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360Insights

Quarterly Investing and Financial Perspectives

What's Inside

Rising Interest Rates... Should Investors Worry?

By **John Scruggs**, VP, Loring Ward

Interest rates are rising. What does that mean to investors? Relax. If you hold short-duration, high-quality bonds, the news is generally good.

First, a caveat: Predicting future interest rates is a treacherous business. The Federal Reserve lowered the federal funds rate to near zero in 2007-2008 in response to the Great Recession. Since 2009, "experts" have been predicting rising rates, but those predictions failed to materialize until the end of 2015 (six years later). The lesson: Nobody can predict the movement of future interest rates with certainty.

The more important question: What happens to the bond funds in your portfolio if interest rates rise?

Interest rate (or yield) changes affect bond funds in two ways: a price effect and a reinvestment effect. The two effects interact with one another. But what really matters to investors is the net effect on their portfolio.

Price effect

Bond prices and interest rates move in opposite directions. So if interest rates increase, bond prices decrease (and vice versa). Long-maturity bond prices are more sensitive to changes in interest rates.[1] Price effects show up immediately in daily prices and quarterly statements, so people tend to focus on them.

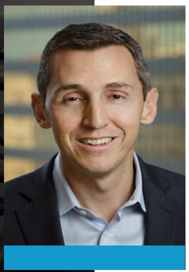
Reinvestment effect

The reinvestment effect is related to a fund's turnover. Since funds holding short-maturity bonds must replace their bonds more frequently, reinvestment effects tend to be stronger for funds holding shorter-maturity bonds. Thus, the yields of funds holding short-maturity bonds tend to respond quickly to changes in interest rates. However, the reinvestment effect only shows up in quarterly statements when bond funds pay higher dividends.

On balance, short-maturity bond funds have generally done well in rising interest rate environments — the net effect has been positive. Long-term investors typically enjoy higher yields in the future. The funds themselves tend not to be very volatile, and since most of the bonds in such funds are held to maturity, the negative price effects tend to be negligible in the long-run.

Remember that bonds in a portfolio are intended to help reduce overall volatility. Shorter-term bonds can generally help dampen overall portfolio risk, regardless of what happens with interest rates. It is always a good time to review your bond exposure with your own financial advisor to make sure that it's in line with your financial goals.

[1] A bond's sensitivity to changes in interest rates is known as its *duration*.



Investing vs. Speculating

By **Matt Carvalho**, VP, Loring Ward

While many stock markets around the world rose in 2017, truly stratospheric returns came from cryptocurrencies, with some (like Bitcoin) rising by more than 1,000%. Suddenly, cryptocurrencies were everywhere and many wanted to own Bitcoin, though few really understood it.

Do cryptocurrencies have a role in your own portfolio? To answer that question, it's important to understand the difference between long-term investing and speculating. Investors take a long-term view and look to place their money into assets that will grow in value over time, and intrinsically be worth more in the future. Speculators take on significant risks in the hopes of making quick profits. Which do you think is more likely to help you meet your long-term goals: investing or speculating?

Cryptocurrencies may be in the headlines, but as with any new technology the risks are high. Think about investing in other industries based on the belief that they were going to reap huge economic profits down the road…

Cell phones:

If you had invested in Nokia 15 years ago you would have watched it dwindle while smart phones took over the world

Search engines:

From Netscape to Alta Vista, more than 20 sought to catalog the evolving internet before Google came along

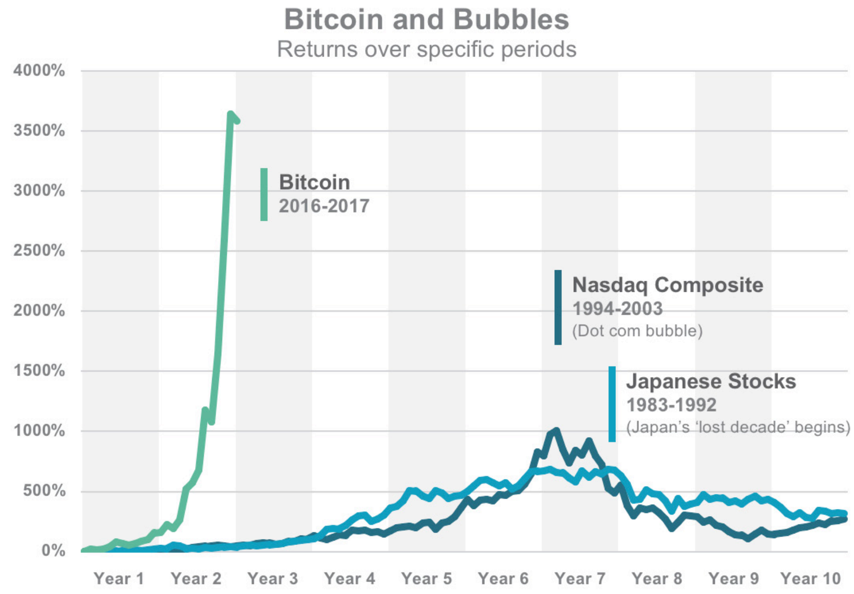
Social media:

Would you want to have invested heavily in MySpace?

Predicting the future of technology is hard enough, but predicting who will capitalize on its evolution is even harder. Speculating on a cryptocurrency is akin to trying to pick one car company that will profit from driverless cars, or investing in a startup aiming to cure cancer. There is a chance it could work out, but do you want to bet your ability to retire on picking the right company? And even picking the right company is no guarantee that company will do better than the market over the long term.

