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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.

Nevertheless, 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 timely act of kindness 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. Rather, 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 being resilient, which means that your finances will be able to withstand or recover quickly from difficult conditions. Here are some thoughts on what may constitute being fragile or anti-fragile with respect to your finances.

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 prior to retirement
- High positive correlation in all personal money matters (Ex. I work for a well-known tech company, and most of my investments are stock in the same company)
- Expect high returns to make up for poor savings habits (I.e. low savings rate)

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

Remember, in the immortal words of Mike Tyson, "Everyone has a plan until they get punched in the mouth." Take the time to evaluate your finances for critical vulnerabilities now. Everyone will face adversity at some point. Better to harden you finances before that event occurs.

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GREEN BOOK WISH LIST

Every year around this time, the current presidential administration releases a set of tax-related proposals, essentially a wish list for tax legislation for the coming year. These so-called 'green books' are never passed in their entirety, but they offer a hint as to what kind of proposals will be working their way into and (possibly) through the next Congress.

The latest green book contains more than the usual number of proposed tax changes. Some of them are familiar to those who read articles in the business press. For example: raising the highest corporate tax rate to 28% (currently 21%), and creating a new highest marginal tax rate of 39.6% for individual taxpayers with income above $400,000 a year.

For those who pay a net investment income tax (joint tax filers with $250,000 or more income; single filers whose income is above $200,000) the added tax rate on capital gains, interest, dividends and rental income would go up from 3.8% to 5%. Employers would be required to withhold a 5% Medicare tax on individual wages paid in excess of $200,000 (up from the current 0.9%), and taxpayers whose net worth is above $100 million would pay a 25% minimum income tax on their total income, which would (unlike for most taxpayers) include taxing the unrealized capital gains on their investments.

The proposed corporate tax changes would also include a 4% excise tax on share repurchases by publicly-traded companies (up from 1%) and a higher corporate alternative minimum tax rate of 21%—up from 15%. And companies would be prohibited from deducting "excess" compensation for any employee earning more than $1 million a year.

Interestingly, the green book offers no proposed change to the estate tax exemption, possibly because, at the sunset at the end of next year, the generous current exemption will automatically drop to somewhere around $6-7 million. But the green book does propose to tax heirs on any gains of appreciated property that they inherit at capital gains rates. Currently, the heirs would get a step-up in basis, meaning that the capital gains obligation would go away as the tax basis resets.

It's worth repeating that this is a legislative wish list, and not something that is currently included in a tax bill in Congress. But we can expect to see some or (possibly) all of these proposals debated in the House and Senate next year. If the past is any indication of the future, then they will be heavily modified due to lobbying efforts and other political considerations.

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PROFITS AND MORE PROFITS

It isn't being widely reported, but aggregate U.S. corporate profits reached record levels in the 4th quarter of last year, increasing 4.1% after going up 3.4% the previous quarter. The net profit margin for companies in the Standard & Poor 500 index reached 10.7%, and the tech-heavy companies on the NASDAQ exchange reported a 23% aggregate profit over the fourth quarter.

Is this sustainable? Overall, corporate earnings rose 9% last year, which is higher than the 3.3% growth in the economy as a whole. Generally speaking, corporate revenues grow at roughly the same rate as the economy overall, so one might expect future revenues to fall back in line. But the interesting part of the picture is that companies are paying higher wages and still generating greater profits from the products and services they offer. At the same time, inflation is stuck at around 3%—which suggests that companies have the ability to raise their prices without much pushback from consumers, and are able to increase profits even as expenses go up incrementally.

This economic picture is generally bright for stock market investors, but perhaps not as bright for people who are rooting for inflation to come down.

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2024 FIRST QUARTER INVESTMENT REPORT

We should probably get this out of the way at the beginning: nobody should expect that 10% quarterly gains in the stock market will continue forever, or even for the rest of the year, unless you believe that stocks will become 40% more valuable into the foreseeable future. But we can celebrate a generous quarter of returns nonetheless.

Double-digit and near-double-digit gains were everywhere to be found in this unusual quarter. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—gained 9.95% as of March 28 (March 29 data is apparently unavailable for the index). The Russell 3000 index gained 10.02% in the first quarter.

Looking at large cap stocks, the Wilshire U.S. 2500 Large Cap index was up 10.02% as of March 28. The Russell 1000 large-cap index is up 10.38% so far this year, while the widely-quoted S&P 500 index of large company stocks gained 10.16% during the year's first quarter.

Meanwhile, the Russell Midcap Index has gained 4.68% in the first three months of the year.

As measured by the Russell 2000 Small-Cap Index, smaller companies posted a 5.18% gain in the year's first three months. The technology-heavy Nasdaq Composite Index has gained 10.78% so far this year.

Foreign markets have provided more modest gains. The broad-based EAFE index of companies in developed foreign economies gained 4.15% in the first quarter of 2024. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 1.69% in dollar terms so far this year.

Real estate securities posted an essentially flat quarter, with the Wilshire U.S. REIT index unchanged over the first three months of the year. The S&P GSCI index, which measures commodities returns, posted an 8.74% gain in the 1st quarter. Gold prices are booming, up 9.08% for the quarter to a record $2,257 an ounce. The S&P 500 utilities index, a broad measure of the performance of utility stocks, is up 3.59% as of the end of March.

The bond markets, in contrast to what was happening with stocks, were relatively calm. Yields on 10-year Treasury bonds have dropped modestly, from 4.76% at the start of the year to 4.32% currently. 30-year government bond yields have risen incrementally from 4.03% to 4.46% in the first quarter. But the yield curve remains sharply inverted; 12-month Treasuries offer a higher 5.07% rate, and 6-month government bonds are yielding 5.34%. Five-year municipal bonds have risen from a 2.22% aggregate yield to 2.55%, while 30-year munis moved from roughly 3.40% in January to 3.75%.

It's always wise to be a bit wary when stock markets are achieving new highs seemlingy on a weekly basis, but there aren't a lot of dark clouds on the current economic horizon. Inter- est rates in the U.S. are currently at a 25-year high, with the Fed Funds rates at 5.25-5.55%, but the recent Federal Reserve Board announcement reas-sured investors that the rates would go down, not up in the current year. Inflation remains at 3.2%, which is a full percentage point higher than the Fed is targeting, but hasn't been rising lately. Unemployment is up slightly, to 3.9%, but anything under 4% is considered full employment by economists, and the U.S. economy added a robust 275,000 new jobs last month. America's GDP grew at a 3.4% rate last quarter, which is above both expectations and recent histor- ical averages.

But there is a bit of a creepy feel to the enthusiasm of quick-twitch investors whose buys and sells drive markets up or down, seemingly at random, on a daily and even hourly

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basis. The insiders are calling the bull market we are experiencing an 'AI' boom, meaning that there is perhaps more enthusiasm for how artificial intelligence will impact the world economy than can be realized by the actual facts on the ground. And one wonders if consumer spending can continue to grow at a 3% rate when there is evidence that consumers, in aggregate, are taking on increasing amounts of debt.

All of this is to say that, after a robust first quarter, it might be time for the smarter buy-and-hold, long-time-horizon investors to fasten their seat belts. Nobody gets a totally smooth ride on the investing roller coaster, and we all know what happens on the amusement park rides after your car climbs up a long summit. The only difference is that roller coasters end where they began, while the markets, through all the ups and downs, have generally ended higher at the end.

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