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# STRIVE FOR ANTIFRAGILE, ACCEPT RESILIENT, AND DON'T RELY ON CROWD-FUNDING

*by Aaron M. Puttroff*

When I was a child, my father was injured on the job and could never work again beyond sporadic and low-paying temporary work. He got a settlement and a few bucks from the pension each month, but more was needed (made worse by a few unproductive decisions) to keep our house or pay for the necessities of life. I'll forever be grateful to the many people who helped. Further, I'm happy to pay it forward and provide support where possible in someone else's moment of need.

A sentiment I often hear is that people want to be efficient in managing their finances. On the surface, there is nothing wrong with efficiency. Waste not, want not, and so on. Most, if not all, aspects of modern society strive for a high degree of efficiency. Therefore, it's not surprising that we also apply this concept to our finances. The challenge is that highly efficient systems are not built with redundancy in mind and may be overwhelmed by random shocks to the system. As Scotty said in Star Trek III, "The more they overthink the plumbing, the easier it is to stop up the drain."

Our personal finances can quickly take a turn when an unforeseen event takes our plan on a detour (assuming there is a plan). Unfortunately, we get grim reminders of this from the various crowd-funding pages we see on social media or in the news. Observe, and you'll note that most of the time, money is being raised to help with a situation that's not uncommon or unpredictable. It's just that the victim probably didn't think it would ever happen to him or her, always to other people. This isn't meant to be a criticism of people who are experiencing a crisis and are short of money. On the contrary, as mentioned earlier, I probably wouldn't be where I'm at without the timely charity and support of people in my life.

Here's where the paradox comes in. I hope you will be generous and contribute to that crowd-funding page you scroll upon to help someone in your neighborhood or community. A few bucks may make all the difference. I also hope that you will arrange your finances with the mindset that you never want to be dependent on the charity of others when the inevitable shock to your finances occurs. In other words, avoid having your finances be fragile. Instead, strive to have them be antifragile. Applying the logic of author Nassim Nicholas Taleb, this would make your finances stronger due to random events or shocks rather than weaker. And suppose it turns out that antifragile isn't possible to attain. In that case, hopefully, you'll at least land on resilient, which means that your finances will be able to withstand or recover quickly from difficult conditions.

To that end, here are some examples.

**Possible examples of fragility in personal finance:**

- Insufficient insurance for low-probability but high-consequence events
- Belief that its more efficient or even possible to self-insure
- Long-term commitments relying on short-term and/or variable-rate debt
- Too much of savings/investments in retirement accounts or other vehicles that limit access
- High positive correlation in all personal money matters (Ex. I work for a well-known tech company, and all my investments are stock in the same company)
- Expect high returns to make up for poor savings habits

**Possible examples of antifragility (or at least resilience) in personal finance:**

- Enough life insurance to replace any lost income because of premature death of income earner
- Disability insurance to replace lost income because of sickness or injury
- Umbrella policy pay for losing a lawsuit or avoiding a lawsuit altogether through a negotiated settlement
- Sufficient liquid savings to pay for an unexpected event and take advantage of opportunities
- Little to no consumer debt and/or variable rate debt
- Consistent saver with tempered expectations of investment returns

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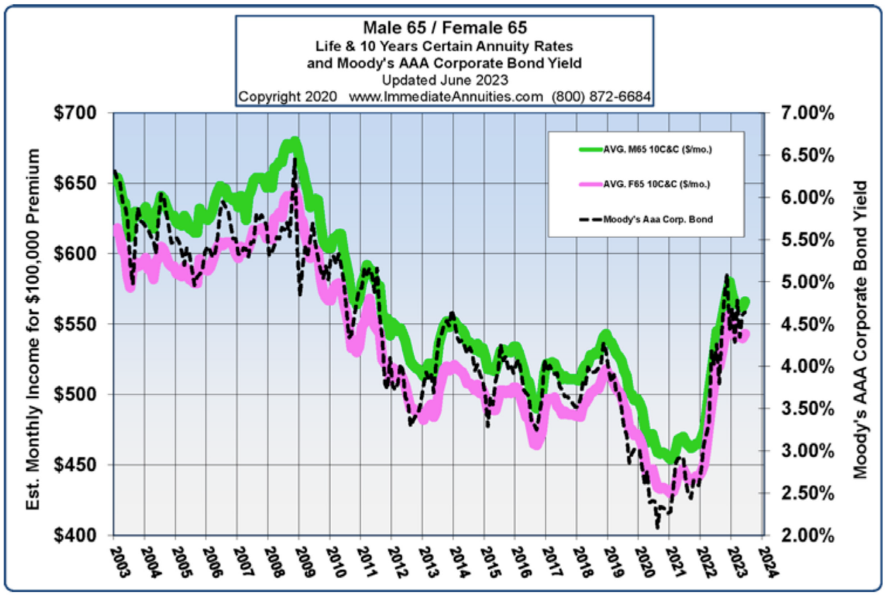
# BOND COMPLEXITIES




