# Demming
Financial Services Corp.

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July 2018- September 2018

## 3rd Quarter

### Heads Up…

Due to regulatory changes, account updates may be required on your T.D. Ameritrade accounts. Thanks in advance for your help and cooperation in updating your accounts.

As a friendly reminder, for your protection, it is our ongoing policy that any requests for funds sent to us via email will also be confirmed by phone.

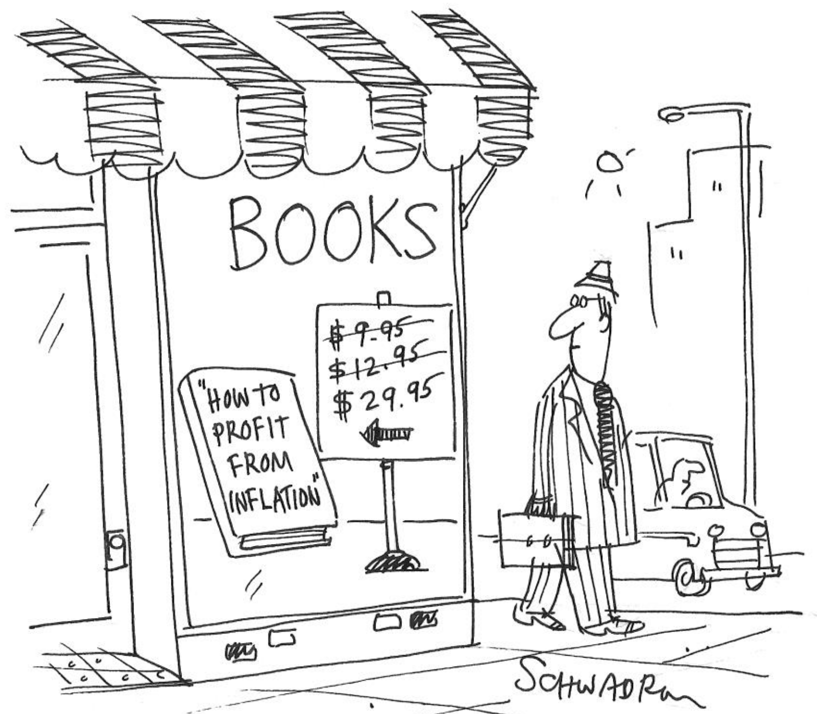
Please be sure to let us know if there are any changes to your contact information (address, phone number, email, etc.)

Please note, the main inbox for prompt email correspondence is info@demmingfinancial.com!

Also, please be sure to check out our website at www.demmingfinancial.com!

# Deficit Funding

Many were alarmed when, on June 5, the good people who run Medicare and Social Security released a report that said that the Medicare program will become insolvent in 2026 and Social Security will face a similar fate in 2034. The Medicare projection is three years earlier than the previous report, while the Social Security projection is unchanged from previous estimates.




These problems are not new, of course. People are living far longer than anticipated when Social Security was created in 1935; in fact, the average life expectancy for a person who managed to reach age 30 at that time was age 68 for men and 70 for women. Today it's 79 for men and 82 for women. Meanwhile, Medicare has been hit with higher-than-inflation medical expenses—along with, of course, those longer lifespans.

Alarmists point out that the Social Security and Medicare Trust Fund reserves are "invested" in government securities, which is essentially the government writing itself an IOU—currently to the tune of $2.8 trillion, which is the total "asset reserves" in our largest social programs. Individuals are advised not to run their own finances this way, accumulating deficits but meticulously keeping slips of paper around which represent a promise to pay back every single nickel and dime eventually. But in fact, today nearly all of the money paid out to Social Security recipients, and on behalf of Medicare enrollees, are simply transfers of money paid into the program by workers. The money comes in in the form of FICA payments and taxes on Social Security benefits, and goes back out the door to beneficiaries.

So, where's this alleged deficit? That can be found on page 9 of the report, in a section labeled "Assumptions About the Future." There, the report makes economic projections about the next 75 years, including the future fertility rate (children per woman), mortality, the annual percentage change in worker productivity, average annual wage increases, inflation, unemployment and the interest rate earned by those IOUs the government is writing to itself. Page 18 shows a graph that illustrates the projected outcomes of three different sets of assumptions for all these (basically unknowable) variables, and one can see that two of them are, shall we say, not optimal, while the third projects not just solvency, but actual prosperity for the combined trust funds going forward well past the year 2090.

Even if the worst case comes to pass, and the programs goes "bust," they won't actually stop paying benefits. There will still be workers who pay FICA taxes, and even if there is no trust fund, these collected payroll taxes can be transferred, as they are now, to Social Security and Medicare recipients. The Social Security trustees report, on page 58, how much of the projected payments would be covered by workers going out to 2090 under the three future scenarios. The worst-case scenario says that there will be roughly an 18% shortfall in 2040, rising to roughly 22% by 2090. Basically, that means that Social Security recipients, worst case scenario, would have to get by on 82% of the benefits they were expecting in 2040, and 78% if they manage to live all the way out to 2090.

