rebalance

Market Review

Fall 2018

Invest in Happiness

To varying degrees, we all find ourselves struggling and often confused about our emotional relationship with money and how it brings us more or less happiness.

Will a market collapse change my life? Do I have enough? Am I doing the right thing with the money that I've made? I know there is a correction coming and I don't want to live through that again!

You are not alone. Even the Beatles were torn over the subject, declaring, "You can't buy me love," and then lamenting in another, "Your lovin' don't pay my bills –– give me money. That's what I want." Years later, even Bruno Mars' hit single "Billionaire" was about his craving for money "I wanna be a billionaire… buy all of the things I never had."

At **Rebalance**, our job is to manage your hard-earned money, the results of your years of toil and effort. We want you to have less stress and more energy to focus on other aspects of life that make you happy.

We know that in investing, acting on emotions usually leads to disastrous portfolio decisions. We often talk about the science of our investment process and why decades of academic research have proven that "portfolio indexing" is a superior way to invest. But using science and data to convince a client not to panic over the stock market can only go so far.

Emotions and World Markets

Since our emotions often dominate logic, let's look at some studies about emotions, money, and happiness.

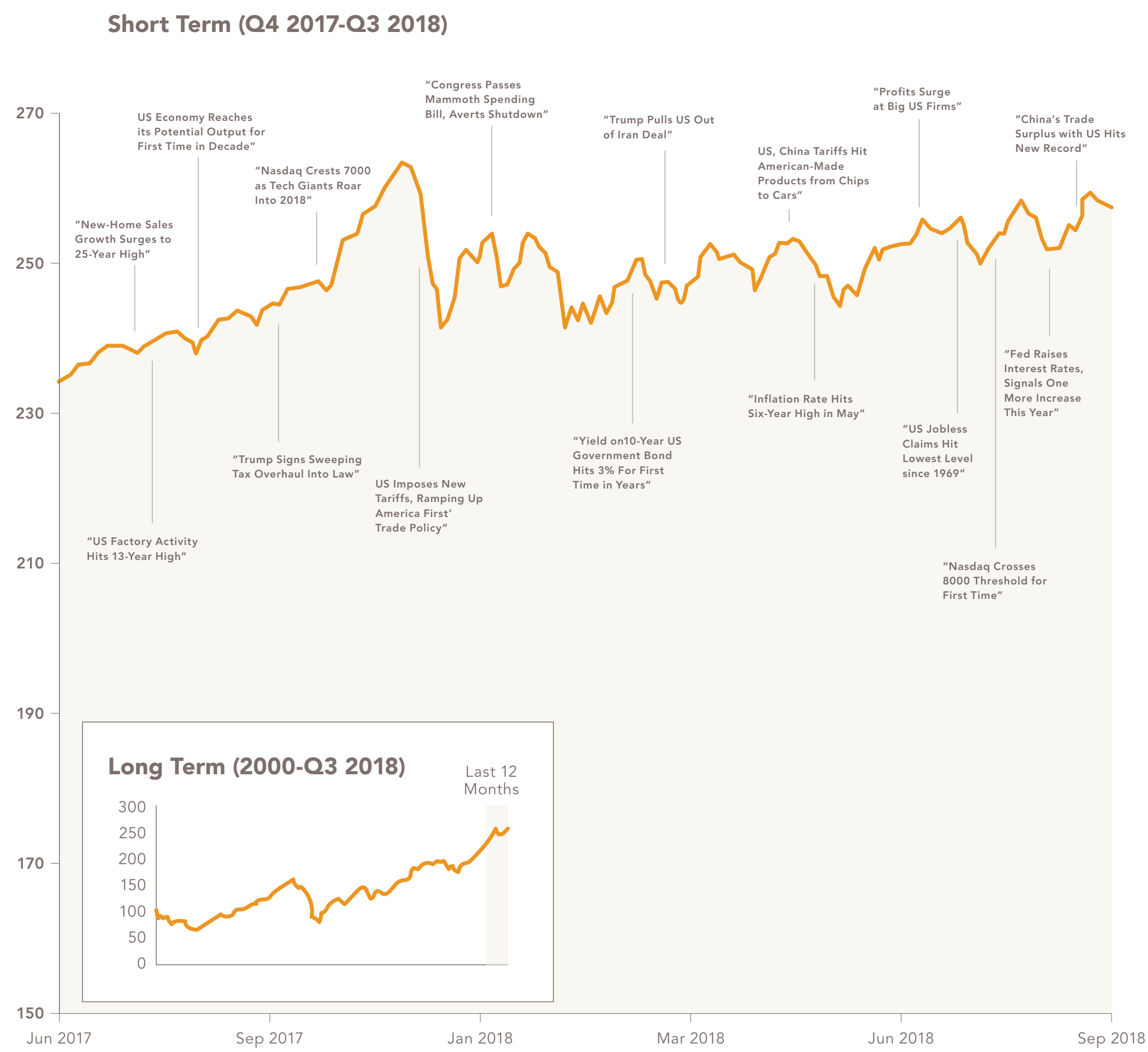
In a 2011 study, two Princeton professors, Angus Deaton, Ph.D., a renowned economist, and Daniel Kahneman, Ph.D., a Nobel prize-winning psychologist, analyzed Gallup worldwide data to help clear up the conundrum of money and happiness. The results stirred interest in this ancient debate, answering the age-old question with the discovery that annual earnings above $75,000 (in 2018, inflation-adjusted to about $85,000) fails to add to an individual's happiness.

