Welcome readers! Welcome to the second issue of “Inve$t – ed” the investment education newsletter. Thanks for the great feedback on the first issue from several readers.

As you saw in the first issue, each monthly newsletter covers a mix of 3 broad subjects. Each of the three topics has a different focus and is designed for investors with different levels of investing knowledge.

- **“Just the data please”**. Under this topic, you will see data that gives perspective and insight useful in managing your investments. The topic is written with a focus on investors with some experience.
- **“Start Strong”**. This topic for graduating high school and college students, is focused on building good money management skills and is written for beginner / learner.
- **“Senior Power”**. This topic will focus on investing successfully in your senior years. It is written so retirees with a little basic knowledge of investing can easily follow.

These three topics do not come together in any newsletter. Why this combination? Many retirees I talk to, want to bring investment knowledge to the young in their family. We will fill this education gap with the “Start Strong” section. Having this knowledge pays dividends over a lifetime.

The process of enabling a web based version of the newsletter is underway. Many seniors want paper copies of the newsletter. Younger readers want the web version. My effort is to make the newsletter easy to access for all readers. Once the web based version is up and running, we will try to add additional features useful for readers.

As I explained last month, the goal is to make this newsletter affordable and donate a significant portion of the earnings to charities focused on education. I expect that the subscription process will begin early next year. Get ahead of the game and indicate your interest in subscribing by sending me an Email at the address at the bottom of this page.

Let’s dig into issue # 2 – December 2019.

In the “Just the data please” section we address the wall street adage “As goes January, so goes the year”. You will see that there is useful insight in the data behind this.

Last month in the “Start Strong” section we addressed the idea of Net Worth being a measure of financial condition. This month we go deeper with practical details of how this can be used to track progress in building wealth.

Interest rates are at historic lows and what happened in the bond market for the last decade is unlikely to repeat in the next. In the “Senior Power” section we look at how short duration bonds may be relevant in the current market conditions.

Enjoy reading the issue and send me your feedback on the Email address at the bottom of each page.

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Inve$t – ed

…the investment education newsletter Issue #2 – Dec. 2019

Just the data please!!

The case:

Soon, the year-end will be upon us and as we head into January, you will hear the phrase “As goes January, so goes the year”. Is January a good fortune teller for the year? That is, has performance in January been a good predictor of how the market will perform in the rest of the year?

The data:

To answer this question, I looked at S&P 500 data from 1950 to 2018. Excluding dividends and assuming that we will end 2019 with gains, here is what I found.

- Counting 2019, the S&P500 has recorded gains in January in 43 of the 70 years. That is a 61.4% win rate for January. Taking all 12 months into account for the 70 years, there is a 60% probability of winning months. So first, the win rate in January is not exceptional.
- Counting 2019, there has been a gain for the overall year in 51 of the 70 years.

So, at face value, January showed gains in 84% of the years where the index recorded a gain for the full year. This is where the adage “As goes January, so goes the year” comes from. But there is more to this if we look deeper.

- As we said, the S&P 500 recorded a gain in January in 43 out of 70 years. In 38 of the 43, the index also had a gain for the full year that followed. So, when a gain is recorded in January, there is an overall gain for the full year 88% of the time. January is indeed a good fortune teller for the full year when there is a gain in January,
- The index recorded a loss in January in 27 out of 70 years. In 14 of the 27 years, the market followed suit and the index also had a loss for the full year that followed. In 13 years, the opposite happened and there was a gain in the full year that followed. So, when a loss is recorded in January, there is a loss for the full year only 52% of the time. That is not much better than a coin toss. So, January is not a good harbinger for the full year when there is a loss recorded in January.

I will close this section by repeating what I said last month. If you are investing over the long horizon, this is interesting but not relevant. Not counting dividends, the market has shown gains in 51 of the last 70 years including 2019 and the chance of losing money in a 20 year hold period has been nearly zero. So, to use a phrase from Mad magazine “What me worry?”.

On the other hand, if you are investing for the shorter term or are concerned about managing risk, understanding market patterns can give you useful insight. Use the data as it fits into your investment plan.
Start Strong - Good money management and building wealth

Last month, we talked about Net Worth being the number on the scoreboard to measure financial success for most people. We discussed four key things to grow your net worth year over year. They are highlighted in the box on the left. Doing these every year creates a rising spiral that builds wealth over time. They look easy but many households do not do them consistently. If you are ready to start the winning journey, you want to know what the score is at the start of the year and what it is at yearend. That way, you can assess whether the actions you took during the year worked. So, how do you measure where you are starting from on Jan 1, 2020?

