FINANCIAL DESIGN STUDIO
DESIGNED FOR LIFE

FEBRUARY 2021 NEWSLETTER

INVESTING AS THE HARE AND THE TORTOISE

BY: ROBERT STOLL, CFP® CFA

As a parent, I've always been a big fan of reading Aesop Fables to our kids as part of their bedtime routine. Stories have a way of teaching kids valuable lifelong lessons. They allow kids to imagine themselves as an active part of the story, learning lessons in real-time as if they're one of the major characters. One of my favorite fables is The Hare & The Tortoise. Recent events with the company Gamestop – which saw its stock rise to dizzying heights before descending just as quickly – reminded me of this time-tested story and brought up the question: "Is it better to invest as The Hare or The Tortoise?"

Gamestop: A Battle Between Long and Short Investors

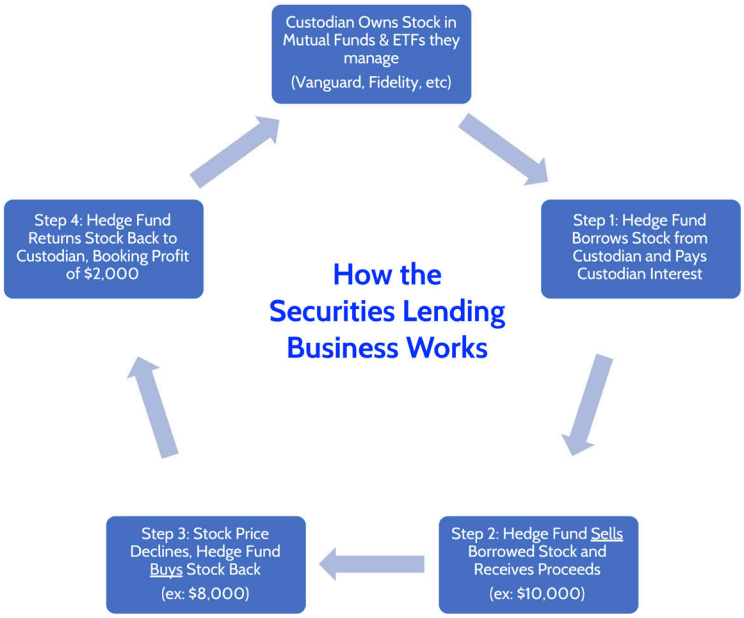
Before hopping into the moral of the story, we need to set the stage about what happened with Gamestop stock. In Wall Street parlance, it was a classic battle between "longs" and "shorts."

Almost everyone reading this newsletter is a "long" investor. In plain English that means you buy a stock today expecting the stock price to rise. And if it does, you sell it and make a profit on the difference between the purchase price and the sales price.

"Short" investors want the exact opposite; they're hoping the stock price goes DOWN. They go out and sell a stock today and then hope to buy it back at a lower price in the future. Their profit is the price difference between where they sold the stock and where they buy it back.

You might think, "How can a short investor sell a stock they don't already own?" The answer lies in a business many large brokers and custodians have called "Securities Lending."

If you've ever wondered how Vanguard, Fidelity, and others can make money despite charging extremely



low fees on their funds, their Securities Lending business is one answer. Since they own a lot of stocks as part of their mutual funds and exchange-traded funds, they have a lot of stock to "lend" to hedge funds looking to short stocks.
It's an interesting dynamic, isn't it? These brokers sell you – the retail investor – funds that are "long" stocks for almost no cost. Then they turn around and make a lot of money lending stock to investors who are betting on the same stocks going down. Gotta love Wall Street!

With that background, let's look at what happened to Gamestop.

