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BEAR OR NO BEAR? DOES IT MATTER?

In U.S. stock market history, bear markets—defined as a drop of 20% or more for a broad market index—happen roughly every four years and eight months. With a couple of recent down days in the markets, we may be in the early stages of a new one.

Or we may not—and that, of course is the problem. It is very easy to see these market downdrafts in retrospect, but impossible to know when one is occurring, or to predict them in advance. Nor can we know how far down they'll take us or when the recovery will begin.

Some of the longest declines were triggered by major geopolitical events—such as the attack on Pearl Harbor that pulled the U.S. military into World War II (a 308 day downturn, nearly a year), and Iraq's invasion of Kuwait in 1990 (108 days). The terrorist attacks of 2001 and the North Korean missile crisis of 2017 also triggered market declines. In 2008, the collapse of Wall Street speculation nearly brought down the entire global economy. More recently, in 2020, the emergence of a major global pandemic caused a rapid decline which was, as most of us remember, followed by a precipitous rise in market values that has continued through the end of last year.

At the moment, it's not easy to see a major catastrophic trigger that would cause investors to race for the exits, but there have been other bear markets where a bull market simply ran out of steam—a recent example is the bursting of the dot-com bubble in 2000. The hardest-hit investors in that period were all crowded into the latest craze—tech stocks—and the tech-heavy Nasdaq index didn't recover its former value until 2015. The lesson there was not trying to time the market but to maintain the discipline of diversification despite the temptations of rising valuations.

Which brings us back to the possibility that we're entering a bear market today. Taking another look at history, since 1929, the average duration of these 20%+ downturns is 21 months—and it is just as impossible to predict these durations as it is to predict the downturns to begin with. The Covid-related downturn in 2020 is a terrific example of how unpredictable the recovery can be. The pandemic news didn't change from February to April 2020, but the markets recovered anyway, and were not discouraged through the ensuing political drama, the Delta and Omicron variants, and the highest inflation rate in decades.

The most important historical fact is that every bear market in U.S. history has been followed by new highs. Since 1950, we have experienced 53.8% up days in the market and 46.2% down days, and the magnitude of the positive days has exceeded the magnitude of the downdrafts. The champion investors always have some cash or cash-equivalents in their portfolios, which lets them buy when the markets go on sale—which is perhaps the best way to view bear markets: as an opportunity to buy valuable stocks at a discount.

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WHAT WE KNOW, WHAT WE DON'T

Financial planning professionals often hear people confess, sometimes in embarrassment, that they don't really understand investing or the markets. The investing part is pretty simple: you put together a thrifty portfolio (meaning low annual internal expenses) with a mix of U.S. and international stocks and bonds, leavened perhaps with real estate or gold. The precise mixture is often less important than a steady hand at the tiller, which means not doing a lot of trading or making a lot of changes.

The markets, however, are a different animal; in fact, it is fair to say that nobody understands the markets, in the sense of knowing why they move (or have moved) up and down in the short term, or when they will. Nobody.

Why is that? The problem with predicting market movements in any time frame under 10 years is that there is a heavy dose of sentiment behind the dynamics. You can think of it as mass psychology. Tens of thousands of stock owners wake up in the morning and either feel anxious or confident, which means they are prone to selling or buying. Professional investors, of course, are holding tight, but there are a lot of individual investors, especially now in the age of Robinhood, who are trying to figure out whether the markets are about to go up or down this week. Add to that the brokerage traders who stare at six or eight different video screens, trying to determine how those individual investors are feeling this morning, and then adding their buy or sell orders—which amplify the psychology of the moment.

You can see these things play out in real time. To take a totally hypothetical example, suppose one morning a slight majority of investors suddenly decide that the pandemic they were hearing about in China has arrived on U.S. shores, is not contained, and might be a bigger threat than they realized. This might force companies to allow their people to work from home, and how efficient can that be?

Best to move to the sidelines. Traders notice the trend, amplify it, and the market goes down a percent or two.

The next morning, a slightly bigger majority of investors (maybe 54% as opposed to 52%) notices that the market has gone down AND realizes that the pandemic might be bad for business. They log into their brokerage account, traders notice a sell pattern, and move accordingly. A few more sessions, and suddenly there's a rush for the exits that has nothing to do with the underlying fundamentals of global businesses.

Until one day a slight majority of investors notices that companies are actually coping pretty well with having workers do their jobs at the kitchen table. Who imagined that? They see that stocks are on sale, cross their fingers and add to their holdings. Traders notice that the sentiment has shifted, and start buying again. The markets recover, and a lot of individual investors, still on the sidelines, rue the day that they participated in the sell psychology. Now stocks are higher than when they sold. Belatedly, they get back in, and the market recovery is sustained.

In retrospect, it seems obvious that the downturn was just a blip on the long-term uptrend. But these things are never obvious at the time. Never. If you are embarrassed to say that you don't understand the markets, don't worry; you have plenty of company. As in: the rest of the world.

