Wish Lists

December 2017

It is the Christmas season and families are exchanging wish lists for Christmas. As a father of 11-year old twins, my view of Christmas lists has been evolving as my kids have been getting older. Gone are the days of Emily and I suggesting “appropriate” ideas that just happen to make it onto their lists each year. These were great experiences in expectation management. Now, they are more independent and less willing to listen to our advice.

This newfound freedom brings its own risks. The list process provides an early education in risk and return management. If they choose to include an expensive or elusive gift on their Christmas list (i.e. high potential return), they should know they have increased their risk of getting something they did not ask for. Is this gift idea worth the potential risk? That decision will be theirs. The investment lesson for them is acknowledging they are making a risk and return tradeoff. Their Christmas present opening experience (i.e. investment return) might be very good or very bad. Though having the appropriate expectations would help.

This wish list idea partly arose from a guest lecture I did this past month for two Portfolio Management courses at the University of Wisconsin-Milwaukee (UWM).[1] Dr. Kevin Spellman and David O. Nicholas, Director of Investment Management at UWM who invited me to speak, find these guest lectures to be incredibly valuable for the students. It was also a great opportunity for me to be able to give back with some practical lessons learned throughout my fifteen year career. During my 75 minute talk I had to create a “student wish list” of topics that I thought were most important. The output was a summary of what we try to do for our clients every day.

From that we created our top three ideas for an investment wish list:

Economics and Long-Term Investing

The world is very complicated. Due to the complexity, many theories can be written and spoken about without being accurately tested. One event usually cannot be viewed in isolation. Drawing direct cause and effects is dangerous. The 2017 Tax Cuts and Jobs Act is another prime example. Many well-paid lobbyists are currently voicing their opinion on what specific tax legislation will do to their particular industry. Maybe they are right. Maybe they are wrong. What we can say is their view of the topic in isolation is wrong. Some recent examples:

- *The National Association of Realtors "cannot support a bill that takes homeownership off the table for millions of middle-class families"* –National Association of Realtors President William E. Brown[2]
- *"There are seven million homes on the market right now that are more than $500,000. Those houses are automatically going to be devalued. What we've seen is that when house values start to go down, it spreads to the next market after that, and another market, and the next thing you know you have a housing recession."* – National Association of Home Builders CEO Jerry Brown

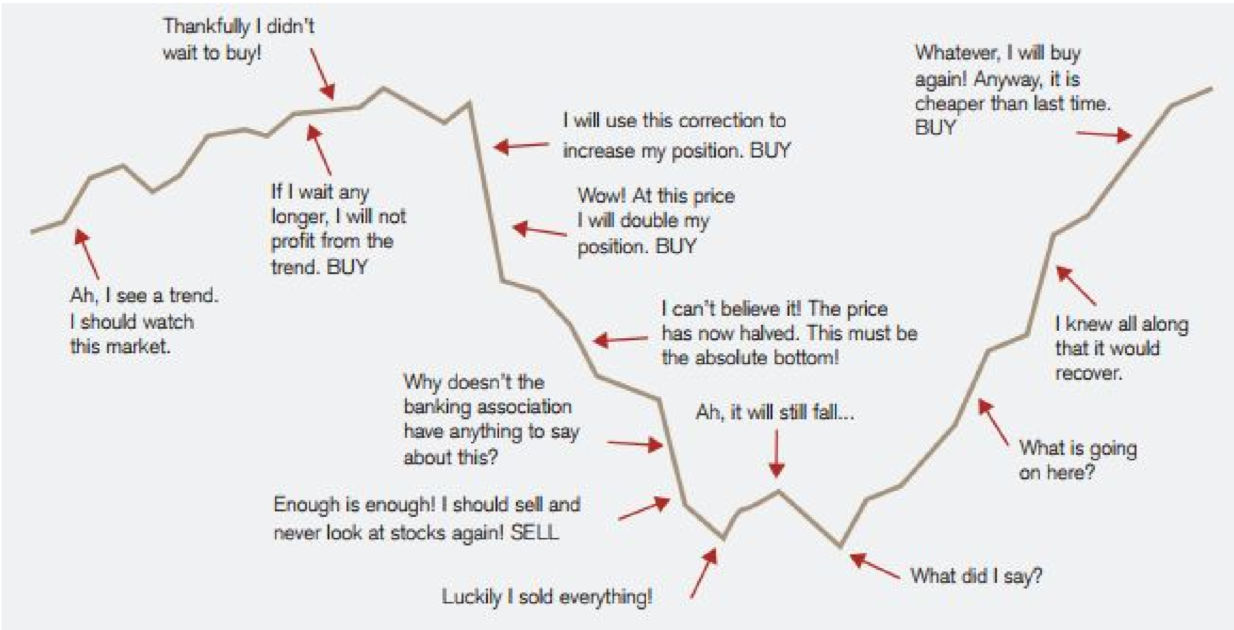
For diversified long-term investors, the issue is not what legislation will do to the economy in the short-term, as there will be winners and losers from this tax legislation. In our view, the successful long-term investor will not try and guess who those will be. The long-term investor will participate in the underlying capital growth of the overall economy.

