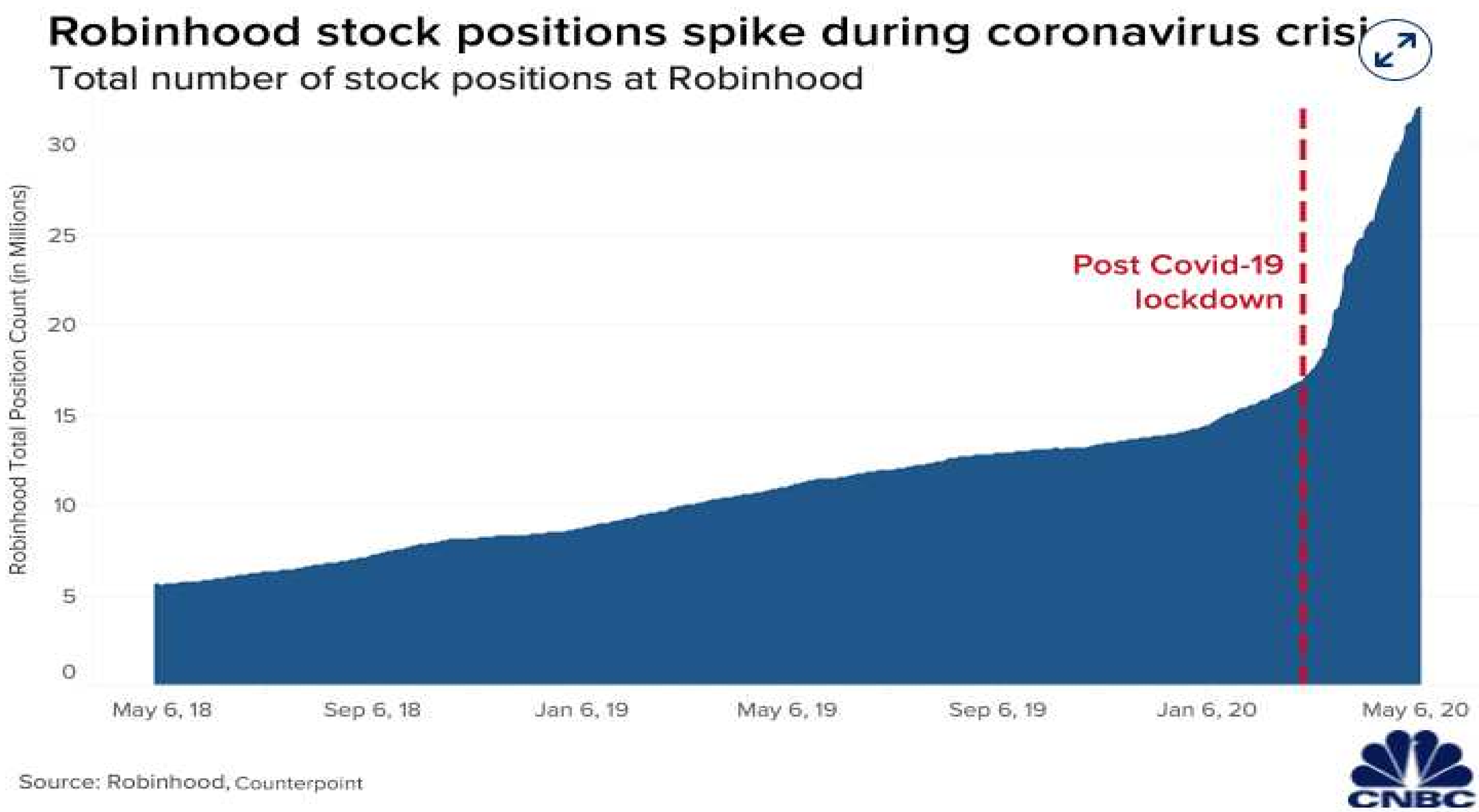
And yeah, I got caught up in all of it. My younger coworkers and I would trade the latest "dot-com" ideas despite knowing very little about what these companies actually did or how they planned on making money. But stocks went up anyway, which was a great feeling for a fresh 20-something right out of college!

