



Are you an Econ or a Human ?

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A fashionably quirky American Professor recently won the Nobel Prize in Economics. Richard Thaler's work over several decades centered around re-thinking some assumptions regarding how humans act as regards financial matters.

The widely held legacy economist's view was (often still is) that humans are entirely rational and, provided good information, will direct their lives towards appropriate incentives and act in their own self interests. Based on these assumptions, policies were adopted and programs were enacted around the world by governments, central banks, financial service firms, etc. One big snag - the majority of people didn't act as predicted. As a result, many of the programs failed miserably.

Thaler believes, as regards finances, there are two distinct types of people. He calls them Econs and Humans. The significantly smaller group, Econs, are the quintessential rational actors. They save and invest intelligently, don't spend impulsively, and are adept at keeping emotions from interfering with their financial decisions. Humans are the rest, given to letting all sorts of biases impede taking actions that are in their best interests over the long-term. This explains, he asserts, why programs developed

by trained economists fail, because they expect the majority to act like Econs, when the opposite is true.

Thaler and several cohorts gave lectures and wrote articles and books on this subject widely known as Behavioral Economics. Slowly their ideas began displacing the rational-human dictate.

In what is likely their most well-known publication, "Nudges", Thaler and his co-author offered alternative strategies with the goal to create better outcomes, ones that benefit both the individual and their company, society, nation, etc.

Example: In some companies new employees are automatically enrolled in 401-k programs, with the option to opt-out if they wish. Although I see different percentages, the results are clear: many, many more people began retirement savings plans when they weren't asked to make a decision, the default took care of it for them. They were nudged in a smart direction.

Examples of Humans are also plentiful in investing. Thaler writes about stock valuations, where people pay absurdly high prices for companies, way above any rational basis. Remember the Palm Pilot ? He reminds us that in July 2000, 3

Com spun-off 20 % of Palm in an IPO. Subsequently Palm's market capitalization (the value of all its stock), was greater than 3 Com even though 3 Com still owned 80 % of Palm's stock, plus it had all its other business segments too. This is just one of many examples that markets are not always efficient, caused mainly by irrational people.

So which are you ? I'm in my 32nd year as an Investment Adviser, over those years a lot, maybe most of my clients were very rational as regards their money. They were willing to defer gratification and save a lot of money. They understood this was the most likely way to ensure a stable economic future. They bought homes and cars they could afford, didn't need the latest fashions to feel good about themselves, and tried to teach their children these habits as well.

When I observe the 'average' American's personal finances, however, I think Thaler is mostly right about Humans. But I know a lot of financially successful Econs. And if you're not one, today is a great day to start adopting their strategies. It will likely have a very positive effect on you and your family's future.

The Calm Before the Storm?

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Numerous data points show overvaluation in just about everything from the traditional capital markets in debt & equity to RE and the new “asset class” of cryptocurrencies (Bitcoin, Ethereum, etc.). Yet broad market indices keep inching higher to record levels with record low volatility, as measured by the VIX (CBOE Volatility Index), aka the “fear gauge”. Recent VIX readings below 10 compare to levels above 80 during the most acute phase of the Global Financial Crisis (GFC) in late 2009. The 10-year chart below compares the VIX (dark line) with the S&P 500 (light line). We’re clearly back to the level of complacency seen just before all hell broke loose during the GFC.



The price-insensitive technical & indexing systems driving this are mindlessly buying more of the same (emphasis on FAANG & other mega-cap names) until something triggers them to reverse course. What might that look like when it occurs? Having been in this business for almost 35 years, I (and most folks of a certain age) can recall the following:

30 years ago – 10/19/87 (Black Monday) was the worst day in Wall St. history, with the **DJIA** falling - **23%** in a single session.

17 years ago – 3/10/00 was the **Nasdaq** peak during the dot-com mania, followed by a **-78%** decline over the next 2 ½ yrs.

10 years ago – 10/9/07 was the beginning of the worst bear market since the 1930s, with the **S&P 500** falling **-57%** over 18 mos. during the GFC.

I keep reminding myself of how bad it can get when markets head south & believe it is crucial to be able to weather these infrequent, but severe, episodes. I continue to play defense in a major way, holding cash, bonds, short ETFs, stop-loss orders and ETFs that own gold bullion and miners. ETF = exchange traded fund. All are intended to hold value or appreciate in the face of broad stock market declines.

In the words of Warren Buffett, “We must be fearful when others are greedy, & greedy when others are fearful.” Only extreme caution during this time of unprecedented economic and political turmoil can we accomplish this in a way that will meet our financial and retirement goals.

Fee Based or Broker?

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One question I get frequently is what is the difference between a Fee-Based Adviser and a 'Stock Broker' who gets paid when the client makes trades? While many factors go into what type of relationship you should enter, knowing the differences between the two might help you make that decision. Our office offers both types, depending on which is most beneficial to the client.

