NORTHSTAR FINANCIAL PLANNERS INC.

March 2018 Financial Planning Notes - Client Newsletter

"Investors have very short memories."

Roman Abramovich

In This Issue:

Tax (Scam) Season

From Detective DiCristofalo, Fort Lauderdale Police Department:

It is tax season and with that comes the numerous scams thieves and criminals use to attempt to gather your personal information to use in fraudulent crimes.

One such scam tells victims they owe money to the IRS and it must be paid promptly through a gift card or wire transfer. Victims may be threatened with arrest, deportation or suspension of a business or driver's license. In many cases, the caller becomes hostile and insulting. Victims may be told they have a refund to try to trick them into sharing private information. If the phone isn't answered, the scammers often leave an "urgent" callback request.

The IRS will never:

- Call to demand immediate payment over the phone, nor will the agency call about taxes owed without first having mailed you several bills.
- Call or email you to verify your identity by asking for personal and financial information.
- Demand that you pay taxes without giving you the opportunity to question or appeal the amount they say you owe.
- Require you to use a specific payment method for your taxes, such as a prepaid debit card.
- Ask for credit or debit card numbers over the phone or e-mail.
- Threaten to immediately bring in local police or other law-enforcement groups to have you arrested for not paying.

If you get a phone call from someone claiming to be from the IRS and asking for money or to verify your identity, here's what you should do if you don't owe taxes or have no reason to think that you do:

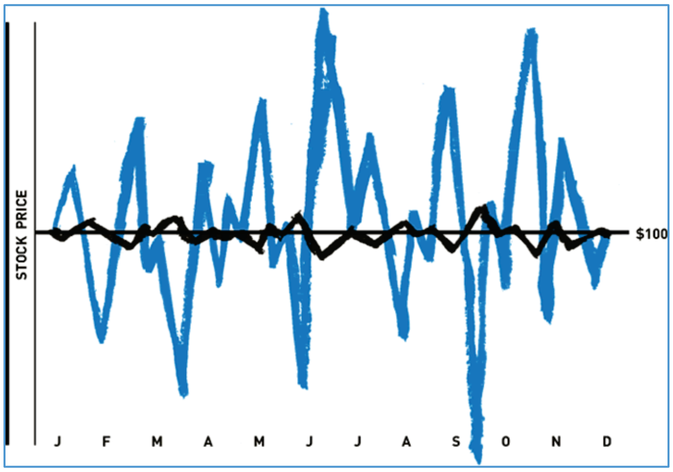
- Do not give out any information. Hang up immediately.
- Contact the United States Treasury Inspector General for Tax Administration (TIGTA) to report the call. Use their "IRS Impersonation Scam Reporting" web page. You can also call 800-366-4484.
- Report it to the Federal Trade Commission. Use the "FTC Complaint Assistant" on FTC.gov. Please add "IRS Telephone Scam" in the notes.

If you know you owe or think you may owe tax:

- Call the IRS at 800-829-1040.

Stay alert to scams that use the IRS as a lure. Tax scams can happen any time of year, not just at tax time. For more, visit https://www.irs.gov/newsroom/tax-scams-consumer-alerts

Volatility in The News



We have all heard about the market and volatility lately. But what does it mean? What exactly does volatility mean in terms of your portfolio? In raw terms, the definition implies an item or measurement scale that is prone to change. Let's dig into it…

Volatility is defined as a tendency to change quickly and unpredictably. This can apply to:

- Price *volatility*
- The *volatility* of the stock market (prices of the indexes fluctuating at different rates)

What is the basic definition of 'volatility' in terms of finance and investing?

To answer that, we need to understand how it is calculated. Looking into a statistician's toolbox, we encounter measurements called variance and standard deviation. In layman's terms, these are simply a measure of how far a set of actual data points lands from its expected mean or average. If the data points are landing all over the map, further from the average, there is a higher deviation in the data set. If the data points are close to the average, then the opposite, low deviation. For the detailed readers out there, variance and standard deviation are not the same numbers per se but the standard deviation is simply the square root of the variance.