In any mania, there's a point where greed and arrogance take over. It's not enough to make good money in stocks; you want to make MORE than the guy you're sitting next to. That's the precise moment when a rally turns into a bubble. The telltale signs of a bubble I list here were plainly evident at the height of the Tech Bubble.

Clue #1: Retail Investors Start Trading A Lot

During the Tech Bubble, you knew the stock market rally was turning into a mania when stocks were the topic du jour at cocktail parties. "Hey, did you see what Yahoo did today? I've made a lot of money in it!"

I used to take a taxi from my Wrigleyville (Chicago) apartment to work every morning. When the cabbie asked me what I did for a living and I told him, invariably he'd start telling me about some stock he had made a lot of money in. Everyone was trading. Today we're starting to see some evidence of the same thing happening.



In the 1990's retail investors were opening accounts at eTrade, TD Ameritrade, and Charles Schwab. They were the leaders in online investing. Today, it's Robinhood, which offers free trading and even gives you free stock as a sign-up bonus. The number of retail trades over Robinhood's platform has exploded since the onset of COVID.

Not only are new investors hitting the markets for the first time, but there's also herd mentality with many investors chasing the same stocks. Instead of jumping on Yahoo stock message boards like we did in the 90's, investors today are trading investment ideas on Reddit.

Clue #2: Disparaging Warren Buffett

Warren Buffett was the guy I spent time idolizing as a kid in business school. He was the kind of investor I wanted to be. So it was strange to me that his company, Berkshire Hathaway, was underperforming the market so badly in the late 90's. "Has he lost it?" "Does Buffett still have his mojo?" This Wall Street Journal headline from late December 1999 – very near the market top – was the question on everyone's mind.

What's Wrong, Warren?

Berkshire's down for the year, but don't count it out

By By Andrew Bary
Updated Dec. 27, 1999 12:01 am ET

A fter more than 30 years of unrivaled investment success, Warren Buffett may be losing his magic touch.

Remarkably, we're starting to see the same questions popping up today. The most over-the-top comments have been coming from Dave Portnoy, this generation's version of CNBC's Jim Cramer.

Dave Portnoy @stoolpresidente · Jun 9
I'm sure Warren Buffett is a great guy but when it comes to stocks he's washed up. I'm the captain now. #DDTG

The Tech Bubble knocked a lot of well-known investors out of the market in 1999 because they didn't "get it" with tech. Buffett stayed the course, and when the bubble popped in early 2000 he massively outperformed the market for years afterward.

Clue #3: "Does This Make Sense?"

The firm I worked for in the late 90's invested in "value" stocks. Typically, value stocks encompass 'old economy' companies like banks, oil companies, auto manufacturers, and the like.

I can't remember exactly what we were looking at, but I think we were looking at some new internet play – Cisco – which was only a few years old at the time. When we looked at how much the company was worth on the stock market, it was worth more than all the banks and auto companies in the U.S. at that time. "Does this make sense?"

Today we're seeing similar headscratchers. For example:

- Microsoft, Apple, and Amazon are EACH worth more than the entire Australian stock market. Australia isn't some economic backwater, they're a fully developed, advanced nation.
- Tesla, the electric car maker, is worth more than General Motors, Ford, BMW, and Volkswagen COMBINED.

Now, these stars of the U.S. stock market aren't bad companies. But when you start comparing these valuations against those "old school" companies, a little voice in your head starts whispering, "Does this make sense?"

Clue #4: Hertz Hysteria

The car rental company, Hertz, filed for bankruptcy on May 22 in the wake of travel stoppages related to COVID. When public companies declare bankruptcy, the value of their stock goes to $0. Maybe not on the day they declare bankruptcy, but eventually it's a zero.

