The Papyrus

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Slicing and Dicing the Financial Markets

The Dow Jones Industrials and S&P 500 Index may be the most widely known stock market indexes, but their use to slice and dice the stock market into sectors, segments and investment themes is actually rather antiquated. The Index Industry Association surveyed their members to find out how many indexes they maintain and found out that there more than 3.2 million financial market indexes. That compares to just 43,192 public companies in existence according to the World Bank.

A stock market index is essentially the combined performance of a specific group of individual publicly traded companies. It is not an average, but rather an aggregate. How that aggregate is determined can get complicated. The Dow Jones, which originated long before today's computing power was available, is a relatively simple price-weighted index, where the price gain or loss of even one stock can affect the value of the entire index. In a cap-weighted index, such as the S&P 500, price moves in the largest companies based on market capitalization can have a dramatic effect on the value of the index while

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Cycles and the Financial Markets

One of the best insights into human nature may well be financial markets throughout the world. Stock markets are fascinating in their ability to condense into very succinct time periods the cyclical nature of human behavior. While larger social patterns may take decades to play out; within a 10 to 15-year bull to bear cycle, financial markets vividly demonstrate the pendulum swing of the human behavior over time from one extreme to the opposite.

Every lesson of past market history tells us that the cycle from bull to bear, and repeat, is inevitable. There is something in the human psyche that pushes us to extremes, from extreme optimism to extreme pessimism; from overbought to oversold; from rise to fall of enthusiasms.

While the future can never be predicted, as the saying goes, all too often it rhymes. Market data allows one to look back over 100s of years and across geographic boundaries to trace over and over the transition of investors from optimism to belief,

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Investor Sentiment Cycle

Looking Forward to Driverless Cars

Growing old in America has always been very different from other parts of the world. Our country grew up in an unprecedented time of vast distances and new means of transportation. Thanks to the early railroads, products and people could move thousands of miles in a matter of days. The automobile and interstate highways, air transportation and the mobile nature of jobs exploded our cities outward into suburbs and communities with open space and large lots. Technology has further reduced the need to cluster business, industries, and employees in narrow geographic regions, dispersing populations over ever wider expanses.

But, all this distance has also made aging in one's home more difficult. Often the defining moment when one is no longer able to live independently is the loss of the ability to drive. Leaving home becomes dependent on others and with that dependency comes added costs, inconvenience, and the loss of spontaneity.

Which is why the development of driverless cars opens the potential to age in one's home without being stranded; to continue favorite activities and social interaction, with the simple words, "Home, car." Yes, it's new technology and a new instruction manual to read, but what a pleasure to think there may be one less worry to look forward to in retirement! So, bring on those driverless cars Alphabet, Apple, Tesla, GM and the 44+ corporations that are actively involved in developing autonomous driving concepts.

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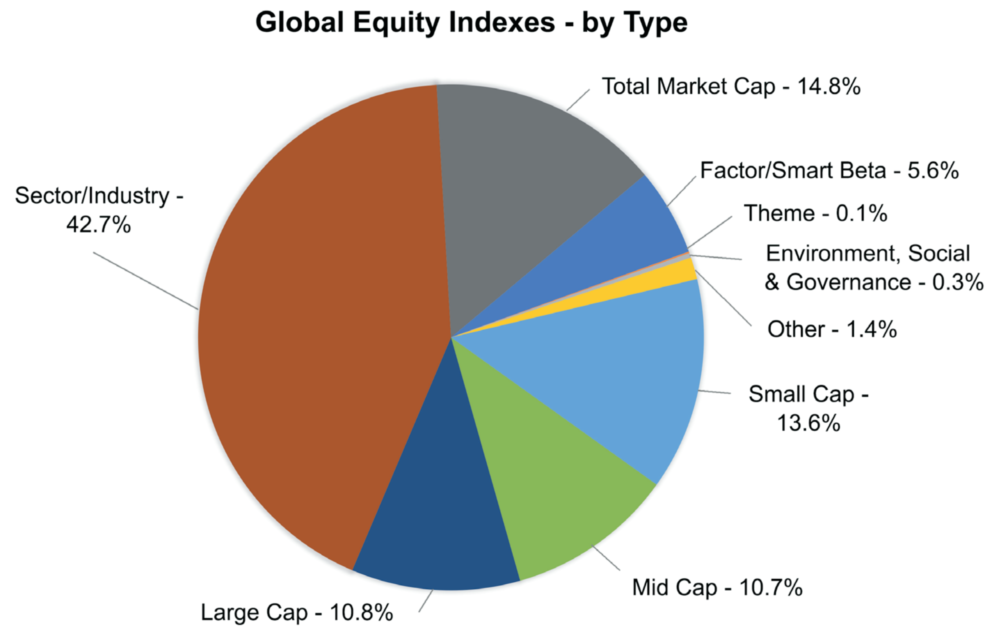
the same movement in a stock with a lower capitalization would have a muted effect. This is why Apple's price performance can rock the entire S&P 500 index. With smart beta and more esoteric indexes, calculations get much more complex.