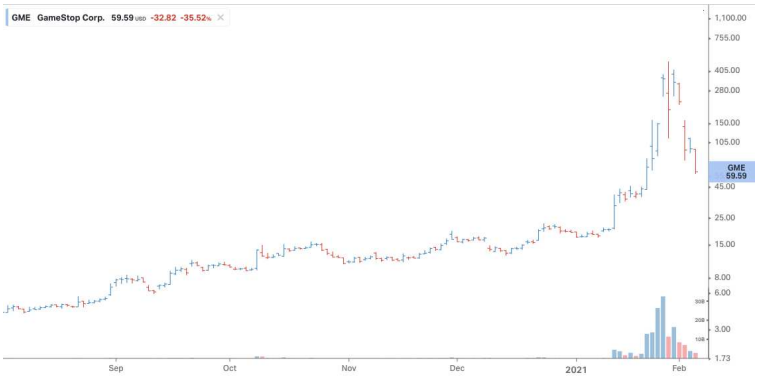
What happened to Gamestop?

The stock price of Gamestop recently rose from $20 at the start of 2021 to a high of $483 on January 28. This is one of the most notable episodes of a "short squeeze" we've ever seen in the market.

Gamestop has been in trouble for quite some time, as more games are sold as a direct download to a gamer's Xbox or PlayStation. Effectively, they're the Blockbuster Video of the gaming market. As people stream more, the need for physical discs evaporates. Gamestop has seen sales plunge. Quarterly sales have been declining -25-30% over the last year. As a result, they're closing stores at a rapid pace.

Short investors have been betting that the company will go bankrupt and the stock will go to $0. These investors have been so aggressive in shorting the stock that by January there were more shares "sold short" than the number of share the company had outstanding!
A group of investors online saw this dynamic and created a strategy: If they drive the stock price higher, then all these hedge funds that are short the stock will be forced to buy it back in order to stem losses. The more they're forced to buy Gamestop stock, the higher the stock will go.

This is exactly how it played out, as seen in this chart below.



As these investors pushed the stock higher in early January, it forced hedge funds to "cover" their shorts by buying the stock back. Given the huge number of shares that were sold short, this created a buying frenzy as higher stock prices led to more short covering which led to higher stock prices. Hedge funds got trapped.

"Hare" Investors Pile In

Individual investors watched as Gamestop's stock price went up like crazy. Stories popped up on the internet about people making hundreds of thousands of dollars on the move. The bait was set on the hook.

As we all know, the lure of a quick buck is very hard to resist. During my lifetime, I've piled into dot-com stocks, stock options, commodities futures, and have even gambled on football games to get rich quick. "Man, if these corn futures go to $X, I'm gonna be able to cover the rent on my apartment for a year!"

Just like the lottery, however, very few people are actually hitting jackpot investing this way. Too often – and this was the case with my own misadventures – these get-rich-quick experiments end in ruin. Markets have a way of turning against you at the exact moment you try getting in on the action, as is happening right now with Gamestop, whose stock is dropping back to earth.

Being a "Hare" investor can be exhilarating, but can create long-term damage. The risk for "Hare" investors is that after getting burned in the market a few times, many conclude that investing is too hard so they quit completely. This is exactly what happened with many savers after the Tech Bubble burst in 2000. The problem with quitting the markets is that it's very hard to achieve long-term financial goals like retirement or sending kids to college if your savings are stuffed in a mattress. So while the actual cost of losing money in hot stocks like this may be manageable, the psychological cost of avoiding markets all together can create lost long-term opportunities.

Investing as a "Tortoise"

If you burnt yourself on the stove as a kid, you probably didn't quit using it forever. You just learned how to use it more safely. Similarly, a positive result from "Hare" investing is learning the hard lesson but looking for a better way to invest: "Tortoise" investing, as I like to call it.

Tortoise Investing is basically this:

- Determine your investment allocation between stocks & bonds depending on how much risk you're able to take.
- Create a well-diversified portfolio of various asset classes in each of those buckets, stocks and bonds.
- Have a disciplined process to rebalance your portfolio when it moves away from your investment allocation target.
- Lather, Rinse, & Repeat as necessary.