A recent article[2] from Dimensional Fund Advisors reminds us that our investment decisions should always be in relation to our goals: *Unlike stocks or corporate bonds, it is not clear that bitcoins offer investors positive expected returns. Unlike government bonds, they don't provide clarity about future wealth. And, unlike holding cash in fiat currencies, they don't provide the means to plan for a wide range of near-term known expenditures. Because bitcoin does not help achieve these investment goals, we believe that it does not warrant a place in a portfolio designed to meet one or more of such goals.*

[2] "To Bit or Not To Bit: What Should Investors Make of Bitcoin Mania?" December 2017, Dimensional Fund Advisors Issue Brief



Source: Yahoo! Finance and Morningstar Direct, 2018. Japan defined as MSCI Japan PR USD. Tech Stocks defined as Nasdaq 100 PR USD. Price Returns. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

When we think back to significant and rapidly increasing financial bubbles, two that often come to mind are dot-com stocks on the Nasdaq in the late 1990s and Japanese stocks in the 1980s. But as the chart above illustrates, those two remarkable runups of over 500% in a few years pale in comparison to the price increase — over 3500% — seen in Bitcoin over just the last two years.

The fear of missing out on the enormous gains won't go away anytime soon. There will always be an asset or part of the market that will look appealing. But true investors should keep in mind what they are investing in, and why they are invested in it. Changes to your financial plan should be based on changes in your own personal financial situation, not whatever new cryptocurrency the "experts" are speculating on that day.

Your New Quarterly Statement

You will notice your statement has a new look this quarter, as part of our recent technology upgrade. Have you checked out your new client portal? You can access your daily account balances, quarterly performance statements, and trade reports. We will continue to make enhancements to this new technology, including adding more information to your statement and making it easier to read. Please contact your Financial Advisor if you have any questions.

2017: Another Bad Year for Expert Predictions

By **J. William G. Chettle**, VP, Loring Ward

Every year, experts make bold pronouncements about the market and the economy. And every year, most of these predictions are wrong. If you had listened to the experts in 2017, you would have worried about global economic turmoil, a flat-to-disastrous stock market, even the end of the world. Instead, the U.S. economy continued to grow, most international markets were in positive territory, the S&P 500 returned 19% for the year, and the earth is still here.

Gurufocus.com tracks the performance of so-called market gurus, some of the best and brightest mutual fund and hedge fund managers in the world. Last year, the nearly 50 gurus tracked by Gurufocus.com returned 14.4%, almost 5% less than the S&P 500.[3] We believe it is better to focus on your long-term goals, and the ability of markets around the world to reward patient, diversified investors, than listen to the pundits and prognosticators and try to outsmart markets.

Here are 10 particularly bad predictions about 2017 that demonstrate the only thing we may be able to predict with confidence is that most predictions will be wrong.

1. “It really does now look like President Donald J. Trump, and markets are plunging. When might we expect them to recover? A first-pass answer is never… So, we are very probably looking at a global recession, with no end in sight.” **Paul Krugman**, *New York Times*, November 11, 2016
2. “Despite Trump euphoria, Wall Street’s 2017 forecast is the most bearish annual outlook in 12 years… Wall Street’s consensus S&P 500 forecast calls for a little more than a 5 percent gain in 2017.” CNBC.com, January 3, 2017
3. “Today’s stock market is priced at an all-time high and has been on a tear for eight years. My recommendation: Sell your stocks (and your long-term bonds, too) until the dust settles. If your stocks and long bonds are in retirement accounts, transfer them to short-term Treasuries.” **Laurence Kotlikoff**, Economist, *Seattle Times*, February 11, 2017
4. “With stock valuations high, it’s time to reduce your holdings.” **Robert Shiller**, economist at Yale University, CNBC, February 24, 2017
5. “The Fed has no clue, and will ruin us all… A $68 trillion ‘Biblical’ collapse is poised to wipe out millions of Americans.” **Jim Rogers**, co-founder of the Quantum Fund, *Bloomberg TV*, March 28, 2017
6. “This is one of the most dangerous market environments we’ve ever been in. It’s the calm before a gigantic, horrendous storm that I don’t think is too far down the road. The S&P 500 could easily fall to 1,600 [a 34% drop from current level].” **David Stockman**, former director of the Office of Management and Budget, CNBC, June 11, 2017
7. “It’s going to end extremely badly, with stocks set to plummet 40% or more…a gut-wrenching drop that would rival the greatest crashes in stock market history…. Investors are on the Titanic.” **Marc Faber**, Publisher, *The Gloom, Boom & Doom Report*, CNBC, June 23, 2017
8. “I have no stocks. I advise people not to invest in the stock market, not now. Way too dangerous.” Filmmaker **Michael Moore**, August 2017
9. “The S&P 500 has suffered a 7 to 10 percent decline in each year since 1995. I believe this year is no different — and that, in fact, such a decline is around the corner.” **Matt Maley**, equity strategist with Miller Tabak, CNBC, August 28, 2017
10. “I think Planet X is going to cause a whole series of catastrophes including asteroids striking the Earth…with one third of the grass and oceans and islands and so forth being destroyed…the US will probably be split in half, we will have experienced tsunamis, volcanic eruptions from Yellowstone, fire falling from the sky with trails of smoke, probably limited nuclear exchanges… I don’t think it’s going to be the same world.” **David Meade**, author and futurist, predicting a near collision between earth and an unknown planet, *Late Night in the Midlands*, September 30, 2017

[3] Gurufocus.com