And, of course, that's if nothing is done to shore up the program between now and then. One of the simplest options on the table is to raise the age people can collect full retirement benefits as the average lifespan goes up, basically "indexing" retirement benefits to changes in longevity. Congress could marginally raise FICA taxes or impose more taxes on Social Security income.

The best advice here is not to panic about the fate of our country's social programs. There is no question we need to address their solvency, and with gridlock in Washington, that seems like a bit of a long shot. But even if Congress can't agree on tweaks and fixes, the world won't come to an end. Social Security and Medicare recipients will have to tighten their belts a bit—and maybe start voting for candidates who offer real solutions to the budget issues in Washington.

Have you ever wondered how often the average person interacts with his or her mobile device? As it turns out, the mobile research firm Dscout, Inc. has the answer! According to its statistics, the average person taps, pokes, pinches or swipes his/her personal phone an astonishing 2,617 times a day. It adds up to about **2 hours and 25 minutes of interaction a day**.

According to a 2016 survey of more than 2,000 executives and human resource managers, conducted by HR software and services firm CareerBuilder, smartphone use is now the leading productivity killer in the workplace. A later study, by the University of Texas and the University of California, found that even when workers had their phones placed on their desks—untouched—their cognitive performance was lower than when their devices were in their pocket or handbag. Mobile devices are both distracting and addictive.

If you're curious whether you are above or below the average, there's now an app called Moment that can be downloaded onto iPhones, where it will track the total daily amount of time you spend on your phone. One product manager has asked his staff to use the app and post their daily hours on a whiteboard at the office. The team member with the lowest time gets bragging rights. (The next version of the Android phone operating system will include a feature that will let users see how much time they spend on their phones, which apps they use the most and display how often the phone gets unlocked.)

A growing number of corporate managers have banned smartphone devices altogether at their staff meetings—but they say they've received hard pushback from their workers, and by and large the bans have been ineffective. Staffers simply wear smart watches or bring a laptop, which can be just as distracting from those Excel spreadsheet slides in the PowerPoint presentation the office manager is delivering.

## 2018 Second Quarter Market Report

The U.S. equity markets suffered a small setback in the first quarter, but the second quarter brought us back into positive territory.

The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—finished the quarter up 3.83% and is now in positive territory for the first half of the year, at +3.04%.

Large cap stocks more than recovered their earlier losses. The Wilshire U.S. Large Cap index gained 3.41% over the past three months, to finish up 2.62% for the first half of the year. The widely-quoted S&P 500 index of large company stocks gained 2.93% in value during the year's second quarter, rallying to a 1.67% gain so far in 2018.

Meanwhile, the Russell Midcap Index is up 2.35% in the first six months of the year. As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies posted a 7.87% gain over the second three months of the year, and now stand up 7.08% at the half-year mark. The technology-heavy Nasdaq Composite Index finished the quarter with a gain of 6.31%, and is now up 8.79% at the halfway point of 2018.

International stocks are not faring quite so well. The broad-based MSCI EAFE index of companies in developed foreign economies lost 2.34% in the recent quarter, and is now down 4.49% for the year. In aggregate, European stocks were down 2.74% over the last three months, posting an overall loss of 5.23% for the year, while MSCI's EAFE's Far East Index lost 3.24% in the second quarter, down 3.33% so far in 2018. Emerging market stocks of less developed countries, as represented by the MSCI EAFE EM index, went into negative territory for the quarter, down 8.66%, for a loss of 7.68% for the year.

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, gained 9.73% during the year's second quarter, and is just eking out a 1.52% gain for the year. The S&P GSCI index, which measures commodities returns, gained 8.00% in the second quarter, up 10.36% for the year.

In the bond markets, coupon rates on 10-year Treasury bonds have continued an incremental rise to 2.86%, while 30-year government bond yields have risen slightly to 2.99%. Five-year municipal bonds are yielding, on average, 2.00% a year, while 30-year municipal are yielding 3.00% on average. What's going on? There appear to be several forces fighting for control over the investment markets.

The current bull market started in March of 2009, and seemed to be running out of steam in the first quarter, before a sugar high—the stimulus provided by the recent tax bill—kicked in for companies that have traditionally experienced higher tax rates.

This pushed a tired bull market forward for another quarter, and could do the same for the remainder of the year. A fiscal stimulus in the ninth year of an economic expansion is almost unheard of, but it is clearly having an effect: economic activity was up nearly 5% in the second quarter, unemployment has continued a downward trend that really started at the beginning of the bull market, and corporate earnings—with the lower corporate taxes factored in—are projected to increase roughly 25% over last year.

The other contestants for control of the economy seems destined to lose this year and possibly start winning in 2019. The Federal Reserve Board has raised short-term interest rates once again, and has announced plans to continue in September, December, next March and next June. Meanwhile, the labor markets are so tight that there are more jobs available than workers to fill them. Won't this eventually force companies to share their profits in the form of higher salaries. And there are potential problems with the escalating trade war that America has picked with its trading partners that will almost certainly not have a positive impact in the long term.

Bigger picture, the flattening yield curve—where longer-term bonds are closer to yielding what shorter-term instruments are paying—is never regarded as a good sign for an economy's near-term future. It's worth noting that the financial sector—that is, lending institutions—was one of the economic sectors to experience a loss. Banks borrow short and lend long, and there isn't much profit in that activity when the rates are about equal.