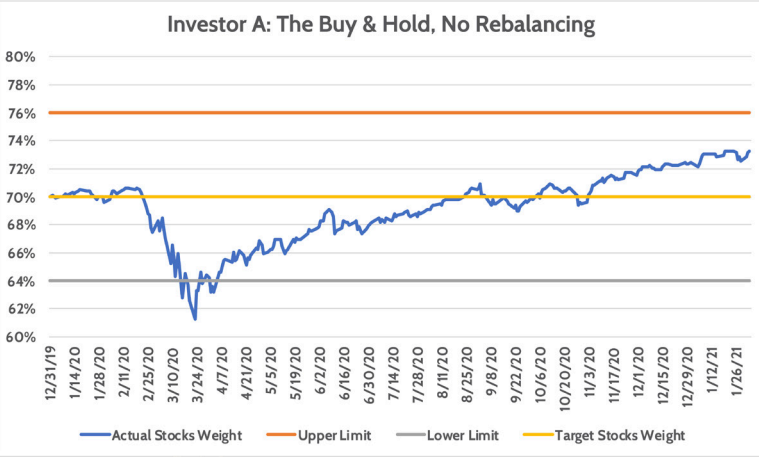
It's a simple way to invest in theory, but putting it into practice takes time and attention. Specifically, the third point – rebalancing – is a very important piece to a Tortoise Investing strategy. The example below will help show this.

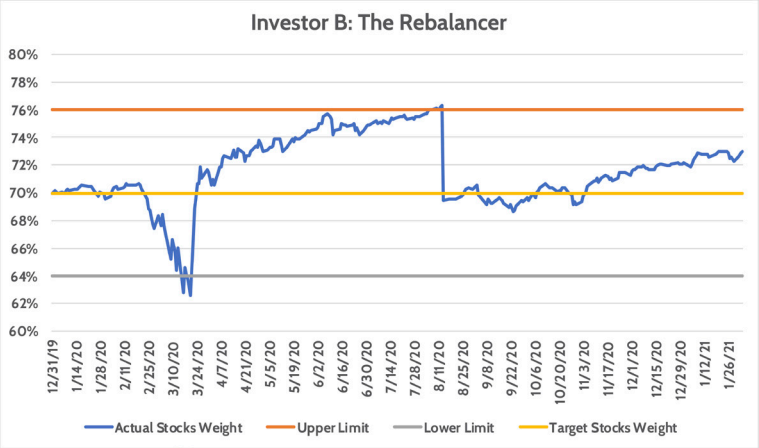
COVID Created Rebalancing Opportunities

The COVID experience of 2020 was a perfect environment to put this philosophy to the test. While we can't show actual client results in this newsletter, we can create a hypothetical simulation using very simple assumptions:

- Client Target Investment Allocation is 70% Stocks, 30% Bonds
- Stocks are represented by the Vanguard Total Stock Market Index Fund
- Bonds are represented by the iShares U.S. Aggregate Bond Fund

If we assume the client started on December 31, 2019, we can plot how their investments would've tracked through January 2021. Investor A is a traditional Buy & Hold investor, meaning that once they buy something, they don't make any changes. Investor B is a theoretical client of FDS and has her portfolio rebalanced when Stocks stray too far away from her target of 70% Stocks.





The charts below show how each investor's allocation towards stocks would've changed throughout that time period, starting at 70% each.

Investor A stuck with what they owned on the first day of 2020 and changed nothing despite the market volatility. At the lowest point of the stock market, their weight in Stocks would've fallen all the way to 61%, which is a long way from their target Stocks allocation of 70%.

