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Independent Objective Advice

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Special Interest Articles:

- ***Lessons from A Financial Crisis (Front page)***
- ***What to Make of the "Trade War" (Front page)***

## Lessons from A Financial Crisis

*By Christopher W. Beale, CFP®*

Ten years ago, in 2008, we were in the middle of a worldwide financial crisis. I personally will never forget that time and its effects on me and the clients of New England Capital. I have been reliving this time, almost day-by-day, with the help of a book I am currently reading. A friend and client (thank you Don) lent me former Federal Reserve Chairman Ben Bernanke's book called "The Courage to Act: A Memoir of the Crisis and Its Aftermath".

Like many financial crises before it, excessive debt can be at least partially to blame for this "Subprime Crisis". Simply put, people, companies and countries get themselves into trouble by borrowing more than they can afford to pay back. As Bernanke said in his book, "The financial crisis of 2007-2009 had several triggers. The most important and best known is the rapid run up and subsequent collapse in housing prices and construction."

Other triggers include risky lending practices to individuals and real estate developers. Banks and mortgage companies were incentivized to construct and sell complicated financial instruments that magnified the leverage while making these loans appear safe.

The crisis caused many weak companies to merge including Bear Sterns, Countrywide Mortgage, Washington Mutual, Wachovia and Merrill Lynch. Insurance company AIG as well as car companies like General Motors and Chrysler had to be bailed out by the US government. Investment bank Lehman Brothers, which was founded in 1850, was forced to declare bankruptcy.

The Great Recession followed this financial crisis. The stock market as measured by the Standard and Poor's 500 (S&P 500), which lost 56.4% from October 9, 2007 to March 5, 2009, has technically been in a bull market ever since. I say technically because a bear market is defined as a 20% or more decline from top to bottom in a particular index like the S&P 500. In the six months from May to October 2011, the S&P was down 21.6%.

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## What to Make of the "Trade War"

*By Christopher M. Lee, CFP®*

Last week, there was finally some evidence that the investment markets were starting to get jittery about the escalating tit-for-tat tariffs and threats of tariffs that some economists are calling "America vs. the World." Most investors are probably wondering whether new taxes on items flowing into and out of the U.S. really is something to worry about.

It is on several fronts. First, and most specifically, certain economic sectors will be big losers in an escalating tariff battle. When President Trump imposed tariffs on steel and aluminum imports, solar panels and washing machines, China responded with an equal dollar amount of tariffs on certain agricultural products, including soybeans, meat, fish, milk and cream, various fruits and vegetables, alcohol, dog and cat food and cotton—all of which directly impacted the economics of many midwestern farmers (who China obviously presumes to be Republican voters). China and the European Union have imposed tariffs on Kentucky bourbon, Harley-Davidson motorcycles, pork and maple syrup, whose manufacturers and workers probably reside on both sides of the political aisle.

If you're a soybean farmer, then the fact that Brazilian soybeans are now extremely competitive in the large and growing Chinese market can be extremely discouraging.

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## Lessons From A Financial Crisis

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So why wasn't this a bear market? Because - and this is the technical part - the 21.6% decline was based on intra-day moves, not end-of-day 4pm closing values. The closing day decline was 19.4% thereby barely missing the strict definition of a bear market.

Again, during mid-2015 to early 2016, while the S&P 500 never closed down 20%, the average stock in that index declined more than 25%. The other widely known stock market index, the Dow Jones, was down more than 32% during the same time. Therefore, as anyone who has been invested in the stock market for the last 10 years knows, while it has been a very good time to be an investor, it has also been a time of market ups and downs.

Historically bear markets average a decline of -33% and last 14 months. The average bull market, or up market, averages an appreciation of +268% and lasts 70 months.

The stock market is considered a leading economic indicator. This means it tends to "predict" future economic activity. Currently, there is no consensus that the US or world economy are on the verge of plunging into a recession. In fact, there isn't much evidence of things that would be corrected by a recession including high inflation, extreme levels of debt, large unsold inventories of goods, or rich stock market valuations. I don't believe that stocks are cheap, but I also don't think they're excessively expensive. I know stock market indexes have recently hit new highs but corporate earnings have hit new highs too. Hitting all time stock market highs don't necessarily mean that stocks are about to crash. In fact, more than 70% of the time after we experience a new stock market high, it is followed by another new high. And historically, every new market high has been eventually surpassed by another new high.

Armed with this information, what should you do now before the next bear market? Please note I am not trying to prepare you IF we have a bear market; I want to prepare you for WHEN the next bear market happens.

Here's a list of ideas that can help you survive the next market downturn.