But don't some investors do better than others? Of course they do, but this can largely be explained by the law of averages. Yes, there are asset managers who do a lot of research into individual companies and draw astute conclusions from data sets and calculations that would numb the minds of the average investor. But it's helpful to remember that they are all using exactly the same data (the Securities and Exchange Commission expressly

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forbids companies from giving out preferential information; it's called 'insider trading'), and many are doing the same kind of analysis. These are the people who set the market prices, long-term, and there is seldom a wide difference of opinion, among the experts, about the fair price to pay for any individual stock.

So you are left with luck as an explanatory factor—if you could call it that. To see how hard it is to separate out the luck factor in someone's investing track record, imagine a contest where 10,000 professional investors are engaged in a coin flipping contest: a contest to see who can flip the most heads in a row. In the first round, simply by the law of averages, 5,000 (more or less) contestants will flip tails and be eliminated. The next round, 2,500 (or so) others are disqualified. Next flip: 1,250 contestants are left, then 625, then 312, then 156, and finally, at the end of the 7th flip of the coin, only 78 contestants are still standing.

At this point the press starts to take note. Who are these people who were capable of flipping seven heads in a row? What's their secret?

The next round, 39 contestants are still in the game, and then 20, and then 10, 5, 2 and ultimately, purely by the law of averages, one person will have managed to flip 13 heads in a row. If this person were a mutual fund manager, he or she would be inundated by fawning interviews from the consumer press, and millions of investors would be flocking to his or her fund, abandoning all those losers who dropped out of the contest long ago. And remember, there is no trace of skill, whatsoever, involved in this contest.

The point of all this is that there are no experts in what the market is going to do in the next day, week, month or year—and you and I and everyone else can stop feeling embarrassed that we don't understand market dynamics well enough to take advantage of superior knowledge. What we DO know is that every day, all over the country, all over the world, millions of workers put their best efforts into adding value to their respective companies, incrementally, a day at a time, making the stocks in our portfolios a bit more valuable than they were the day before. This seems like a very slow process, and it is. But when you look at the result, investing in stocks, patiently and without trying to figure out what the markets will do in the short term, has been remarkably rewarding. Right around this date in 1987, the Dow Jones Industrial average—basically, a small handful of prominent stocks—was valued at $851. An investor who held onto those stocks until 1995 would have seen that value grow to $4,000. Most recently, the value is up to around $35,000.

The average return on stocks since 1957 has been just over 10% a year, and if you go back to 1926, you get roughly the same number. Over the last 50 years, the markets have been up on 53.7% of all trading days. Since the end of the Great Depression, from 1941 onward, there have been only two rolling 10-year investment time frames when the S&P 500 index showed a (very slight) negative return, and hundreds where the returns were positive.

We may not be able to predict what will happen tomorrow, but there's a very solid chance that the next ten years will reward the patient investor. THAT is literally all we know about the markets.

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PUERTO RICO EXITS BANKRUPTCY

Did you know that a major U.S. territory had filed for bankruptcy?

On January 19, a federal judge approved a plan to restructure billions of dollars of debt—chiefly municipal bonds sold to investors—filed by the island territory of Puerto Rico. This marks the end of a bizarre saga which saw Puerto Rico issue debt as fast as it could print the certificates into a vast demand for triple-tax-exempt municipal bonds—that is, exempt from federal taxes, state and local taxes in all 50 U.S. states.

The bankruptcy came about because, while Puerto Rican bonds were popular, especially with certain mutual fund providers, the $72 billion in debt issued could not be repaid through the taxes Puerto Rico was collecting from its citizens and business community; indeed, the outstanding debt eventually came to equal a whopping 68% of the island territory's total economic output, and that doesn't count the $55 billion owed in unfunded pensions to government workers. The restructuring will reduce $33 billion of Puerto Rico's debt by 80%, but will still obligate its government to pay $666 million a year over the next decade to bondholders. Investors in Puerto Rican munis, meanwhile, are being promised additional "contingent" repayments if sales tax collections exceed projections.

There is a saying on Wall Street, which they obviously hope investors won't hear: "feed the hungry pig." Translated, that means that if there are credulous investors who want to buy something that Wall Street executives know is a dog investment, then the most profitable course is to sell as much as possible regardless of the underlying fundamentals. Companies like UBS, Santander Securities, Merrill Lynch, Morgan Stanley and Wells Fargo all doubled down on buying Puerto Rican bonds which they must have known were unsustainable and would be repeatedly downgraded. But as the yield on these downgraded bonds moved higher and higher compared with more stable muni securities, thousands of brokers touted the yield, perhaps forgetting to mention the increasing likelihood that bankruptcy was just around the corner—and the victims were investors greedy for yield and the Puerto Rican citizens whose leaders became addicted to the tsunami of easy money.