Beyond that, in a good year, corporate earnings would grow around 5%, so one could argue that the economy is now experiencing five years of earnings growth. Add these factors to the doddering age of the current bull market, and you have to wonder how long the party can continue. Nobody knows what tomorrow will bring, but everybody knows that bull markets don't last forever. This may be a good time to mentally prepare for an end to the long bull run, and to hope it ends gracefully.

## The Tao of Wealth Management

The path to success in many areas of life is paved with continual hard work, intense activity, and a day-to-day focus on results. However, for many investors who adopt this approach to managing their wealth, that can be turned upside down.
The Chinese philosophy of Taoism has a phrase for this: "wei wu-wei." In English, this translates as "do without doing." It means that in some areas of life, such as investing, greater activity does not necessarily translate into better results.

In Taoism, students are taught to let go of things they cannot control. To use an analogy, when you plant a tree, you choose a sunny spot with good soil and water. Apart from regular pruning, you let the tree grow.

This doesn't mean that we should always do nothing. In fact, insights from financial science suggest you should direct your investment efforts to the things you can control. These include taking account of your own preferences and sensitivities when choosing investment strategies, diversifying your allocation to moderate the ups and downs, being mindful of the impact of fees, and exercising discipline when emotions threaten to blow you off course.

Successful investing requires taking actions that can have a positive impact on the outcome. For instance, to maintain their desired asset allocation, investors should regularly rebalance their portfolio by reallocating money away from strongly performing assets.

But rebalancing is a disciplined, premeditated activity based on each person's circumstances. It contrasts with the "busyness" of reflexively following investment trends and chasing past returns promoted through financial media. Look at the person who fitfully watches business TV or who sits up at night researching stock tips. That sort of activity is likely counter-productive and can add cost without any associated benefit. With investing, constantly tinkering with an allocation does not perfectly correlate with success.

Now, while that makes sense, many people struggle to apply those principles because the media tends to look at investing through a different lens, focusing on today's news, which is already priced in, or on speculating about tomorrow. Guesswork can surely be interesting. But is it relevant to your long-term plan? Probably not.

People caught up in the day-to-day may constantly switch money managers based on past performance, or attempt tactical changes in their allocation, or respond in a knee-jerk way to news events that turn out to be noise.

Again, the assumption underlying these approaches is that if you put more effort into the external factors and adjust your position constantly, you will get better results. Unfortunately, people may end up earning poorer long-term returns from trading too much, chasing past performers, or attempting to time the market. Ultimately, that's just another reminder of the potential benefits available to disciplined investors who stay focused on what they can control. As the ancient Chinese proverb says: "**By letting it go, it all gets done. The world is won by those who let it go. But when you try and try, the world is beyond the winning**."

Article Courtesy of: Jim Parker Vice President DFA Australia Limited

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*Article Courtesy of: Bob Veres with minor edits by David W. Demming Jr. CFP®*

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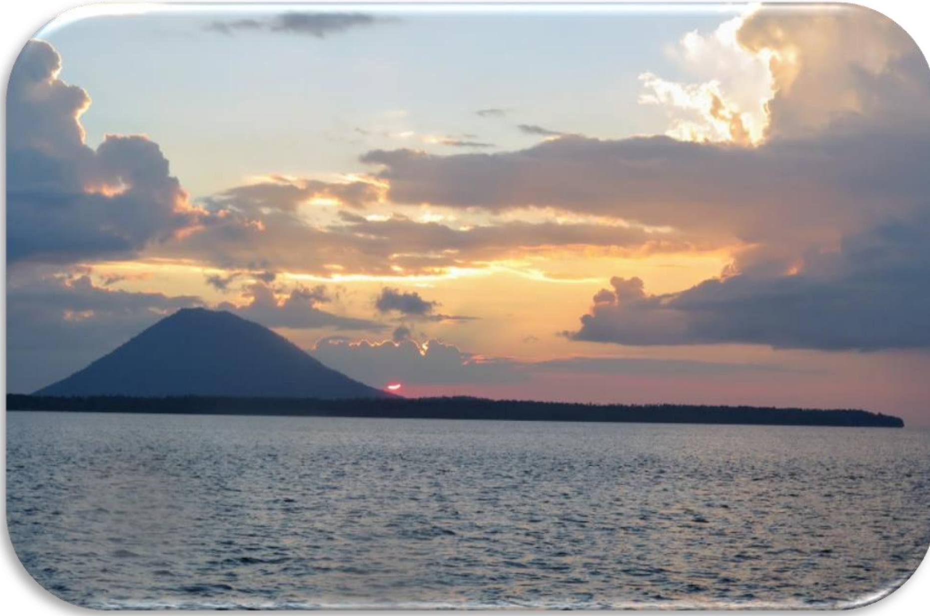

**2018 Indonesia Trip**

Photo taken by David W. Demming Sr.

***Please send a copy of your 2017 Tax Returns. Feel free to send them or request your preparer to send them to info@demmingfinancial.com.***

***Thanks!***