Norman J. Politziner's
Financial Planning

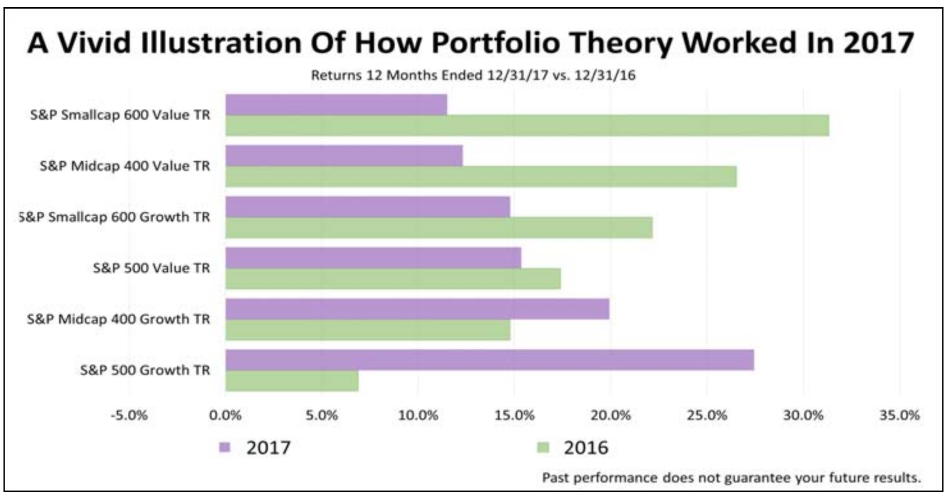
Fourth Quarter 2017 www.politziner.com (732) 296-9355

How Portfolio Theory Worked In Real-World 2017

For investors, 2017 was a mirror image of 2016. The top performing types of American companies in 2016 were the biggest laggards in 2017. Meanwhile, the worst performing types of U.S. stocks in 2016 were the biggest winners in 2017.

The orderly rotation of the leaders and laggards vividly illustrates how Modern Portfolio Theory worked in the real world last year. Modern Portfolio Theory is a large body of knowledge solution spawned of the research by several generations of the world's best minds for increasing the likelihood of investment success, and it is the framework for investing that this firm believes in.

Applying portfolio theory at the end of 2016 meant lightening up proportionately on the most-appreciated types of assets — small-cap value stocks — and buying more of the types of assets that lagged, the S&P 500



based on 70 years of research by investment academics. It's a framework for how investing is now taught in the world's best business schools and long embraced by institutional investors. Basically, classifying investments based on their statistical characteristics imposes a discipline for managing assets based on history and fundamental facts about the economy.

Of course, human judgment based on a good sense of history is critical in applying the theory to people in the real world. And all this doesn't guarantee success. It's a theory. But it is the best large-cap growth stocks. The exact amount of each type of asset is set based on your personal preferences and appetite for risk.

Usually, when you look at the returns of asset classes from one calendar year to the next, the performance seems random - there is no order to what occurred. The orderly reversal of leaders and laggards from 2016 to 2017 vividly illustrates a key concept in managing wealth prudently. In real-world 2017, then, the theory

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Time Flies When You're Having Fun

Yes, I realize that the banner on this newsletter says "4th Quarter 2017". However, let me explain...

Sometimes I like to sit back and reflect on things when everything quiets down, but nothing has been quiet since the beginning of the year. The weather, the markets, the news, my waistline... all seems to be so changeable... and volatile. There has not been the required respite to relax and ruminate.

So, in the midst of this global hyperbole, I would like to present an encouraging synopsis of two economic seminars I attended this past month. Each economist, Ed Yardini and Fritz Meyer, presented an upbeat report on the state of the economy.

The basic economic indicators are good. There is little inflation now and the long-term, 7% market trend seems to be on target. Earnings drive the market and corporate estimates are strong. There is strong global expansion which drives U.S. companies. 50% of U.S. company revenues come from overseas. The Federal Reserve will continue to raise rates, but the bond market is quiet. Technological disruption will continue to affect every business. Unemployment is low.

The current expansion has lasted 106 months, not the longest but still long, and this has been a "panic prone" bull market (61 panic attacks since 2009).

Both economists seem pretty bullish.

We shall see...