I will start with Fee-Based Advisers. These are generally clients who pay an annual, ongoing fee, for their adviser to make trades on their behalf inside their account. Investment Advisors are expected to act as Fiduciaries; meaning they must always act in the best interest of their client. The adviser does not make commissions on trades, but is tasked with keeping the portfolio suitably invested for their client. They may trade often, or rarely, depending on the client's situation or current market conditions. Most 'fee-based' clients give the adviser discretion on their accounts, so the adviser does not need to call them before making trades in their account, giving the adviser flexibility to trade when he thinks is best.

However, many clients who may have different needs may choose to find a broker to help them with their portfolios. In this relationship, the broker gets paid when trades are made in the client's account. Perhaps the client is just getting started with some 'buy and hold' investments, and the yearly fee may not be in their best interest if they do not plan on adjusting their strategy for a long time. (This is especially true with younger investors who may hold the investments for a

long time while working towards retirement.)

There are also plenty of 'hands-on' investors; those who like to make the decisions inside their account, but need a resource on how to best invest towards that strategy. They possibly are looking for a specific type of fund or asset class to invest in, and use us a resource to find a suitable investment for them. These investors have a general idea of how they want their portfolio built and how much risk they want to take, but use brokers to select the actual investments.

We also find that with time, the needs for the adviser's assistance may possibly change. Many investors who started out as brokerage clients have moved to having their assets managed now that they are nearing retirement and need a more active approach to managing their investments. Buy and hold is no longer suitable, and they hire us to manage their assets comprehensively.

Most importantly, find somebody you trust. Nobody knows short term what the market is going to do, so trusting and believing in your adviser's strategy is very important. Long term investing can be a very bumpy ride, make sure your investment professional is sitting on your side of the table. If you want to discuss your situation more in detail to uncover what's best for your situation, please feel free to give me a call.

Global Debt Spiral

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Remember, this debt mania is a global event and has been aided and abetted by central banks around the world – in particular the Federal Reserve, European Central Bank and Bank of Japan. The warnings are not just coming from the U.S. What the central banks have done is print money and with that printed money they buy bonds and drive interest rates too low. Those low interest rates encourage debt – lots of it. The European central bank and Bank of Japan continue to print massive amounts of money for such purposes. This helps keep rates low in the rest of the world. As stated on Bloomberg related to “the developed world hegemony was doing it in tandem. My low rates are your low rates.”

Jim Rogers stated the following in a RealVision interview on September 20:

“Janet Yellen will tell you that we’re not going to have a bear market again, because she’s smarter than we are, she’s smarter than the markets, and the central bank has things under control now. She’s publicly stated this. ‘Do not worry we will not have a financial calamity again.’ Head of the central bank in America said that out loud, officially. Mrs. Yellen.”

I will interrupt with the following headline from CNBC:

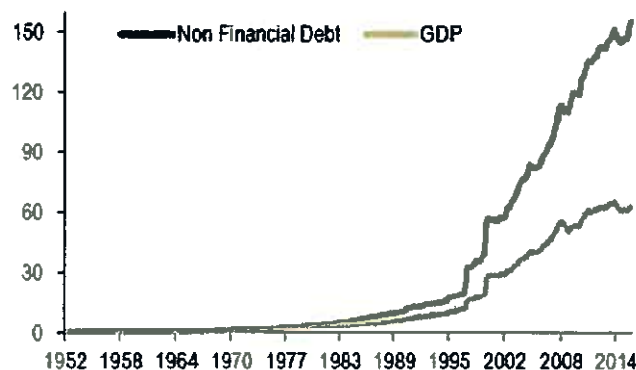
Yellen: Don't expect another financial crisis in our lifetime

1:27 AM ET Wed, 28 June 2017

Rogers continues: “I happen to have a different view. We’ve had – we used to have – bear markets every several years. We always, always, since the beginning of

the Republic. In my view we will have them again and the next one is going to be horrendous... The worst in your lifetime. And the reason, you know in 2008 we had a bear market because of too much debt. Staggering amounts of debt. Since 2008 the debt has gone through the roof. Every country in the world talks about austerity, nobody has reduced their debt in the last few years, everybody has increased their debt in the last few years and so the next time we have a bear market it’s going to be horrendous.”

Chart 2: Growth of Global non-financial debt vs GDP



Source: BofA Merrill Lynch Global Research, BIS. Data for 47 countries making over 90% of world GDP. Note EM countries only have data since 1997. Eurozone countries added in 2000. Non-financial debt includes government, non-financial corporates and households.

The following comment is from ZeroHedge on September 13: “As a result, both the global economy and central banks are now held hostage by both the unprecedented stock of debt injected into capital markets over recent years to offset the financial crisis depression, and the record low interest rates associated with it.”

Some recent news:

Financial Times: Global debt woes are building up to a tidal wave.

Bloomberg: In Debt We Trust For U.S. Consumers With \$12.7 Trillion Burden.

Financial Times: Wolfgang Schäubel Warns of Debt-Driven Global Financial Crisis.

Wolfgang Schäubel has been the German Finance Minister. Quoting Schäubel: “Economists all over the world are concerned about the increased risks arising from the accumulation of more and more liquidity and the growth of public and private debt.”

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