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THE LOST DECADE: A DECADE LATER (AND A BUNCH OF NBA FACTOIDS)

Remember the end of the 2000s? Or would you rather forget? Plummeting stock prices, growing financial hardship, a presidential race thrown into turmoil by an economy in recession. Thank goodness those days have passed. (Insert head-slap emoji.)

Back then, one hot topic in the financial press (and picked up in the wider media) was the concept of the "Lost Decade," specifically a 10-year period in which capital markets gave investors no return. This had followed an unprecedented period of peacetime expansion during the 1990s.

The numbers back up the headlines. Here is the return of the S&P 500 for the '90s and the naughts:

FIGURE 1

Annualized Return on the S&P 500, 1990-2009 by Decade

Decade	Return
1990-1999	18.2%
2000-2009	-0.9%

No doubt the 2000s were a troubling period for investing. There were good years in there, but we also had the dot-com bubble burst and 9/11 at the beginning, and of course the Great Recession at the end, which wiped out all gains. But the financial news did not stop with reporting numbers. Do they ever? That doesn't sell papers. (I think they were still selling papers in 2009, right?)

Financial experts wanted you to know what the numbers meant, and many said capital markets weren't a good place to get rewarded for your investment risk. They implied if markets could be bad for 10 years, why not 20? Or 30? Or the rest of your life?

Well, technically there is nothing to say we couldn't see a lost 20, 30, or more years. But investing is about probability. If you are investing for 30 years, you are assuming the overwhelming probability that over the next 30-year period, markets will be up, and the very, very strong probability that markets will be way, way up. You have no guarantees. Just very favorable probabilities.

Think about an NBA player shooting jump shots in a game. If he's any good, he probably averages around 50%—he makes about half his shots and misses about half. Ever see a player go stone cold and miss shot after shot after shot? It happens. Science has still not explained the phenomenon that when it does happen, 100% of the time it's someone on the team you're rooting for.

Players miss 10 shots in a row sometimes. It happens. How about 20? Or 30? What's the most? Well, I happen to remember this, and I'm not sure why: It was a record-setting night for Tim Hardaway in Minnesota back in 1991. (OK, I looked up the city and year.) Hardaway would later have some good years with our local Miami Heat, but this was earlier in his career, when he was playing for the Golden State Warriors. That night, he went 0 for 17 to set an NBA record for futility that still stands today. No one has ever missed 20 or 30 in a row.

So if you're the head coach and your star point guard just pulled off the most miserable performance of all time, what do you do? Sell him to the Milwaukee Bucks at a fire sale price? That wasn't Coach Don Nelson's decision. Probably gave him a "we'll get 'em next time" kind of speech and sent Hardaway back out on the court three nights later against the Lakers. He finished the night 13 of 21 for a shooting percentage of .619, which experts call "really good."

So our investing decision following the Lost Decade should have been "we'll get 'em next time" and see how the next decade performed. And it turns out next time was really good:

FIGURE 2

Annualized Return on the S&P 500, 1990-2019 by Decade

Decade	Return
1990-1999	18.2%
2000-2009	-0.9%
2010-2019	13.6%

Concluding that the lost decade was not a signal to sell ended up being a really good strategy a decade ago. And while there's one bad period in that chart, your overall return for the 30 years isn't bad: almost exactly 10% per year.

Do you know what happens to $100,000 invested with a 10% return for 30 years? It turns into more than $1.7 million. (OK, taxes, management costs, and volatility reduce that a little. It's still gonna be a lot.)

If I haven't made the case yet, let's go back to the NBA once more: A good NBA player will make about 50% of his jump shots, which of course means he will miss about 50%. Therefore, half his shots have a positive return (2 or 3 points) and the other half are "lost," providing no return at all. The best way for him to be more successful, therefore, is to take fewer missed shots.

Yeah, it's a ridiculous strategy, for one obvious reason: He has no idea which shots he's going to miss until after he takes them, at which point it is too late. Capital markets are the same. If we knew which decade is going to be lost, we could avoid investing during it. But we only know it's lost after the decade ends.

Theoretically, every day, week, month, or year that the wider capital markets have a negative return is a "lost" day, week, month, or year. But to draw conclusions about investment strategy from those periods that don't reward us is a big mistake and is likely to hurt our overall performance.

And just one more factoid: The record for the most missed shots in an NBA career is held by Kobe Bryant. Man, the Los Angeles Lakers must feel pretty silly trading for him on draft day in 1996. Yet somehow, despite getting a zero percent return on 14,481 of Kobe's shots over the next 20 years, they managed to win five NBA Championships. 14,481 missed shots! That's a heck of a lot of "we'll get 'em next times." And a lot of reward for the strategy.

—Steve Tepper

Past performance is no guarantee of future results. Indices are not available for direct investment.

THE POWER OF REBALANCING

June was another interesting month. I don't know about you, but I'm kind of longing for boring months for a while. But at least June started out with a positive kind of interesting. During the first week, some of the accounts I manage started to signal they were ready to be rebalanced … because of positive market performance! After the slaughter of March and April, how wonderful it was to look at the accounts that I had made trades on at or near the lowest point of the March panic, and realize they had earned back enough to sell off some equities.

I was looking forward to trading more accounts as the rebound continued, but (as always) the market had its own plans. The second week of June brought more panic selling, including an 1,861-point drop in the Dow in one day (its fourth-biggest point drop ever).

Plans for more rebalancing were out the window for a while. Instead, I pondered if a second wave of panic might necessitate more rebalancing the other way soon.