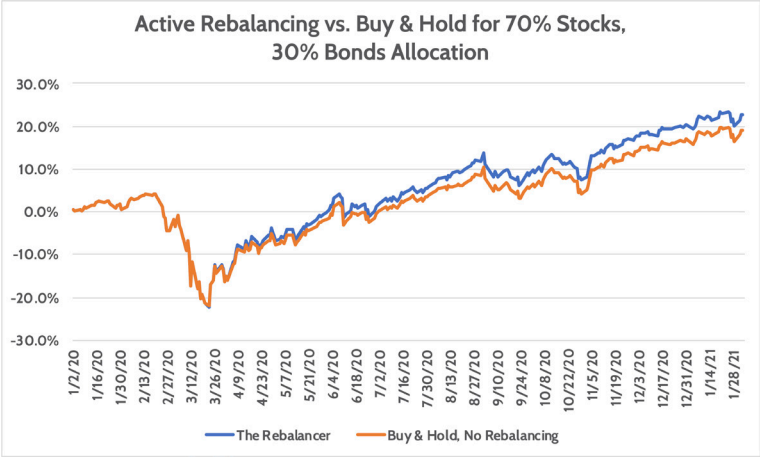
Meanwhile, Investor B had a very similar start as Investor A. But when the market cratered in March, she found her Stocks allocation breach the lower limit of tolerance at 64%. At this point, her portfolio was rebalanced back to 70% stocks by selling Bonds and buying Stocks.

As stocks rebounded strongly for the rest of 2020, Investor B found herself overweight stocks to where they breached the upper limit of her tolerance in August. So stocks were sold and invested back into bonds to bring her Stocks back to 70% of her total portfolio.

Interestingly, both Investor A and Investor B ended the period with the same weight in stocks: 73%. But the path to get there was different.

Can Rebalancing Your Portfolio Help Your Investment Returns?

The critical question is whether The Rebalancer was any better off vs. the Buy & Hold. Based on what happened in 2020 and early 2021, using the examples above, we can say YES.



By January 2021, Investor B "The Rebalancer" saw her portfolio perform well, increasing +22.8%. Investor A – Ms. Buy & Hold – also had a solid performance rising +19.2%.

While both did well, Investor B clearly got value from having a disciplined rebalancing strategy. She outperformed Investor A by +3.6%. The reason is very simple: she was buying stocks when they were beaten down in March, while trimming them in the Summer as they rebounded strongly.

The trick to making this all work, however, is that you have to be nimble. That buying opportunity in March opened and closed in a short 1-week period. If you weren't ready to rebalance, you could've missed your shot.

This is where a trusted financial advisor can create significant value for you. At FDS, we're looking at each client's portfolio allocation on an almost daily basis. So we're ready to react to whatever opportunities the market is giving us.

On top of this, we can often execute strategies to realize tax opportunities for clients. We can execute Roth Conversion strategies at market lows when the tax bill to do so might be much lower. Or improve the asset mix of a client, moving tax-inefficient funds to tax-efficient accounts.