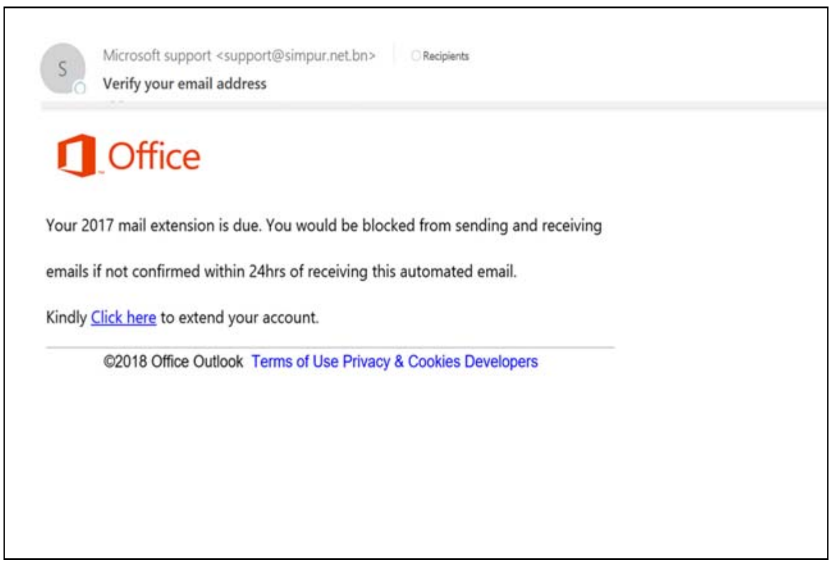
Norm

Six Tips To Avoid Phishing Scams

"Fake news" has exacted a high cost to American culture and political discourse, but the internet fakery that costs you time and money is phishing, emails diabolically aimed to trick you into opening your personal data to crooks and miscreants.

Phishing is the practice of emailing people purporting to be a reputable company to fool people into revealing passwords, credit card numbers, contacts, emails, internet accounts, and your most personal digital data. It's rampant. Whether you're using a smartphone, tablet, or computer, here are some tips for protecting yourself:

Mistakes. Phishing emails often are generated by teens or crooks with weak skills in English punctuation, grammar, and spelling. The phishing email from Office uses an improper style in "24hrs" and the capitalization of the phrase, "Kindly Click here" should arouse suspicion. When you look at this email's bottom line, the copyright is "Office Outlook." The logo is off. The product name is Office 365 and there is no mention of Microsoft in the copyright notice. Does the sentence Terms of Use Privacy & Cookies Developers make sense? It's a hint that this is a fake.



Reply email address. In this phishing email, the reply address at the top left says "Microsoft support," but if you look closer, the reply email address is "support@simpur.net.bn" and that is not a Microsoft address. The "bn" suffix is the internet country code for Brunei, and that's another telltale sign of fraud. Clever phishing emails often fake reply addresses in other ways. The easiest way to verify a reply email address is to double click on it and look at its properties. If the email purports to be from Microsoft or Google, will hitting reply send an email to a Microsoft or Google email account? If not, it's fake.

Links. Don't click on links in a suspicious email without being deliberate. The link could be a malicious website. Right click on the link and check its properties and see if the link goes to the company.

Slow down. The grammar, misspelling, bad links, and other telltale signs are easily overlooked when you're in a rush, and that's perhaps the reason why people become ensnared by phishing emails.

Verify before you trust. Trust but verify works for some things but not with internet security. First verify and then you can trust.

Secure Software. Microsoft and Apple release updates to computer operating systems continually and those are essential to staying secure. Anti-virus and anti-malware programs are also essential and they need to be kept updated with the latest fixes. ●

Bitcoin, Chasing Your Tail, And Investing

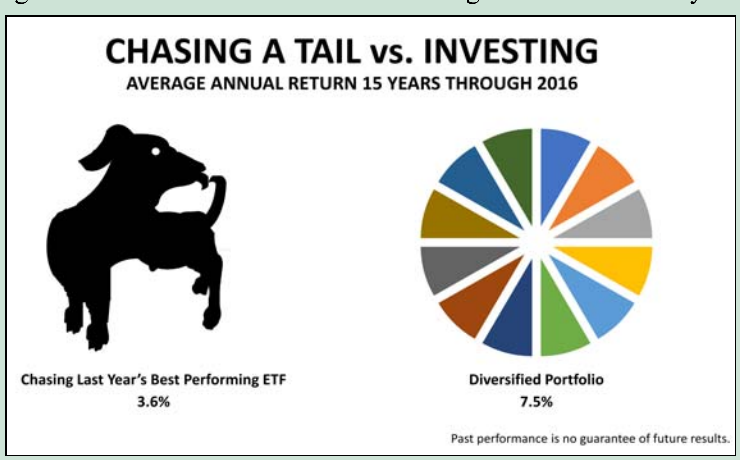
Thinking about Bitcoin? Could be a good time to hop on, right? Wrong! Usually, by the time the average investor jumps on a gaudy, freewheeling bandwagon, it's too late. The price spike has already occurred. If the investment is a fad, a sickening plummet may well await you.

Bitcoin blasted to a record high at rocket speed, hitting $19,783 on December 17, 2017, before plunging 25% in the next 10 days. The crypto-currency may yet be destined for greatness over the long-term, but its supersonic ascent and subsequent nosedive look much like other notorious investment fads.