Probabilistic Outcomes

Setbacks are inevitable even for the most successful investors. However, what sets successful investors apart from those less successful are not their returns, but their evaluation of the situation and the questions they ask themselves. Was the setback due to good or poor process? Successful investors have a good process and know there is a probability that, in the short-term, market prices could fall substantially. Thus, they are able to withstand the short-term events. Warren Buffett, the famous investor, was buying stocks during the 2008 financial crisis not because he knew what was going to happen in the short-term. Here is what he wrote in his October 2008 op-ed in the New York Times[3]:

"Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month – or a year – from now."

Unfortunately, not all investors have a good process, nor do they understand economics and probability. Unsuccessful investors bailed on the equity markets because they realized they could not predict these short-term movements. The successful investors (i.e. Warren Buffett) did the opposite. They invested into the equity markets because they could not predict short-term movements!



Source: Credit Suisse Private Banking North America

Behavior Bias

Even if investors have the necessary knowledge about economics and probabilistic outcomes, that could potentially be for naught if investors let their bias get in the way. Before an investor makes a final investment decision, the investor would be wise to quickly review the following:

- Recency bias –
    - Issue: Economy is doing well right now, so investors believe it will continue to do well.
    - Solution: Take longer term view to test your decision and realize that there are ups and downs.
- Hindsight and confidence bias –
    - Issue: After a stock market increase or decrease, investors tell themselves they knew it was coming.
    - Solution: Know that the events will always become clearer after the fact.
- Confirmation bias –
    - Issue: Investors look only for information that will confirm their original beliefs.
    - Solution: Recognize the source of information.

Tax Law Changes

As our newsletter goes to “print,” the largest overhaul of the tax system since 1986 is being passed into law. Many of the things we discussed in the prior newsletter are being put into law. However, some things are changing. We have put together summary slides of the changes for our clients to review on our website. Many more taxpayers will be taking the standard deduction in 2018, so those taxpayers should make sure real estate taxes, state estimated income taxes and charitable contributions are paid before December 31, 2017. If you have questions about your specific situation, please do not hesitate to contact us.

Appreciate the Present

As we reflect on another calendar year coming to a close, we thank you for being such an incredible group of clients. Our goal is to work with a small group of clients with whom we can have a big impact. Seeing clients make informed decisions about their money so they can achieve all that is important to them is something that gives our team great satisfaction.

From the entire McCarthy Grittinger Financial Group team, have a Merry Christmas and Happy New Year!

Matt Miler, CPA, CFP®

---

[1]http://uwm.edu/business/academics/investment-management/
[2]https://www.nar.realtor/newsroom/house-tax-bill-delivers-tax-hike-on-homeowners
[3]http://www.nytimes.com/2008/10/17/opinion/17buffett.html

Scott D. Grittinger, CFP®
Matthew T. Miler, CPA, CFP®
Jacqueline A. Schneider, CFP®
Amy L. Finley, CFP®
Alicia A. Nordwig, AAMS®
Maggie Mayer
Jacob Hornak

McCarthy Grittinger Financial Group One Honey Creek Corporate Center 125 S. 84th Street Suite 130
Milwaukee, WI 53214 414-475-1369 www.mgfin.com