On the surface, investing in bonds is pretty simple. You buy a bond, which basically means you are loaning a company, a municipal organization, or the US government, the face value of that bond. They pay you a specified amount of interest either monthly or quarterly for the 'term' of that bond, and at the end of that term, you get your money back from whoever you lent it to.

Nothing complicated about that, right?

At some point back in the late 1990s, investors began to realize that bonds are not quite as straightforward as they might appear. A hedge fund called Long-Term Capital Management, whose assets were managed by Nobel laureates, collapsed because the company's bet on bond rates were misaligned with interest rate movements. There were lesser collapses of mutual funds that underestimated the volatility of so-called junk bonds, and in the previous decade bets on high-yielding bonds took down a number of savings and loan associations. The joke at the time was that if you bought a toaster, you would get an S&L as a bonus.

Bond values—and therefore bond returns—are impacted in a bewildering variety of ways. The most obvious is interest rate risk; if rates go up, the value of a bond will go down, for the simple reason that someone could come along and buy a similar bond at the new higher rate. Why pay the same for those older bonds paying lower interest?

Where are the biggest risks? In general (recent history is an interesting exception) bonds and bond funds with longer maturities—the funds that invest in 20 or 30 year bonds—will offer temptingly higher rates than shorter-term bond funds. But… Rising interest rates tend to have a disproportionately bad impact on these longer-term bonds—which means investors reaching for yield in longer maturities can find out about interest rate impacts the hard way.

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Bond values are also impacted by a bond's rating, which is a fancy of saying how strong or creditworthy is the organization the bond investor is lending to. There are a number of rating agencies, and their rating scales are not identical, but in general, you mostly know that if you buy Treasury bonds, the government is going to get you whatever it owes in interest and principal. The same for blue chip corporations and some municipalities where the bonds are backed by the revenue earned through whatever project is being financed.

But going back to those junk bonds, some issuers are not quite so reliable or stable, and as a result, investors demand more yield from them to compensate for the risk of default—that is, t he risk that the borrower will declare bankruptcy and pay out pennies on the dollar. There are many levels of ratings, of course, and some amount of fluctuation among them. Some companies will become more stable and get a higher rating because their fortunes improved or they restructured, and that makes their bonds—including the ones already issued—more valuable. When a company's fortunes decline, the rating agencies will lower their rating, making the bonds less valuable and definitely riskier.

One of the persistent dangers, particularly when there is a chance of imminent recession, is investing in bonds that offer very tempting yields because they fall into those low rating categories. If the economy does experience a recession, a relatively higher number of those companies will be downgraded or go out of business, meaning that the tempting yield will turn out to be lower than expected.

A number of mutual funds specialize in these junk bonds, and they are not always totally forthcoming about where their tempting yields are coming from. Every year, some investors will compare the (low) Treasury or blue-chip corporate rates with the (much higher) rates offered by junk bond funds, and think that choosing the latter is a no-brainer.

The bottom line here is that lower yields tend to be associated with greater stability, both in length of maturity and credit rating. The temptation of chasing higher yields comes with risks that are not always well understood or appreciated.



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# HOUSING STARTS IN DECLINE

Did you know that last year, roughly 1.66 million new homes were constructed? This includes single-family homes (975 million), 2-4 unit residences (54.8 million), and buildings with 5 or more family units (635 million). This total number is actually down from the 1.73 million new homes built in 2021, and 2023 is on pace for a further decline, to somewhere around 1.44 million residences.

These numbers are closely tracked by the U.S. Census Bureau on a monthly basis, and are among the tea leaves that economists are reading to determine the health of the U.S. economy. One of their conclusions is that more construction is needed to combat a persistent housing shortage among younger people in America.

But a bigger issue might be affordability. Just over 28% of new homes sold last year were priced between $500,000 and $749,000, and from 2021 to 2022, there was a 15% increase in the number of new homes sold in that price range. Meanwhile, less than 1% of all new homes sold in 2022 were priced under $200,000.

While developers seem to be dragging their feet a bit, there is evidence that demand for new homes is strong and getting more so. Nearly half (49%) of new homes sold in 2022 were under construction when they were sold, and another 20% were purchased before construction began.

Sources

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