In 1637, Dutch investors lost their bloomers on tulip bulbs. During tulip-mania, prices for bulbs reportedly rose from November 1636 to February 1637 by 2000%, according to academic research published on Wikipedia.

These objects of desire were flowers. It made no sense. The crash of the bulbs shattered lives and has ever since served as a beacon in financial history, warning investors of the risk in chasing performance.

Investing in Bitcoin makes little sense considering that it is one of many



Investing For The Long Run Amid Volatility

91-Years, 1926-2016

1926-2016	US Large Stock	US Small Stock	US Bonds	US Cash	4-Asset Portfolio Rebalanced Annually
Annualized Return	10.04%	11.31%	5.32%	3.45%	9.64%
Standard Deviation of Returns	19.9%	31.5%	5.7%	3.2%	16.6%

* Diversified portfolio rebalanced annually.

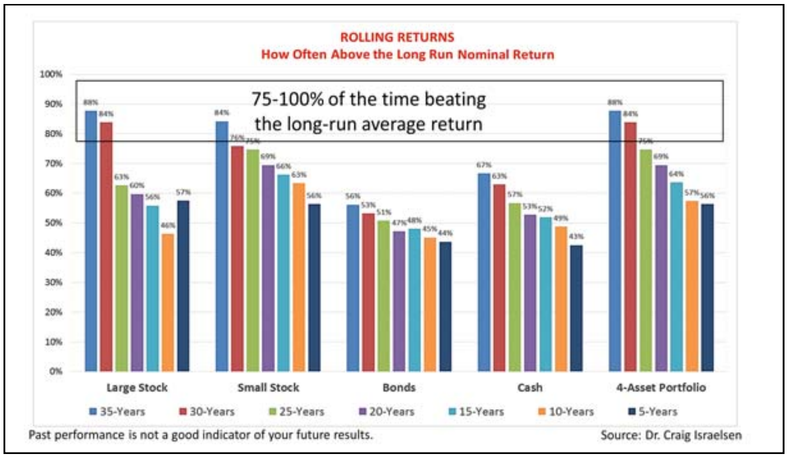
Source: Dr. Craig Israelsen, low-expense portfolio design consultant.

With stocks surging one moment and plunging the next, it's good to remember that, from 1926 through 2016, a portfolio diversified across stocks, bonds and cash averaged a 9.6% annual return, with a better risk-reward ratio than any one of the four investments with large liquid markets.

Ninety-one years goes back to when stock returns were first recorded on Wall Street, but most people don't invest for 91 years. The bar chart shows returns of the four investments versus the diversified four-asset portfolio over more realistic holding periods.

Over 35 years, large-company stocks beat their long-term average return over 91 years in a whopping 88% of the 35-year rolling periods! In contrast, over all of the 10-year rolling periods between 1926 and 2017, large-company stocks beat their 91-year return in only 46% of the 12-month rolling period.

In addition, the longer you stayed in the diversified portfolio, the more likely you were to experience the 91-year results. While holding the diversified portfolio for five years beat the 91-year return of 9.6% in 56% of the 12-month rolling periods over the 91 years, holding the four-asset portfolio for 35 years beat the 91-year results in 88% of the 12-month rolling periods. Diversification neither assures a profit nor guarantees against loss in a declining market and past performance is not a guarantee of future results, but these results show that the longer you invest, the more likely you are to experience the 91-year return and risk statistics.



Recently, volatility surged after investors were spooked by rising inflation and lending rates, and growing concern over the long-term U.S. debt. Statistically, the chance of a bear market decline of 20% or more increases as the eight-and-a-half-year bull market grows older, and the new tax law increased the chance of a Federal Reserve interest-rate policy mistake quashing growth for allowing inflation to surge. Fed mistakes caused every recession in post-World War II history.

However, earnings drive stocks and earnings expectations have recently surged. When the tax law was signed on December 22, 2017, the average company in the S&P 500 was expected to earn $131 a share in 2018, but that was revised to $152 and could be boosted again. S&P 500 operating earnings per share as of February 7, 2017 were $132.40 for 2017, $155.26 in 2018, and $170.93 in 2019, according to data from Yardeni Research, Inc. and Thomson Reuters I/B/E/S. According to independent economist Fritz Meyer, 2018 and 2019 estimates were revised up in December 2017 from, respectively, $146.19 and $160.69.

With real wages continuing to grow, consumers are spending and consumers account for 69% of economic growth. So, despite the recent correction, the bull market and economic expansion could strengthen and last many months longer. ●

crypto-currencies being mined on the Internet. The value of a crypto currency is set by supply and demand and supply is set by a software program that's not tied to a sovereign state. Transactions are easily hidden from tax authorities. Ultimately, crypto-currencies compete with sovereign nations, which is why some governments are starting to move to regulate them. In the time this was written, not only had the price of Bitcoin plunged 25%, but South Korea became the first nation to ban all anonymous crypto currencies and regulate the rest.