1. **Be diversified** – Avoid being overly concentrated in one stock, one bond, one asset class or sector (i.e. owning only technology companies) or one geographic area (i.e. owning only US companies or only emerging market companies).
2. **Rebalance** – If you decided your balanced portfolio in 2009 should be a mix of 60% stocks and 40% bonds AND you have not rebalanced, you could now be closer to 80% stocks and 20% bonds. This is a much more aggressive mix than you originally planned.
3. **Invest for total return, not yield** – I've seen too many people hurt themselves by chasing the highest current yielding investment instead of approaching their portfolio with regard for total long-term returns.
4. **Know there are different types of risk** – An investment that allows your principal to fluctuate could be a poor short-term investment, but a great long-term investment designed to protect you against the risk of inflation. Longevity risk is often overlooked. On average (and all of my clients are above average!) you'll spend 8000 days in retirement. The cost of food, energy, taxes, etc. will undoubtedly be greater towards the end of those 8000 days than in the beginning. Now you know why we need to guard against inflation or purchasing power risk, not just principal risk.
5. **Understand and apply the new tax law** – Old tax strategies won't be as helpful under the new law. We need to adjust our thinking around charitable giving, required distributions from IRAs and interest deductions from mortgages and home equity loans.
6. **Finally, understand what's in your control** – If you're still in the accumulation phase of life, be prepared to increase your savings rate during market declines. Know ahead of time that this is an emotionally difficult thing to do. If you're in the distribution phase of your life, beware of your spending rate. Splurge a little while the market's up. Remodel or travel internationally. But reign in spending if the market drops. Eat at home more or try the staycation closer to home during the market down turns.

As always, call us to review your unique situation. We're here to help in good times and in bad. And remember that neither lasts forever.

"In a time of domestic crisis, men of goodwill and generosity should be able to unite regardless of party or politics."

-John F. Kennedy: 35th President of the United States

## What to Make of the "Trade War"

*(Continued from page 1)*

But if you aren't buying steel or semiconductors in bulk, you probably aren't experiencing a lot of economic pain from the tariffs. However, when the U.S. threatened to impose new 10 percent tariffs on an additional $200 billion of Chinese exports, and added Canada, India, Mexico and a lot of European Union products, suddenly there was potential collateral damage across a much broader spectrum of the economic landscape.

You can see the proposed trade war targets in a succinct chart, all of which would raise prices for consumers. For instance, a proposed import tax on automobiles, if reciprocated, would raise the cost of top-selling vehicles like the Toyota Corolla, Honda CR-V or Ford F150 by $1,000 each, due to taxes on car parts manufactured abroad. It would add $5,000 or more to the cost of imported vehicles.

This is already creating another loser: American workers. Harley-Davidson now plans to move some of its U.S. production overseas, firing American workers and hiring people in Europe, in order to keep its motorcycles competitive in overseas markets. General Motors has estimated that the proposed tariff on car imports would kill 195,000 automotive-related jobs over the next three years—and if targeted nations retaliated with their own tariffs (as they almost certainly will), the number could rise to 624,000. On a smaller scale, a Missouri nail manufacturer recently laid off 60 workers because it lost customers after it was forced to raise prices due to steel tariffs.

The list of proposed tax targets actually covers some 6,000 items, including clothing, handbags, suitcases, televisions and even dog collars. Most of these new levies won't go into effect until September at the earliest, and negotiations are ongoing, but there is no sign that the Trump Administration plans to back down.

Who else loses? What's often forgotten in all the talk about free trade is that a tariff is a tax that has to be paid by someone. Who pays? The cost is shared by manufacturers at home or abroad and the consumers who are buying those products. The additional $1,000-$5,000 cost of a new car represents monies collected by the U.S. government: specifically, the portion paid by car buyers. Many manufacturers will eat some of those additional costs and new supply-chain expenses for components manufactured outside U.S. borders, which represents a new (and largely hidden) corporate tax. A 10% tariff on $400 billion imports is $40 billion taken directly out of the pockets of American buyers and foreign manufacturers, while a retaliatory tariff would take $40 billion out of the pockets of U.S. manufacturers and foreign buyers.

It will be hard to find any reputable economist who thinks that a trade war is good for the U.S. economy, and in fact President Trump's own Republican Party has conspicuously not cheered his trade interventions. The U.S. Senate is quietly moving forward on a bill jointly sponsored by six Republicans and four Democrats that would curb the President's ability to unilaterally impose tariffs, which could become part of the next National Defense Authorization Act.

It is certainly possible to overreact to the trade war scenario. After all, $200 billion worth of goods represents less than 1% of U.S. GDP. The tariffs will hit larger-cap companies, which tend to sell their products around the world, much harder than smaller-cap firms which market themselves to the U.S. domestic market. Other countries cannot be expected to back down; who wants to have a gloating President Trump calling them a loser in his "war?"

The question will come down to: how much is the average American willing to pay, in new taxes concealed in the form of higher costs, to "win" a trade war whose benefits to the global or U.S. economy are murky at best? The campaign rhetoric to protect American industries, tear up multilateral trade deals and force trading partners back to the bargaining table sounds great in an election. But it doesn't sound as good when restated as: pay more for food, beverages, appliances and cars, deprive farmers of access to foreign markets—and maybe lose your job in the process.

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"Optimism is the faith that leads to achievement. Nothing can be done without hope and confidence."

-Helen Keller: American author, political activist and lecturer

“If you’re going through hell, keep going.

-Winston Churchill: British politician, army officer and writer

## What to Make of the “Trade War”

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