I don't know if that's coming or not. Maybe. And if it does, fine. Rebalancing works. And I've got numbers to prove it.

Our standard procedure is to rebalance accounts if they get more than 5% out of balance at the top level (stocks vs. bonds). So if we are targeting your account to have 60% stocks and 40% bonds, we would sell stocks and buy bonds if stocks rose to more than 65% of the account, and we'd do the reverse if stocks fell below 55%.

Simple math tells us how much to buy and sell. Selecting which holdings to buy or sell is a little more complicated, as we have to consider capital gains, trading fees, your cash needs, and other factors. But for the following exercise, I ignored all the details and just looked at the top level of total stocks and total bonds.

I hypothesized a series of negative daily stock returns that would result in a one-third drop in stock prices (about what we had earlier this year), followed by a series of returns that would take the stock value all the way back to its starting value. I assumed there would be no trading at all in the account. Then I repeated those same negative and positive returns to take the account value down and back up again.

On the bond side, I just assumed a very small (.01%) constant daily return.

I started with $500,000 in the account, allocated 60% to stocks and 40% to bonds, or $300,000 and $200,000 respectively.

So basically, the stocks in the portfolio fell to about $200,000, then went back up to $300,000, and then did the same thing. Bonds just added about $20 per day and increased steadily over 36 trading days from $200,000 to $200,721.

(Note: Bonds haven't been quite that reliable in 2020, but the small amount of volatility they have shown wouldn't impact the value of rebalancing. And of course, stocks haven't been as predictable either and I have no indication they will be—it's just a model!)

So now comes the fun. (Yes, this is how I define fun). Look at the same account, the same daily returns, and every time stocks drop below 55% of the total, do two rebalance trades (at a cost of $10 each): Sell bonds and buy stocks. If stocks rise above 65%, do the opposite. The purpose is to see how much it impacts the ending balance of the account.

Well, the answer was quite a bit. A rebalance trade was triggered each time the market went down, and another each time it rebounded. And rather than ending up with a balance of $500,721 as we did without rebalancing, the ending balance was $313,367 in stocks and $205,922 in bonds for a total of **$519,289**. That's about a 3.9% return, compared with a 0.1% return if we had done no rebalancing.

IMPACT OF REBALANCING IN A VOLATILE MARKET

	NO REBALANCING			WITH REBALANCING		
	Equities	Fixed Income	Total	Equities	Fixed Income	Total
Day 1	$300,000	$200,000	$500,000	$300,000	$200,000	$500,000
Day 7	$200,000	$200,140	$400,140	$223,934	$173,767	$397,701
Day 18	$300,000	$200,360	$500,360	$307,665	$202,175	$509,840
Day 25	$200,000	$200,501	$400,501	$228,055	$177,013	$405,068
Day 36	$300,000	$200,271	**$500,271**	$313,367	$205,922	**$519,289**

Maybe a 3.9% return doesn't thrill you, but remember what the stock market has given during that time: **0%**. My hypothetical market returns were specifically selected to leave your stocks at the same value as when you started (if you took no action). But because of rebalancing, you have more.

Big market drops are not my idea of fun—I think I share that with most of you. It's not just portfolio values. It's that market drops usually happen for a reason, and it's rarely a good one. Bear markets of more than 30% drops usually mean people are losing their jobs, losing their businesses. 2020 has given that and so much more misery. And it's only July.

WHO WE ARE

ALLEN P. GIESE, ChFC®, CLU®, ChSNC®
President, Investment Advisor Representative

STEVE TEPPER, CFP®, MBA
Vice President, Chief Operations Officer, Investment Advisor Representative

GARY S. GLANZ
Director of Business Development, Investment Advisor Representative

GARY C. GONZALEZ
Investment Advisor Representative

STACY SAAVEDRA
Client Service Specialist

RICHARD LOTTIER III
Client Service Specialist

NORTHSTAR
FINANCIAL PLANNERS INC.

(954) 693-0030
1250 S. Pine Island Road, Suite 275
Plantation, FL 33324

northstarplanners.com
info@northstarplanners.com

That's why we aren't happy to do rebalancing in falling markets, but we must. The chance to keep ourselves well-positioned for when the panic ends is a small silver lining around some very dark, ugly storm clouds.

—Steve Tepper

HAPPY *Anniversary*

HAPPY ANNIVERSARY TO US!

On Wednesday, July 1, we recognize 20 years since we hung our shingle and began doing business as Northstar Financial Planners. It was just Allen with his long-time office assistant Candy Heeschen back then, with Gary Glanz soon following. Gary Gonzalez and Steve were next to join the party in 2007, and Stacy and Richard rounded out the crew most recently. (Candy retired and moved with her husband to Melbourne Beach, FL, a few years back.)

We've had a lot of consistency over our many years: The same office location until 2012, when we couldn't fit another paper clip in our 800 square feet and moved to our current digs. Very few staff changes. Many, many clients who have been with us all the way back to the naughts. The same family feel. And of course, a consistent planning strategy based on academic principles, not Wall Street products.

We have seen a lot of market movements and contortions in the last 20 years: from 9/11 and the dot-com bubble burst of '01 to the housing collapse of '05 to the "unpleasantness" of '08-'09 straight through to an unprecedented worldwide economic freeze this past spring.

And each time, worldwide capital markets came roaring back and rewarded investors, at Northstar and all over the world.

It has been and is our pleasure to serve you, whether you came onboard this month or have been with us for the whole ride. Who knows what lays in store for the next 20 years! We're looking forward to it!

—Steve Tepper