"No matter where you live, your emotional well-being is as good as it's going to get at $75,000," says Dr. Deaton, "and money is not going to make it any better beyond that point. It's like you hit some sort of ceiling, and you can't get emotional well-being much higher just by having more money."

More money beyond what we need doesn't help because people adapt quickly to the things money can buy. An expensive car is exciting for a month or two, but soon it's just another car. Thinking less about money and financial security, as opposed to net worth, also plays heavily into an individual's happiness.

World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months



Asset Appreciation and Enjoyment Depreciation

Daniel Gilbert at the University of Liège in Belgium took the Gallup findings further through his research into what is now known as the "experience-stretching hypothesis." His studies demonstrate that when individuals experience greater luxuries, their ability to appreciate the simpler pleasures in life decreases incrementally.

These findings put an ironic twist on the American dream of wealth and the good life. As Gilbert points out, just when someone finally has gathered the discretionary income to enjoy the finer things, he subconsciously trains himself to lose appreciation for the common daily pleasures.

Jonah Lehrer of *Wired* magazine commented on these findings, stating, “Strangely, the more we indulge our desires, the more we end up simply needing more. Discovering satisfaction, the ability to appreciate all we already have, is revolutionary.”

Researchers found two categories of happiness that do correlate to wealth. The first relates to our overall assessment of our life, rooted in how we compare ourselves with our peers.

The second type of happiness was “day-to-day contentment” as measured by behaviors such as laughter, smiling, joy and what researchers call “social-psychological well-being.”

One of the more revealing findings was that the more time we spend thinking about money, the lower our happiness rating becomes. When researchers exposed subjects to pictures of large amounts of dollars or euros, their savory rating (a measurement of how good the subject felt towards images of a sunset, a panorama and the like) substantially decreased.

Buying more happiness

When we sense that our life is financially secure, we score higher in terms of day-to-day happiness. As Dr. Ed Diener of the University of Illinois points out, one individual may have a motorhome while another a mansion. If the person with the motorhome feels secure that it will never be taken, then his happiness rating will be higher than the individual who is fearful of losing his mansion. This security principle underscores the importance of living within one’s budget and not putting retirement capital at unnecessary and higher risk.

Other findings reveal that money can in fact be useful in promoting well-being in several surprising ways:

1. Give to charity: Charitable giving was shown to improve a person’s sense of happiness. When people free up money to support a cause they believe in, their happiness rating increases. Try practicing the historic discipline of carving out a predetermined portion of your earnings for charitable causes. Adding this giving principle to your portfolio’s allocation will provide an excellent return to your sense of well-being. Or write an anonymous check to a charity you support and see how that feels.

2. Invest in personal growth: When money was spent on personal or professional growth, an individual's overall sense of well-being increases. Graduate studies, counseling, and other forms of development seem to pay great dividends in terms of personal satisfaction.

3. Allocate to "memory capital": Money may not be able to buy you love, but according to research it can buy you great life memories. Researchers call "memory capital" money spent creating outstanding experiences that will be savored over a lifetime. Throughout the seasons of our lives we revisit these memories, delivering a "priceless" psychological annuity.

In the end, research affirms what many of us intrinsically know: Materialism has its limits, and that money should be used both for funding retirement and for living. Your emotional life hinges on your relationships with people, not money.

Continually thinking about money (e.g. checking our portfolios daily) leads to unhappiness. Falling prey to the torrent of wealth managers pitching their Yoda-like prognostications, technical analysis wizardry, or insider stock tips will not help in your quest for happiness. The Wall Street machine seeks to appeal to your greed glands and to lure you into its complicated web of high fees and high stress. And these investment strategies fall short, both financially and psychologically.