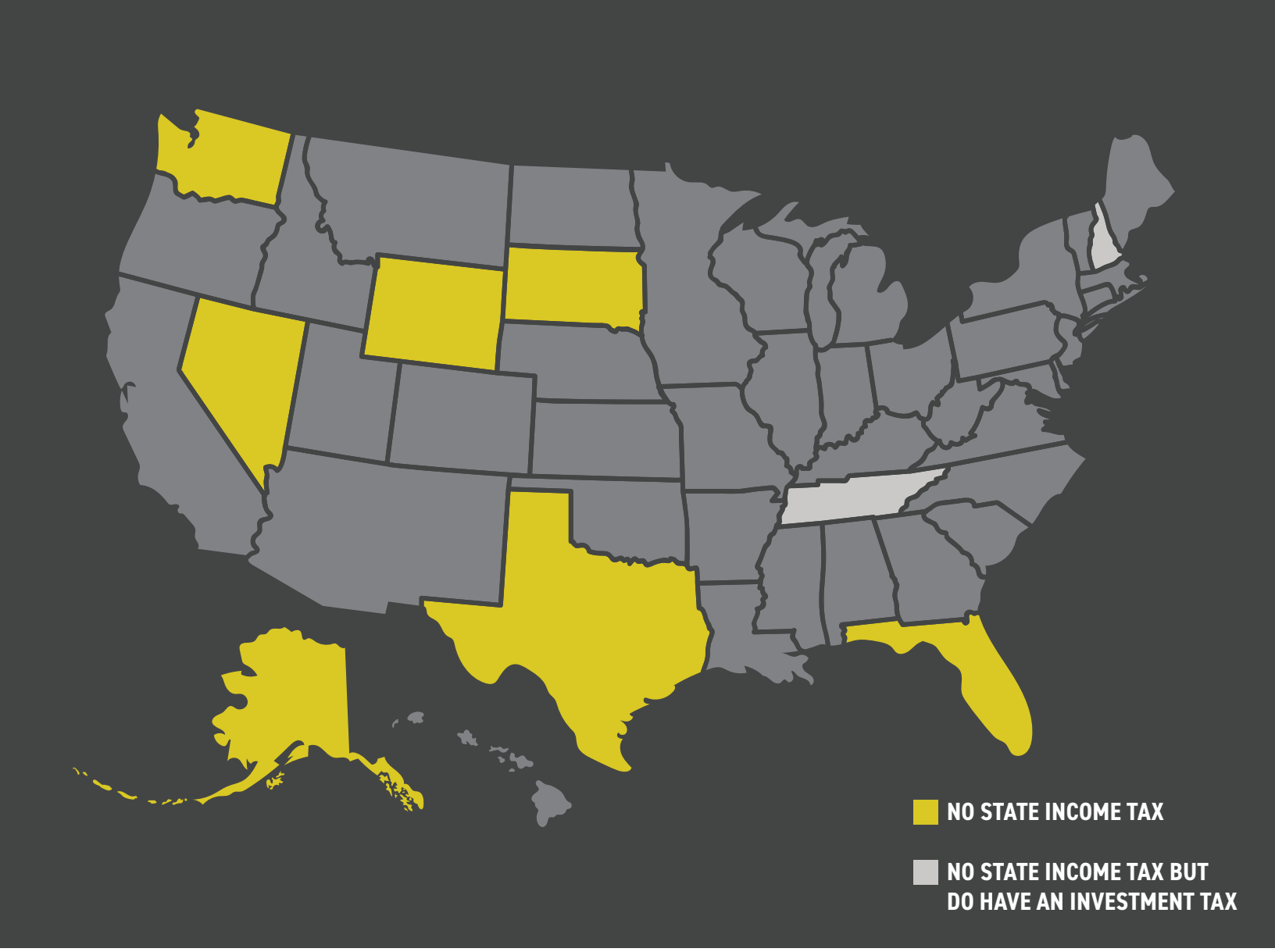
Again, all of this is hypothetical and there's no guarantee of any performance improvement from rebalancing. But this is a prime example of how we at FDS helped clients in 2020.

Invest as a Hare or a Tortoise?

We've seen what "Hare" investing looks like vs. "Tortoise" investing. Admittedly, Tortoise investing doesn't have the same pizzazz or excitement that Hare investing does. But it works if you stick with it and keep your eye on the end-game: reaching your financial goals, whether that's being able to send your kid to a good college or having the resources in retirement to take long vacations.

"The race is not always to the swift." The Hare & The Tortoise

2020 taught us the importance of having a disciplined investment process. It also taught us the value of having an ongoing financial planning relationship, where opportunities to execute financial strategies can pop up when you least expect them. Having someone at your side before that opportunity arises helps you take advantage of it quickly. So if you've asked, "is having a trusted advisor really worth it?" the answer can be YES if you're working with Financial Design Studio!



STATES WITH NO INCOME TAX

BY: STEPHEN SMALENBERGER, EA®

One question that we get a lot, especially as clients are getting closer to retirement, is, "Where should I look to relocate? I don't want to live in a cold area. I don't want to deal with snow. I want to move somewhere warm. But does that make sense from a tax perspective? From a financial perspective? Will my money last? And how do I make it last the longest?"

So this really an exercise, just to show you what states don't have any income tax. There are actually seven (two states have no income tax but do have an investment tax).