Bitcoin's ascent was easy to spot as a mania, but the modern-day danger inherent in chasing hot performing investments is often far less apparent. For example, say you bought the No. 1 performing Exchange Traded Fund annually for 15 years through 2016. Sound like it could be a strategy for success? Think again, according to Dr. Craig Israeslen, Ph.D., who teaches portfolio design techniques to financial professionals. Your average annual return was 3.6% — less than half the annual return of a broadly diversified portfolio invested across 12 different types of assets equally and rebalanced systematically every year over the same 15-year period through 2016.

Human nature makes people susceptible to investment manias, shiny bright objects like Bitcoin, and chasing last-year's winners. It's why people will always need investment professionals to stay focused on economic fundamentals, quantitative analysis, controlling fear and greed. ●

US Large Cap represented by S&P 500 Total Return Index; US Small Cap represented by S&P Small Cap600 Total Return Index; US Bonds represented by Barclays US Aggregate Bond Index TR USD; Cash represented by USTREAS Stat UST-Bill 90 Day TR.

Giving More To Loved Ones – Tax-Free

While it may be better to give than to receive, as the adage contends, both givers and receivers should be happy with the new tax law. The annual amount you can give someone tax-free has been raised to $15,000, from $14,000 in 2017.

Exempting $15,000 annually from gift tax, over time, transfers a lot of wealth to those you care about during your lifetime, while avoiding the tender mercies of the tax man, and married couples can have double the fun.

Take the example of a husband and wife with three married children and six grandchildren. The husband can give $15,000 each to his married children and the same amount to their spouses, and also $15,000 to the half-dozen grandchildren — totaling $180,000 — and his wife can do the same for the same 12 beneficiaries. The grand total is $360,000 per year. No federal tax will be levied on these transfers of your wealth to family as well as friends.

In addition, you can give more than the annual exemption caps for college savings. The Tax Cuts and Jobs Act (TCJA) permits bunching five years of $15,000 annual gifts into one year, by plugging it into a 529 college savings plan for a child or grandchild. That's $75,000 in total. Assets in 529 savings plans grow tax-free, if used to pay qualified education expenses.

Gifts made during your lifetime reduce your exemption from tax on your estate. The TCJA more than doubled the estate tax exemption in 2018 from $5.5 million to $11.2 million for individuals, and from $11 million to $22.4 million for couples. All of these new levels will increase with inflation, though the formula annually adjusting inflation is less generous than before.

Lifetime gifts can be made directly or through trusts. With a trust, you place the gift of cash, securities, or other assets in an entity set up to make transfer of wealth after you die. The assets in the trust avoid probate court, and makes the transfer faster, less costly, less likely to be contested, and generally more sure-footed. Trusts can influence the values of your progeny by requiring the money you leave to be spent for religious, philosophical, or any variety of educational activities.

A trust also shields assets left to your heirs from lawsuits and business creditors. Should your grandchild get divorced, the trust money is shielded.

The friendlier tax treatment of transfers under the TCJA affects your estate plan and how your assets will be spent after you are gone, but it also may change your plan for gifting during your lifetime. Giving assets during your lifetime can be satisfying because you can witness your impact and influence on the future of your family. ●

How Portfolio Theory Worked

(Continued from page 1)

worked exactly the way it's supposed to — it was uncanny.

Global stock market returns in 2017 versus 2016 reflected a similar mirror image. Although the seven types of U.S. and foreign stocks did not prove the theory quite as perfectly, the biggest winners of 2016, small-cap U.S. stocks, were the biggest laggards of 2017, and the biggest laggards of 2016 were the biggest leaders of 2017.

The real world of investing in 2018 is filled with uncertainty. Tax reform could accelerate economic growth and prompt the Federal Reserve to make a policy mistake by squelching growth or allowing the economy to overheat and inflation to surge.

The political scandal in Washington could devolve into a constitutional crisis or the nuclear standoff with North Korea could erupt with terrifying consequences. A 10% or 15% drop could occur at any time on bad news and the chance of a bear market decline of 20% or more increases as the eight-and-a-half-year bull market grows older.

On the other hand, the bull market could continue in 2018 and beyond, and prices could head much higher. The economy shows no sign of slipping into a recession; leading indicators signal a strong start to 2018; the world economy is growing in synchronicity with the U.S. - the first time that's happened in many years; and the new tax law is expected to boost earnings sharply and that's what drives stock prices.

You can't be sure what the future holds, but seeing how well portfolio theory worked in the real world in 2017 may give you comfort and boost your confidence to stay committed to a program of long-term wealth management and financial planning. ●

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