As it should have, Hertz stock fell by 80% the day after the bankruptcy announcement, from $2.84 to $0.55. But then a strange thing happened. Retail investors started buying the stock, sending the stock soaring to over $6 by June 8.


Markets

Hertz Pauses After Three-Day Rally Sent the Stock Surging 577%

By Jeran Wittenstein
June 9, 2020, 10:24 AM CDT

The mania got so bad that Hertz actually floated the idea of issuing more stock to investors to help pay off debtholders. Luckily, the SEC stepped in and stopped the insanity and the stock is back under $2. This example, in particular, is pure madness. But this is exactly the kind of crazy stuff that happens in a bubble.

Post-Tech Bubble Fallout

This last example – buying stock in bankrupt companies hoping they'll come back – is the #1 thing I did in the Tech Bubble that I'm most embarrassed about. I had to learn the hard (but obvious) lesson that bankrupt companies are worth zero.

At the end of the Tech Bubble I had lost everything except for $0.42. Yes, forty-two cents. By 2001 I didn't even bother opening my statements anymore and all the companies I owned eventually went bust and were worthless. Lesson learned! Making mistakes is a part of life, and the stock market is particularly cruel in teaching hard lessons to investors. Even the smartest investors are humiliated by Mr. Market at some point in their careers.

So Is This a Bubble?

I can't say for sure. The X-factor this time around is that we have an out-of-control Federal Reserve (see last month's newsletter). Every time the market goes down, they swoop in with new policies to "support" markets. But as the above examples start to pile up – the same ones we saw in the bubble-to-end-all-bubbles in the late 90's – it's time to pay attention. The real risk in a bubble is not seeing stocks go down. It's getting too overconfident and over-extending yourself in the market. Remaining sober minded in the midst of a bubble is really hard. The lure of easy money gets the best of us. This is why having a defined investment process is so critical.

At FDS, we have a "take what the market gives us" approach to investing. If stocks surge, that's great. But our process has us taking money off the table as stocks go up so your portfolio doesn't become too risky. Conversely, if investors are panicking and sending stocks lower, our process leads us to BUY stocks because we don't want your portfolio to end up too conservative. When it comes to investing, the more you remove emotion from the equation, the better the investor you'll end up being in the long-term.

Your Beneficiaries Matter: Check Who They Are

Written By: MICHELLE SMALENBERGER, CFP®

It's time to do a really quick check of your beneficiaries. This is something that is easily overlooked.

Let's review some of the common accounts where you need to set a beneficiary because this is what states who will inherit the funds that are in these accounts. Below is the common list of accounts to check.

1. IRA or Roth IRA

Your Traditional IRA and Roth IRA have beneficiaries listed on accounts.

2. HSA

Your Health Savings Account lists beneficiaries as well.

3. 401(k) or 403(b)

Your 401(k) and 403(b), and really any of your retirement accounts. You set these beneficiary designations with your employer. It is very common if you've worked somewhere for 30 years, that you have people listed as beneficiaries from when you were younger. This is why this is such a big thing to check, because it is so easily missed.

4. Life Insurance

The last one here is life insurance. And again, this is one when you set up these policies, you keep them for many years. It is critical that you check who is listed as a beneficiary or your wishes will likely not be fulfilled.

Primary & Contingent

What you are looking for is that you have a primary beneficiary. That means if something happens to you this is the first person(s) to inherit the account assets. Then the contingent beneficiary inherits assets if the first person predeceases you or chooses to disclaim (deny) receiving them.

Whenever you are updating beneficiaries on your accounts be sure to keep a copy of the changes made. As you are checking off each one from the list, be sure to just print out a confirmation or a summary so that you know you made a change and you are up to date. That way you have a record of it.

Ultimately, when you are reviewing your beneficiaries and checking to make sure the primary and contingent are who you desire, you are ensuring the people you love receive the assets you've worked hard to earn. So you are caring for them by doing this quick check of who the beneficiaries are.