Most businesses use a balance sheet to measure the financial situation at a given point in time. The same concept can be applied to your personal finances. To build your personal balance sheet, you need to begin by measuring the value of everything you own and everything you owe.

Your assets are everything you own. This includes all the money you have - cash, any money in bank accounts, and any money in investment accounts etc. Your assets also include things you own like, cars, jewelry, real estate etc. For these physical assets what counts is the current market value of the asset. As an example, for a car it is the value you would get if you sold or traded in the car. This will of course be lower than what you paid for it. Your liabilities are everything you owe. This includes the remaining balance on all your loans and your outstanding bills.

Now that you understand the concepts. How do you practically put this together?

First, begin with all your bank and investment account statements that show your positions on January 1, 2020. These are the month end balances on your December or fourth quarter 2019 statements. The sum of all these balances and the cash you have on January 1st, are your monetary assets. Next, estimate the current value of the physical assets you own. You can do this for a car by looking up the book or market value on websites using the specific model, model year, mileage and condition of your car. You can similarly assess value of other physical assets you own. The sum of all these amounts is the total value of your physical assets. The sum of the monetary and physical assets together approximates your total assets.

Second, look at principal remaining to be paid at the end of 2019 on statements for all the loans you have. This includes student loans, credit card balances, car loans etc. The sum of all these is the total debt liability you are carrying. Finally add in all the unpaid bills for rents, utilities etc. that you have on January 1. The sum of unpaid bills and loans approximates your total liabilities.

Now subtract the total liabilities from the total assets to get your net worth at the start of the year. Don't be surprised if you are starting with a negative net worth. You are not alone. Many starting their working life are in a similar situation. Do the four things highlighted in the box above during the year and then repeat the calculation at the beginning of 2021. If your net worth is higher at the start of 2021 than it was at the start of 2020, you grew your wealth.

Start Strong!!
Senior Power – Investing successfully in your senior years.

Last month we talked of the value created by producing some income from a retirement nest egg. We discussed the challenge of producing income when interest rates are low and discussed how to lower risk in participating in the stock market to get dividends.

Traditionally bonds have produced income. Besides that, they also work as a hedge and lower risk in the portfolio. So how do you participate in the bond market in the current environment?

Bonds produce value in two ways. The “coupon” or interest payment is income. Change in the value or price of the bond in the market can also deliver a gain or a loss. When interest rates decline, a bond issued earlier at a higher interest rate is worth more than a similar bond issued later at a lower interest rate. As the picture shows interest rates in the US have been declining for the past three decades. The 10 year US treasury yield was nearly 16% in 1981 and is just under 2% now. Bonds have been in a bull market for three decades and returns from bond funds reflect this. Interest rates are at a 30 year low currently. Now, the room left for rates to decline further is small.

In a rising interest rate environment exactly the opposite happens. Bonds issued earlier are worth less than bonds issued later at higher interest rates. Bond funds have risk of losing value in this environment.

The “duration” of a bond is a technical term that is different from the time to maturity of a bond but generally they go together. A 30 year bond has a higher duration than a 2 year bond. The sensitivity of bond value to interest rate changes increases as the duration of a bond increases. The impact of a 1% change in interest rates on the value of a 30 year bond can be 8 to 10 times higher than that on a 2 year bond. So shorter term bonds are more stable in value in an uncertain interest rate regime.

There is one other aspect of low interest rates that is worth pointing out. When rates are low, if you are borrowing money, you want to lock in the low rate for as long as possible. On the other hand, if you are the lender, you want to lend for as short a term as possible because later, you may get a chance to lend at a higher rate. So in a low interest environment, it is good to borrow long term and lend short term. When you buy a bond you are lending money to the institution issuing it.

If you want to add short term bonds to your portfolio, are there any good short term bond funds you can start your search with?

PIMCO’s Enhanced Short Maturity Active ETF (MINT) has a 4 Star and Gold Medal rating from Morningstar. It delivered a trailing 12 month yield of 2.7% as of September 2019 and has an expense ratio of 0.36%. The other Morningstar 4 Star Gold rated fund, in the short term fund category, is the PIMCO mutual fund PAIDX for institutional investors. The Class A shares with a minimum investment of $1000 carry a 0.73% expense ratio. In full disclosure, I hold MINT in my investment portfolio.

Senior Power – Invest well in retirement !!