In finance, volatility is a measure of the distribution of returns for a given security or market index. In simpler terms, volatility is how much uncertainty or risk is present regarding a change of a security's value. The consensus is that the higher the volatility, the riskier the security. Another way to look at it, volatility refers to the amount of uncertainty to the magnitude of changes in a security's value over a given time frame. It can be measured over an hour or over a decade, it all depends on the portfolio manager's time frame. However, regardless if you are day-trading or investing over a generation's time, a higher measured volatility means that a security's value can and will usually be spread out over a larger range of values.

The most common legacy measure of the relative volatility of a particular stock to the market is its *beta*. B*eta* moves towards showing the overall volatility of a security's returns against the returns of a common benchmark (like the S&P 500). For example, a stock with a *beta* value of 1.1 has historically moved 110% for every 100% move in the benchmark, based on the price level. On the other side, a stock with a beta of 0.9 has historically moved 90% for every 100% move in the underlying index.

The good news is that with proper diversification (i.e. low correlation holdings in a portfolio), the *variance* (or volatility) of one's returns can be reduced greatly. This is the reason one is strongly advised against investing too much of a portfolio into a single name, or even an asset class (like small-cap stocks or corporate bonds). You don't want that much in a single name or index or fund type if you want to lower your portfolio's volatility.

OK, I understand volatility now, but what is the 'Volatility Index' that I see on CNBC or in the paper?

In 1993, the Chicago Board Options Exchange (CBOE) introduced a calculated index, the CBOE Volatility Index commonly known as the VIX. It is a measure of market expectations of near-term (30 days) volatility conveyed by the S&P 500's stock index option prices. For over 25 years now, the VIX Index has been considered by many market participants to be the best barometer of investor sentiment and market volatility. It has also grown to be known as the 'fear index' by some.

Specifically, the VIX is calculated by measuring how much participants are willing to pay for index options on the S&P 500 index at any given time during the day. Are participants willing to pay more for a certain option contract over that product's theoretical value? Are they reaching to buy protection for their positions? How much they are reaching in price can be interpreted as how desperate they are to transact. This is what the

CBOE VIX measures; how far above the norm in price are traders buying options.

Now, the VIX is supposed to be a volatility index so it should be measuring volatility on the upside too. Why then is it known as the fear index? Here is where human nature comes in. The madness of crowds if you will.

Imagine a crowd waiting for a popular movie release or an exclusive nightclub to open. When the crowd starts going in, it is usually orderly and slow. No one is panicking to get in. Now imagine either of those two venues, full of people, and a fire breaks out. How is the exit of all those people going to look? It will most likely not be orderly. People may trample or shove each other in an attempt to reach the exit.

Let's apply the same thinking to the stock market. Very rarely do we see up spikes in an index's price. The buying is usually orderly and consistent over time, not panicky. When the music stops though, the selling can be quick and very disorderly. This is why the VIX is known as the fear index. Even though it is made to measure upside as well as downside moves using S&P 500 index options pricing, the moves that make the VIX spike most of the time are those from quick and heavy selling, not buying.

A scenario where the VIX can shoot up would be: a market opens down one morning, then more selling comes in, then portfolio managers try to hedge their long positions with index options. Then more selling begins, those same portfolio managers will pay up to buy protective options (over what they normally would pay). That 'overpaying' is what moves the VIX.

A couple of weeks ago, volatility became a hot topic in the news and resulted in many investors wondering what they should do with their portfolios. While it may be a bit nerve-racking to maintain serenity in such turbulent markets, it is vital to remember that volatility is inherent in investing and reacting emotionally may end up causing more harm than the market correction itself.