Live Financial Planning Updates

During the last few months everyone has experienced many different changes in their lives. This has also affected the various professionals that you work with to renew insurance, get legal documents in order, or consider refinancing your mortgage. Below are the most important changes we think affect you from the professionals we interviewed. You can also watch these on our website or social media too.

1. Estate Planning With Heather:

One of the biggest changes that the COVID-19 virus brought to Estate Planning was that courts closed for a considerable period of time. Some of the most interesting changes became getting a notary and signing Estate Planning documents in a drive thru service. These changes have affected those who needed emergency court intervention to manage an estate or to appoint a guardian. We were happy to share these updates in April so you knew what was available. And many of these same procedures are even still in place today, depending on the state you live in!

2. Insurance Update with Ryan:

When we all started to hear the stay at home orders we considered insurance planning opportunities since driving less. We were reassured by hearing we didn't need to lower insurance limits in order to save some money from driving less. Many insurance providers have given discounts automatically. You can look at your monthly statements to see if you received a small discount. It was also reassuring that even with the virus and precautions taken you can still get life insurance in place if it was on your to-do list.

3. Refinancing Your Mortgage with Tom:

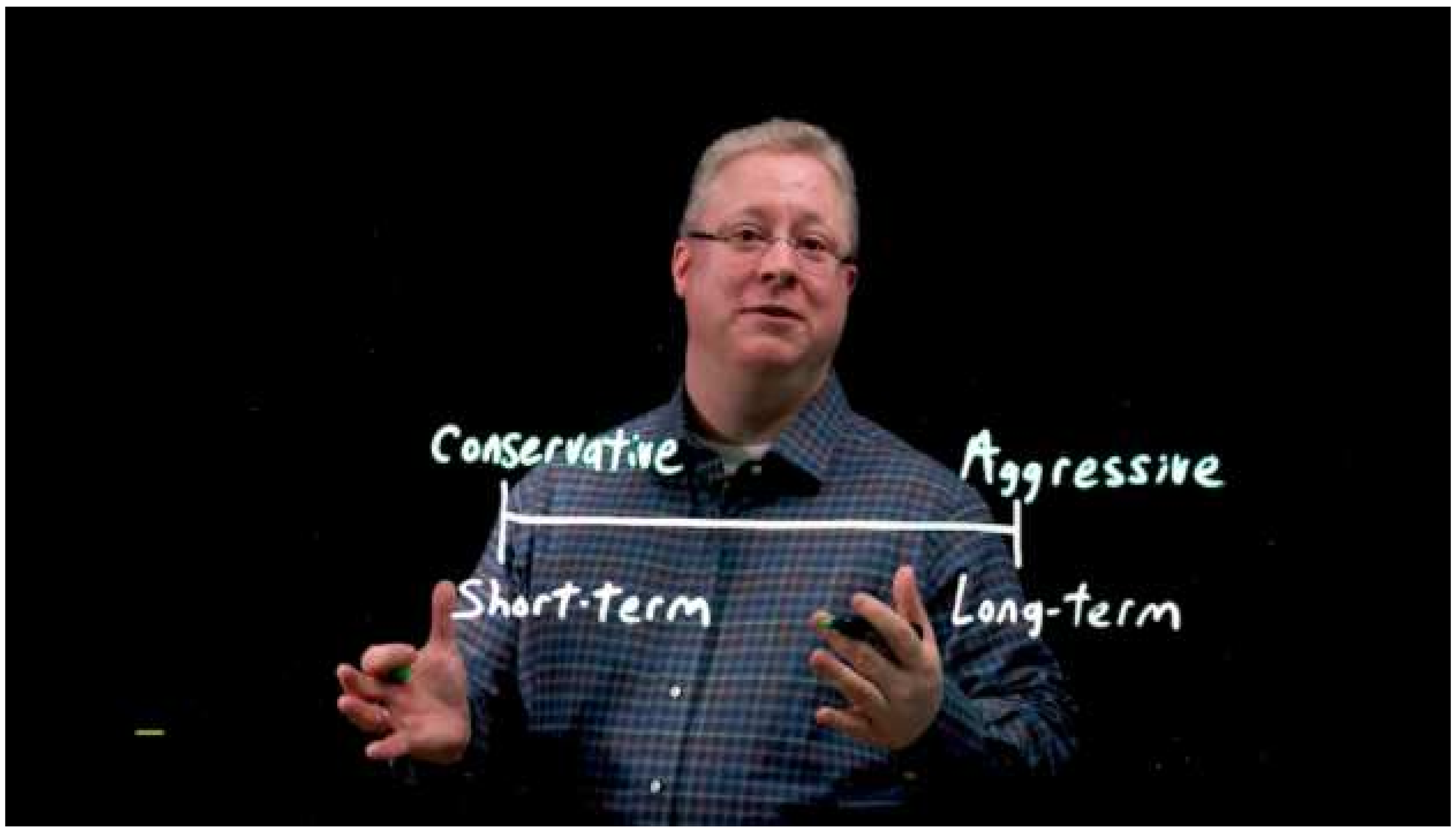
With the various government actions to provide relief the Federal Reserve lowered rates which affected borrowers. There has been a surge of people trying to refinance their mortgages because we have such low rates still today. You may find that refinancing makes sense for you. We have been reviewing this for many people. We have noticed that once you complete your application and lock your rate in you may not hear from your lender until your closing date gets closer. There is such a high volume of people refinancing and we expect rates will continue to stay low for quite a while.