How are investors using more than 3.2 million indexes? Many of the indexes are used to create and maintain Exchange Traded Funds (ETFs) that track individual market segments. Fall 2017, there were more than 10,300 ETFs traded worldwide. While the bulk of the ETF assets are centered in the Americas, the majority of the ETF listings are from Europe, the Middle East and Africa.

But that's no where near three million. The real use of indexes is to benchmark and analyze market niches (sometimes as few as a handful of companies), to contrast the performance of those niches, and to determine trends and opportunities through clues from the financial markets. In addition to investors, governments, regulators and businesses themselves are using indexes to analyze markets, sectors, industries, and more.

According to the IIA, global indexes represent approximately 29% of the equity indexes available by geography. This is followed by Asia Pacific (APAC) and Europe, Middle East and Africa (EMEA), at 24% each of equity indexes available, and frontier/emerging indexes (14%). The Americas have the fewest number of equity indexes, representing 9% of indexes globally. The other most common indexes are based on commodities, foreign exchange and healthcare costs.



One reason the indexes have proliferated is that once the data feeds and the computing power to calculate one index are in place, it costs very little to calculate extra indices resulting in increasingly finer slices and dices of the financial markets.

The 14 members of the Index Industry Association dominate the index industry.

Bloomberg Indices - www.bloombergindices.com

CBOE Holdings - www.cboe.com

Center for Research in Security Prices - www.crsp.com

China Central Depository & Clearing Co., Ltd. - www.chinabond.cn

FTSE Russell - www.ftserussell.com

IHS Markit - www.ihsmarkit.com

Intercontinental Exchange | ICE - www.theice.com

Morningstar - Indexes www.morningstar.com

MSCI - www.msci.com

NASDAQ OMX - www.indexes.nasdaqomx.com

S&P Dow Jones - www.spdji.com

Stoxx - www.stoxx.cotm

Tokyo Stock Exchange - www.jpx.co.jp

Hang Seng Indexes - www.hsi.com.hk

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exuberance, and outright greed before the overextended hot investment of the period starts to lose momentum and anxiety sets in. From there the pattern moves inevitably from denial and fear to despair.

By accepting the cyclical nature of financial markets, we can put in place plans to mute its impact on one's net worth and to exploit the opportunities it offers when others despair. This is the rationale and reason for the use of active investment management.

"Bulls make money, bears make money, pigs get slaughtered" is an old Wall Street saying that warns investors against letting greed get the better of their judgment. Risk is always a part of the financial markets. There are opportunities to make money in both bull and bear markets, but only if one manages the risk of uncertainty and is willing to admit very early if an investment is not working out as anticipated or the trend is shifting.

Active investment management approaches are never perfect. Not every buy or sell decision will be profitable. But the active manager starts with a considerable advantage over passive or buy-and-hold approaches. We know that cycles are a part of investing and that human nature tends to push a trend or belief to extremes, at which point the pendulum begins to swing back to the opposite extreme. Between those extremes are opportunities for profit — as long as risk is also managed.

Build Flexibility into Your Financial Life

"Life is what happens to you while you're busy making other plans."

Allen Saunders, the writer of the dramatic comic strips Mary Worth and Kerry Drake

Developing a financial plan is a very good move. It helps you understand where you want to be and how to get there. But financial plans also have a big failing. They are based on what we know now, which is made up of all our past experiences. The one thing we can count on in the future is that there will be surprises. In financial planning, as in all aspects of our life, we must build in flexibility, i.e. the mental capacity to adjust when life happens outside of our planning zone.

Flexibility means understanding that the unexpected can happen. No matter how much we might think we control our lives, there are forces beyond ourselves that can change the parameters of life. Surviving change (both good and bad) starts with understanding who we are and what our resources are.

What are your personal strengths?

What are you good at? What do you like to do? How have you successfully overcome challenges in the past? How good are you at changing your mind or learning new skills?

What resources can you tap into?

Do you have peer groups, family, business associates, or others that you can turn to and ask for advice and support? Have you created goodwill within these groups by offering support to others?