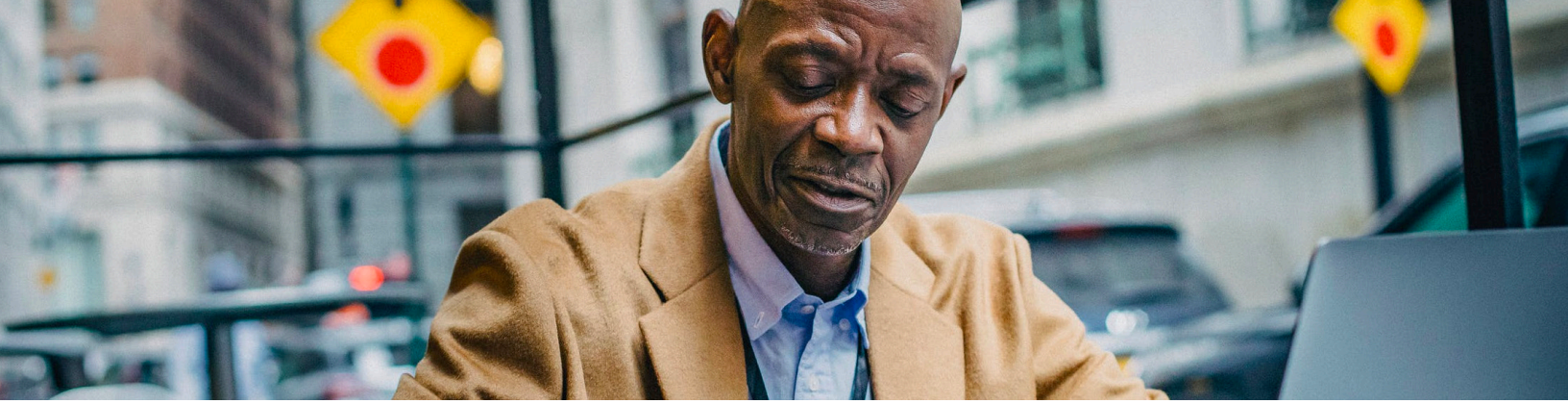
Let me explain: Seven don't have any type of personal income tax.

Those states are Alaska, Washington, Nevada, South Dakota, Wyoming, Texas, Tennessee, Florida, and New Hampshire. So I said seven, but I actually wrote nine.

Because there are two states, Tennessee and New Hampshire, that don't have any income tax, but they have an investment tax. So as you have interest and dividends, they'll tax a portion of that. But all of these collectively don't have any personal income tax.

So if you have wages, if you have retirement income, if you have investment income, in some of these you're not paying a tax on the state level. On the federal you still will. If moving makes sense to you, consider this in your evaluation.

Wondering how this could impact your financial future? Schedule a call with our team to discuss the impact.



WHEN DO I TAKE SOCIAL SECURITY BENEFITS?

BY: TREVORE MEYER, CFP®, CKA®

For many of our clients who are working near the end of their careers the natural next question that comes to mind is when do I take Social Security benefits? Over the life of your career you have continuously been paying into Social Security. It makes sense you would want to maximize any available benefit that you could receive. This allows you not to have to lean on your outside savings nearly as much.

You may already know you have the choice to file and start taking benefits for Social Security. That age range can start as early as 62 years old and go as late as age 70 years old.

Typically your full retirement age will be about 67 years old. However that doesn't mean you have to file at your normal retirement age.

Today I want to walk through some of the things you should be considering and thinking through as you are trying to figure out when along the spectrum makes the most sense for you to file for Social Security benefits.

Things to Consider when taking Social Security Benefits:

1. Life Expectancy

Are you from a family that typically lives a very long time? If so you'll need to make sure you are leaning towards the 70 year mark, potentially the very end limit. As you wait each year past 67 years old, you can get an 8% bump up in your benefit. As you claim a longer time period, collecting the increased 8% benefit for a higher number of years makes a lot of sense. What if your family doesn't typically live a very long time? You may want to consider dropping the age with which you file for benefits. Even though you will get an 8% reduction in your benefit you'll be claiming for a longer period of time.