We like to believe that adopting the **Rebalance** investment philosophy increases happiness, empowering you to reject the greed mantra and free your mind for life's more important activities.

When you know that your money is diversified and your assets are safe, you can leave your computer monitor behind and focus on the truly valuable things in life. And allocating money to charity, personal growth, and memory creation are essential parts of a "well-diversified" life. You'll be thinking less about your money and more about the people around you.

Very truly yours,

Your **Rebalance** Team

Asset Class Performance

Q3 2018 Index Results*

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q3 2018	**Stocks**				**Bonds**	
	7.12%	1.31%	-1.09%	-0.03%	0.02%	-0.17%
Since Jan 2001						
Avg. Quarterly Return	2.0%	1.5%	2.9%	2.6%	1.1%	1.1%
Best Quarter	16.8% Q2 2009	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009	4.6% Q3 2001	4.6% Q4 2008
Worst Quarter	-22.8% Q4 2008	-21.2% Q4 2008	-27.6% Q4 2008	-36.1% Q4 2008	-3.0% Q4 2016	-2.7% Q2 2015

***Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

The **Rebalance** Investment Committee works with two broad asset classes for the basic building blocks of our client's retirement portfolios: Growth and Income. During the second quarter of 2018, these asset classes performed as follows:

Growth Asset Classes

U.S. Stocks. Shares of U.S. companies delivered a powerful third quarter on strong earnings growth and surprisingly strong U.S. economic data, despite the specter of steadily rising interest rates. Healthcare, industrial stocks and technology led the way. The impact of corporate tax cuts was a big reason why U.S. stocks led the world in strength. Markets turned choppy right after the end of the quarter as the Federal Reserve signaled that another rate hike in December was a solid bet, and possibly three more would come during 2019. Whether the growth of the economy will require continued monetary tightening is anyone's guess, including the folks at the monetary authority.

Small Cap Stocks. Stocks of smaller companies fell relative to large-cap stocks, though performance was positive during the quarter and remains well ahead of large companies on a year-to-date basis. The theory was that investors would begin to prefer small caps to avoid the risk in large caps due to the administration's continuing trade war. Yet the tariff fight's effects seem to have been overblown, at least so far. The North American Free Trade Agreement (NAFTA), for instance, is alive and well and operating under a new name.

Real Estate Stocks. The bloom is off the rose in the housing market and in the commercial real estate business (such as apartment buildings), as increasing interest rates drive up the cost of borrowing. Essentially, people aren't making much more, so inflation is still in the future, yet the Federal Reserve can't wait until inflation is obvious to step on the brakes. That squeeze between two distinct realities had to show up eventually and real estate stocks are the first place we see it in action. In time, moderating real estate prices should help housing affordability, but only if supply of new construction meets demand. We could see some volatility here as a result, but that is normal for real estate as an investment sector.

Large European, Japanese & Asian Stocks. While U.S. stocks powered ahead, developed foreign country shares fell flat, victim of an aging business cycle and little appetite among central banks to increase liquidity. Add to that the uncertainties of the U.S. trade war and the impending British exit from the European Union. Japanese stocks benefited from the stronger U.S. dollar as investors looked past global trade tensions and focused on the U.S., Japan's top destination for exports, which in yen became cheaper.

Emerging Market Stocks. Chalk their decline this quarter up to the strong U.S. dollar, rising interest rates and heightened trade frictions with China. Many emerging market governments financed their recent growth in dollar-denominated loans, so the payback cost rises as the U.S. dollar strengthens relative to home currencies. The concern is that already weakened economies might have a harder time repaying their loans. As investors dump those currencies, they get even weaker and the cycle repeats. Given that the long-term growth of the world is found in these emerging economies, we see lower share prices as an incentive and add to them during our rebalancing process.