What are your liabilities?

Do you have debts or financial obligations that limit your flexibility? Is there a way to limit or reduce your liabilities or balance them with insurance or other risk management techniques? If your liabilities are people, such as children, can they be protected in the event of a disaster?

What are the essentials versus luxuries in your life?

If you had to cut back on aspects of your life, what do you truly need? What makes life worth living to you? Are there ways to achieve your greatest enjoyments with less cost? Can you cut back the amount of money you need to withdraw from your savings in retirement to wait out difficult periods in the market?

If you must start over, what are you willing to do to survive?

Many people set a value on their knowledge and time and refuse to accept positions they believe will not fairly reward them. If you have sufficient assets to support this position, go for it. But you also need to weigh the cost of waiting for the right position with deteriorating attractiveness in the job market and loss of current income. If your prior job has become obsolete, how will you find the training and knowledge you need to repurpose yourself?

What if a financial shortfall requires you to find a job in retirement? What could you physically do and what abilities do you have to convince someone to hire you?

Don't Stress Out, Stretch Out

The reason to ask yourself these questions isn't to stress yourself out, but rather to open up your thought processes to consider alternatives. Given we can't see the future, we need to be willing to accept that it may bring the unexpected and we may need to adapt our plans and our thinking.

After an unexpected event has occurred, too many people become frozen, unsure what steps to take to move forward. Role playing potential disasters and identifying small steps to break out of inertia can build confidence in one's ability to survive and provide a sense of stability to your present life. In addition to helping you mentally prepare for the unanticipated, working your way through these questions can also help you break out of mindsets, jobs and liabilities that are limiting your current life.

When we stop and ask ourselves, what do we really want? what makes us deep-down happy? new opportunities can open that, with a little planning, can help us create more satisfying present lives. Flexible thinking can mean more flexible lives and much better long-term survival rates.

2017 Tax Reform Has Made It Essential to Review Estate Plans and Wills

Most of the coverage of the Tax Cuts and Jobs Act passed in December 2017 has centered on business and individual income tax impacts. But the legislation also made some major changes in estate taxes that may require a review of your estate planning and the provisions of your will.

The most important change: The new law **doubles the "applicable exclusion"** from federal estate taxes from $5.6 million to $11.2 million per person, effective 2018-2025. This exclusion will be inflation adjusted in future years. Beginning January 1, 2026, however, unless new legislation is passed affecting the exclusion rate, the exclusion amount and the generation skipping tax exemption will revert to the levels that would have prevailed under pre-enactment law ($5.6 million adjusted for inflation over the eight years).

The tax rates for trusts and estates have also decreased and now consist of only four brackets.
New rates: 10%; 24%; 35%; 37%
Old rates: 15%; 25%; 28%; 33%; 39.6%

A key concern with respect to Wills and Revocable Trusts is that many were written using formula clauses tied to the exemption amount in effect on the date of death. The doubling of the exemption amount may cause significantly larger distributions than intended. This could result in funding trusts with much larger amounts than anticipated when the documents were signed. Automatic, maximum funding of a "credit shelter" trust at the first spouse's death could sacrifice the opportunity for a "step-up" in cost basis at the surviving spouse's death.

Higher generation-skipping exclusions provide an opportunity for rethinking multi-generational wealth preservation planning. Using a charitable bequest may not result in any tax deduction to the estate under the higher exclusion amount. Lifetime giving strategies, which provide a tax deduction against current income if you itemize, may make more sense.

The increased exclusion means that couples who have used their full pre-2018 gift tax exemption amounts, can transfer an additional $11.2 million ($5.6 million each) to their descendants prior to 2026, without imposition of the federal gift tax.

In addition to the increased exemption amounts above, an individual may give annually $15,000 in 2018 (up from $14,000 in 2017) to as many individuals as he or she desires without incurring a gift tax and without using any of the gift tax exemption amount. In addition to making gifts using the gift tax exemption and annual exclusion amounts, there is an unlimited gift tax exclusion for amounts paid on behalf of an individual directly to medical care providers for medical care and to educational institutions for tuition.

Remaining unchanged are the "portability" election, which permits a deceased spouse to transfer unused exclusion amounts to a surviving spouse, and the "step-up" in cost basis at death for capital assets.

When reviewing your estate plans, make a note that everything could change again in eight years. Wills and trust documents cannot be considered "forever" documents if there is any complexity in your estate.

State-level estate taxes are not affected by these changes unless pegged by state law to the federal estate tax provisions. Depending on your state of residency, you may need to make additional plans to minimize the state-level tax bite.

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