2. Spousal Benefit

If you are married one thing you should be considering is how to coordinate your benefit timing with your spouses. There are a couple things that could be going on here; whether that is looking for the actual spousal benefit which is 50% of your own. Secondarily, you could be trying to time the amount of income you receive. You may expect to have high income years when you are starting to file for Social Security. There is a possibility you start making some of that Social Security taxable which you would not have done otherwise. So when you coordinate the benefit between you and your spouse it's important to look at your larger financial picture. This allows you to make sure it makes sense together as well.

3. Outside Finances

You might have been planning all along to file for Social Security at your normal retirement age. If that is built into your plan you may not have much of an opportunity to optimize how much Social Security you have. The likelihood of your plan succeeding may be dependent on you claiming Social Security at that age. If you don't need the income and you have the opportunity to optimize your Social Security benefit we would encourage you to do that. Look at coordinating with your spouse, also leaning into your own life expectancy, and try and time things from that perspective.

Some of the opportunities you might be looking for may already be passed. Making sure you have enough income in retirement through Social Security is an important factor. If you are starting to question when the right time to file for Social Security might be, please reach out and let us know. We would be glad to help!

WHERE DO I PARK MY EMERGENCY FUND CASH?

BY: MICHELLE SMALENBERGER, CFP®

We are all pretty aware and have talked before about keeping 3-6 months of living expenses in an emergency fund. Maybe you already have this emergency fund or you're on your way to actually getting that fully funded. But, with this 3-6 months of cash no one gets excited to just leave that sitting in cash. Today, I want to talk you through some common places where you can park these emergency funds.

Places for your Emergency Fund

Cash: We typically think we should just leave our emergency fund in cash. When I say cash this is leaving it not in your everyday checking account so you see it, but rather a separate account. The only problem with this right now is we do not get much interest on these funds. It can be really hard to see that chunk of money just sitting there. Instead this fund could actually be earning more money through interest.

Money Market: The other place that we typically think is a money market. This comes to mind because just beyond the cash in the account you earn a little bit more. Right now it's significantly more so it might be .5%. As the Fed changes rates this rate will fluctuate.

High Yield Savings Account: Another account that is very similar to a money market is a high yield savings account. A money market and a high yield savings account are basically the same thing. You use the money market because you want to earn a higher interest rate. When you search for these don't be surprised if they have a money market and also a high yield savings account; because they are two separate things. It is possible that one of these is actually yielding more than the other. This is why you want to know that they are two different things. They act the same so you can choose either account type. Some may offer the ability to set up multiple buckets of various savings goals while the other does not. It's those features that affect which one you might choose.

Certificates of Deposit (CDs): If you have a good amount in emergency funds but are nervous about making sure you are going to earn the interest, a CD might be part of a solution. With a CD you have to keep it there for a set amount of time. In the event of an emergency you might have to give up some of the interest you would have gotten if taken out early.

Watching the interest rates!

With all of these you just want to be sure you are watching the interest rates as they change. Like I had mentioned these fluctuate. Right now the Fed holding rates low. Don't be surprised if even money you have in your money market which has been a decent amount for a while, such as 1 or .8% is down to .5%. If you are watching rates you will know that money in a checking account is earning less than in a money market, maybe closer to .001% today. But you can move funds back and forth if you have both of these account types as an option.

These are some of the common places we think when we talk about parking this emergency fund cash. I want to be sure and let you know these are great options of where to put your emergency fund. Be watchful in what the interest rates are on the different types of accounts so you are earning as much as you can with those funds. Especially if they are needed for a rainy day. If you have any questions about this or need help setting up an account for your emergency fund please reach out to us.

FREQUENTLY ASKED QUESTIONS

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?
With advances in technology, it is amazing how much we can accomplish virtually! 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. Most forms can also be electronically signed.

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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21660 W. Field Parkway
Suite 118
Deer Park, IL 60010