On February 5 alone, the S&P 500 Index fell 4% and the VIX spiked almost 116% (volatility went up). The volatility funds that lost over 90% were those betting that volatility would go down (inverse volatility funds). And with the quick spike in volatility, those investors began to frenetically look for ways to get out those losing positions. Unfortunately, for some such as XIV (an exchange-traded note issued by Credit Suisse) and SVXY (an exchange-traded fund); those bets caused some major damage to the tune of millions of dollars.

While market volatility is a nerve-racking experience for investors, understanding how it works and not reacting emotionally to the news could help investors remain calm during the periods of short-term declines. Having a well-thought-out investment plan and a well-diversified portfolio are two good steps.

Mia

Robo Flop

Last month's market plunge was an interesting test for digital wealth platforms (aka Robo advisors) which didn't exist the last time capital markets experienced a similar period of volatility. It's all fine and dandy to use a low-priced automated advisor when markets are steadily creeping up, but what happens when markets crash? Is your robo-advisor looking out for you, making sure your investment plan is still sound?

On Monday, February 5, the Dow Jones Industrial Average experienced its largest single-day point loss in history, a staggering 1,175-point drop. While that 4.2% loss isn't even close to the worst percentage loss in a day (which remains October 19, 1987, when the index fell an inconceivable 22%) it was enough to spook an awful lot of investors.

Probably a lot of investors were trying to reach their advisors to find out if it was Armageddon. I say probably because I don't recall a lot of our clients calling that day. (Dear clients: Have I told you lately that I love you?) But, I guess, advisors whose clients don't understand how their investment plan works in good and bad markets might have had above average call volume for the day. Given that

robo advisor clients have probably never discussed their plan with an actual advisor, well, it all seems like a recipe for panic.

A basic robo advisor agreement does not include professional money management from an actual financial service professional, so about all those clients would have is the ability to log in and watch their portfolio value plummet in real time online. But on February 5, most robo clients didn't even get that level of service.

According to Financial Advisor IQ, as markets free-fell that day, clients could not access their accounts through the websites of robo-advice pioneers Wealthfront and Betterment, as well as major online brokers Charles Schwab and Vanguard Group. That's over $150 billion in assets unavailable to clients through their advisors' online portal.

Now I might argue the point that this service outage was a blessing in disguise if it kept panicked investors from fleeing their holdings and selling everything. The next day the market gained back about half its losses and has been steadily creeping back up since then. (Will it continue up from here? Who knows? But for the last couple of weeks, volatility has settled down.)

But a blessing in disguise or not, it is completely unacceptable to lose access at any time, let alone a panic time, particularly when you don't have a human being you can call as a backup to find out what is happening and receive professional advice.

All four companies released statements confirming service interruption, most claiming it lasted only a few minutes. Only one, Wealthfront, claimed they were working on a fix to prevent a recurrence. I'd like to believe the rest is also working to improve their level of service, but in the meantime, we're pleased to continue to offer the availability of a human being to all of our clients. Call anytime!

Steve

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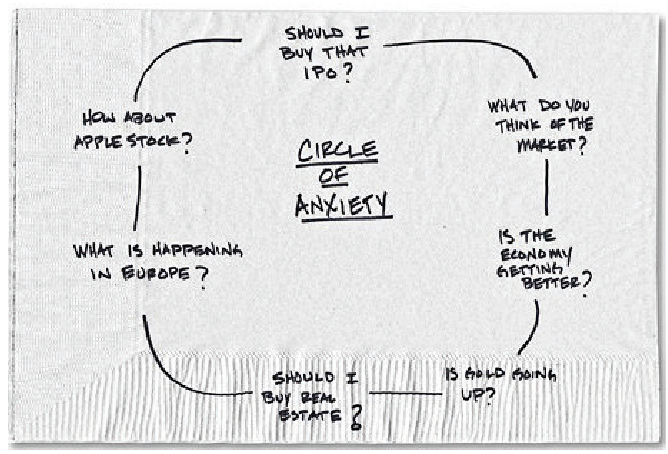
From Carl Richard's Napkin Blog



Final Thought