Investing Based On When You Need Your Money

Written by: ROBERT STOLL, CFP®, CFA®

A lot of investment gurus out there will tell you again and again that you have to save for your financial goals. But what they never really get around to telling you is how to do that exactly. One way that we work with clients to determine how to invest their money is to **look at the time horizon of the goal they are saving for.**

Investing: Short-Term Goals



Now for example they might be saving up to buy a home or a car in a couple years. So in that case, **we want to make sure they are investing conservatively**.

The last thing we want to have happen is for the stock market to have a really bad year just as they are getting ready to buy that house.

Investing: Long-Term Goals

Now on the other hand, for **long-term goals such as retirement,** we would recommend that they invest more aggressively in stocks versus bonds or cash. The idea is that even though stocks are more volatile, you have enough time and the goal is far enough into the future, such that **you can ride out those ups and downs of the stock market**.

Once you have the time horizon of your goal figured out, then you can take a **risk tolerance questionnaire** as well. That gives a more detailed view of how you and your family will react as the market goes up and down.

> ***The great thing is, once you have this figured out, it is easier to stick to your plan because you know why you are invested a certain way.***

So if there is anything we can help you with your investments, identifying your goals, and figuring out the best way to manage your investments for those goals, please reach out to us.

2020 Important Dates and Amounts

Here are updated dates and amounts from the IRS for contributions you can make into various accounts this year:

July 15th, 2020: IRS Federal Tax Filing Deadline - Check your state deadline in case it was not extended.

IRA & Roth IRA 2020 Maximum Contribution Amount: $6,000 ($7,000 if you're age 50 or older)

401(k) & 403(b) 2020 Maximum Contribution Amount: $19,500 ($26,000 if you're age 50 or older)

Health Savings Account 2020 Maximum Contribution Amount: $3,550 (Self-Only) $7,100 (Family)
($4,550 (Self-Only), $8,100 (Family) if you're age 55 or older)

As a reminder, Required Minimum Distributions are <u>NOT</u> required in 2020.

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.

Want to share this with someone?

- Know someone who wants to receive this newsletter? Send us the mailing address at team@financialdesignstudio.com
- If you prefer to no longer receive this newsletter please email us at team@financialdesignstudio.com

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