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WAR IN EUROPE?

For most of us, it's a little hard to believe that Europe might soon be plunging into another war. But the prospect is hard to ignore now that Russia has sent 100,000 soldiers and massive amounts of tanks, fighter jets, missile launchers and other military equipment right up to the borders of the sovereign nation of Ukraine—following up on years of simmering military intervention that has claimed the lives of Ukrainian soldiers on a daily basis.

Lest anyone think that Russia is incapable of brazenly conquering another country's territory in this day and age, it is helpful to remember that it sent in its 'little green men' (later conceded to be Russian soldiers) to annex the entire Crimean peninsula from Ukraine right after the 2014 winter Olympics. Russia has also assumed military control of the Donbas region east of the Ukrainian city of Donetsk, under the pretense of 'protecting' Russian-speaking citizens there. In an ominous sign, Russia has reportedly been handing out hundreds of thousands of Russian passports to Donbas, which would offer a pretext to argue that those visitors 'need to be protected.'

Nor, as most articles have reported, are all the military 'exercises' being conducted on the eastern border; in fact, there has been substantial troop movement to the north and northeast of Ukraine, which could signal a multi-pronged attack on the country.

Or it might not. The Kremlin has denied that there is any plan to attack anybody in the region, and maintains that the massing of troops from Belarus and elsewhere is simply a training exercise—albeit a highly unusual one. And political analysts have pointed out how awkward it would be for Chinese President Xi Jinping if Russia were to launch an invasion while Vladimir Putin was attending the Winter Olympics as Beijing's special guest. There is speculation that Russia is simply using the threat of invasion as a bargaining chip to prevent any expansion of the NATO alliance, or that an invasion would stop once Russia had conquered the coastline between Donbas and Crimea.

Finally, military analysts have pointed out that, for all the belligerence and blustering, Putin's Russia has been extremely shy about direct military confrontations in cases where the enemy is capable of fighting back—and with U.S. aid, the Ukrainian military definitely has the capacity to inflict painful damage on any invasion force. Putin seems to have a knack for manufacturing crises and then resolving them in 'benevolent' gestures, rather than risking the political consequences of large losses of soldiers' lives.

What does all this mean to us sitting safely on the far side of the ocean? If there does happen to be an invasion, we can expect a certain amount of panic in the markets, due to the threat of economic destabilization and uncertainty that such a shocking development would trigger. An invasion could disrupt Ukraine's agricultural production, which is surprisingly important to the world's food supplies. It is estimated that Ukraine farmers account for about a sixth of the world's corn exports.

There would also be some as-yet-unmeasurable impact on world energy supplies. Russia supplies about 30% of the European Union's natural gas, which could be interrupted, raising global energy prices including here in the U.S. An invasion would almost certainly be followed by severe economic sanctions, which means Russia's ability to export oil could be hampered or even crippled.

Perhaps most importantly, all of us—as citizens of the world and as investors in what we always hope will be a peaceful and productive economic community—would feel less comfortable about the global political environment if we were to witness the brazen invasion of one European nation by another. The threat of war is unsettling enough; a real one, playing out on the evening news, would be undeniably scary.

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RETIRE TO WHERE?

You may have read that a record number of people decided to retire during the Covid pandemic, but in fact only about half of all people age 55 and over are actually retired, just 2% more than before the pandemic began. According to statistics compiled by the U.S. Census Bureau, people who are moving as a result of retirement are three times as likely to leave their state as those moving for work-related reasons. Of all the people who retired and moved away from home, a remarkable 47% decided to leave their home state.

Where did they go? The rankings differ modestly from 2020 to 2021, but it seems clear that retirees generally prefer a warmer climate and tax-friendly jurisdictions—but not always both. In 2021, Tennessee was the most popular relocation state (13.1% of retirees), followed by Florida (11.3%), Pennsylvania (10.7%), North Carolina (10.3%), South Carolina (9.4%), Kansas (7.0%), Arkansas (7.0%), Georgia (6.3%), Maine (5.4%) and Louisiana (4.3%). The top states in 2020 were, in order, Florida, Arizona, North Carolina, Texas, Tennessee, Idaho, Oregon, Nevada and Alabama.

Of those states, Florida, Nevada, Tennessee and Texas do not impose a state income tax or tax on pension income, while Florida, Arizona, North Carolina, South Carolina, Kansas, Missouri and Texas do not levy state taxes on a retiree's Social Security benefits.

Some of the most popular cities for retiree relocation included (again, in order): Mesa and Scottsdale, AZ; Henderson, NV; Savannah, GA, Paradise, NV; Charlotte, NC; Fort Myers, FL; Cary, NC; Eugene, OR; and Tucson, AZ. But it should be noted that these are net numbers, where the retirees moving out were subtracted from the number of retirees moving in. Charlotte, Mesa, Henderson and Tucson were among the cities which also experienced the largest number of retirees moving away.

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