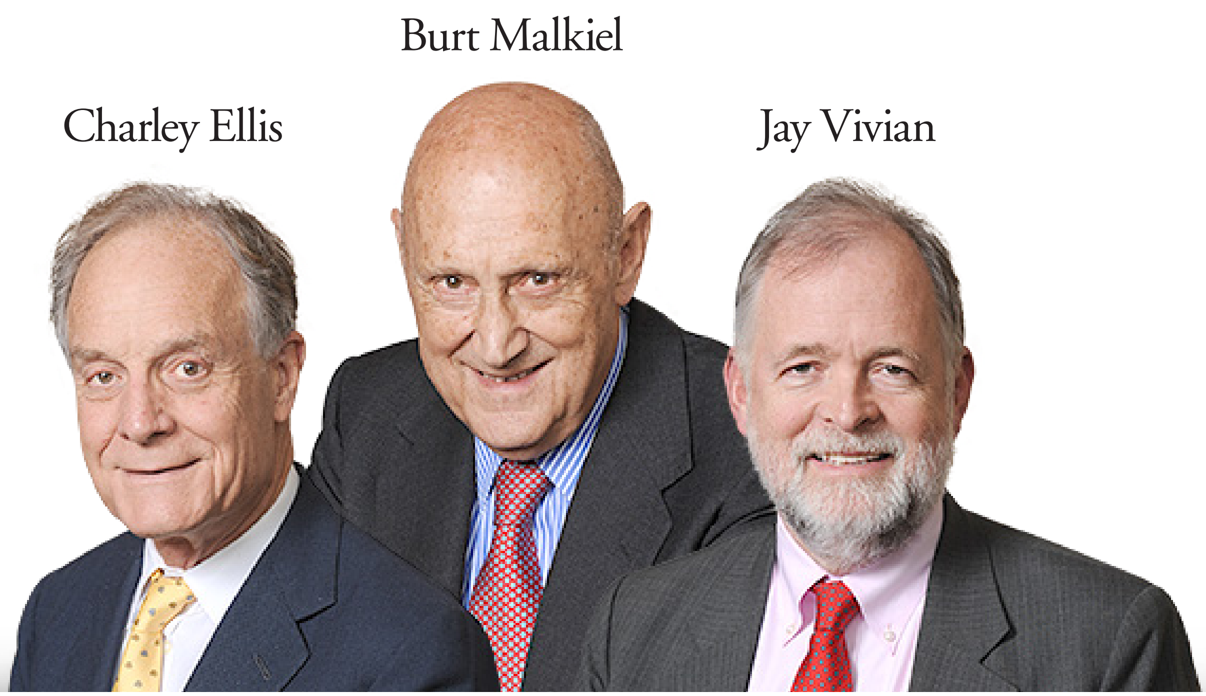
Income Asset Classes

U.S. Corporate Bonds. Corporate bonds turned slightly positive in the third quarter as major bond issuers were able to better finance their borrowing. Strong earnings growth contributed to an improving cash flow picture, and the tax cuts offered by the administration has created a steady flow of repatriated cash from foreign shores, helping liquidity in corporate accounts. That slightly less cramped financial position pushed down yields, increasing the prices of corporates.

High Yield Corporate Bonds. The flurry of mergers and acquisitions and leveraged buyout activity has pushed up gains for so-called "junk" bonds. Many companies used incoming cash to do their M&A, but others went ahead and borrowed. The late-cycle boost from the tax cuts did put high-yield borrowers in a better position to repay, creating demand and helping the asset class this quarter.

Emerging Market Bonds. The pain felt in emerging market stock markets extended to emerging bond issuers as well. A strong U.S. dollar is hurting countries that relied on dollar-denominated debts to finance a run of recent good times. Now they have to pay back in their own, deflated currencies and fight the flight of currency investors at the same time. Rising U.S. interest rates don't help. Part of the money that was in emerging bonds was using those instruments to improve gains in fixed income. Higher, safer returns in the United States pulls some of that money back out.

Preferred Stocks. Preferred stocks, a hybrid of stock and bonds that pay a solid income, were slightly negative for the quarter but remained additive to return for the year to date. So long as the risk in long bonds remains, we remain solidly in favor of the safer, more vanilla gains one receives from preferreds.



The Rebalance Investment Committee

Burton Malkiel, Charles Ellis and Jay Vivian comprise the **Rebalance** Investment Committee. They are renowned for creating and implementing sophisticated investment methods used today by elite pensions and endowments. The Investment Committee actively develops, oversees and sets policies for the portfolios offered to **Rebalance** clients. Their core ideas include diversification across multiple types of assets on a global basis and disciplined portfolio rebalancing. They also advocate techniques for keeping investment fees low.

Professor Malkiel is an emeritus Princeton University economics professor, a former board member of The Vanguard Group, and the author of the investment classic A Random Walk Down Wall Street.

Dr. Ellis was for three decades the managing partner of Greenwich Associates, the leading strategic advisor and consultant to large institutional investors around the world. He was Chairman of the Investment Committee of the famed Yale Endowment, and he has served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over $100 billion in IBM investment funds for more than 400,000 employees worldwide.