

# FINANCIAL PLANNING NOTES

## CLIENT NEWSLETTER

*“Experience is something you don’t get until just after you need it.”*

—Anonymous

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### A QUESTION OF EQUILIBRIUM

*By Jim Parker, Vice President, DFA Australia Limited, October 2018*

“Sellers were out in force on the market today after negative news on the economy.” It’s a common line in TV finance reports. But have you ever wondered who is buying if so many people are selling?

The notion that sellers can outnumber buyers on down days doesn’t make sense. What the newscasters should say, of course, is that prices adjusted lower because would-be buyers weren’t prepared to pay the former price.

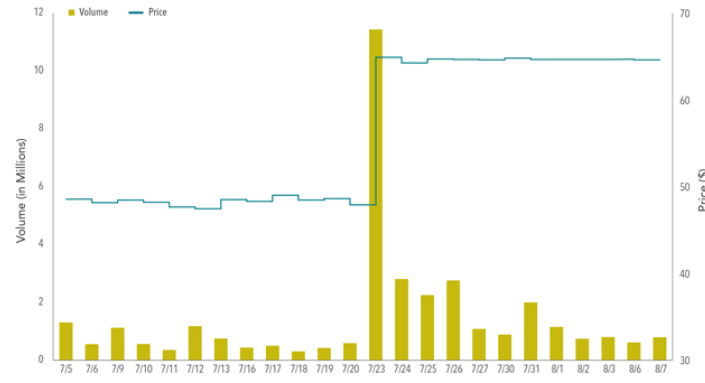
What happens in such a case is either the would-be sellers sit on their shares or prices quickly adjust to the point where supply and demand come into balance and transactions occur at a price that both buyers and sellers find mutually beneficial. Economists refer to this as equilibrium.

But the price at which equilibrium is reached can change. That’s because new information is coming into the marketplace continually, forcing would-be sellers and would-be buyers to constantly adjust their expectations.

That new information might be company-specific news on earnings. It might be news that has implications for specific industries—like a spike in oil prices. Or it might be an economic development that affects the entire market, like a change in the unemployment rate. Given this constant flux in the flow of news and information and the changing expectations of participants, it can be reassuring to remember that for everyone selling shares there must also be buyers of those shares—or the trade will never take place. And whenever information changes, prices may change and quickly reach a new level of equilibrium.

Recent trading activity by market participants in shares of a U.S.-based health care provider offers a clear example of how quickly prices adjust to new information. It was reported in late July 2018 that a large private equity firm was in talks to purchase the health care firm at a price valuing the company at \$65 per share. Prior to the announcement, shares of the firm were trading around \$48. As we see in [Exhibit 1](#), when the announcement broke, the market price for the stock adjusted overnight to just below \$65. In other words, after news of the impending sale hit the market, the supply and demand for the stock met at a new equilibrium price.

Exhibit 1: Price Movement and Daily Volume for Shares of US-Based Health Care Provider  
July 5–August 7, 2018



In USD. For illustrative purposes only. Stock price data as shown are official NASDAQ closing prices. Data provided by Bloomberg L.P. See end disclosures for additional important information.

Given that security prices rise and fall based on a multiplicity of influences, how should investors interpret and act on these signals? We believe that trying to untangle all these influences and profit from perceived mispricing is not possible in a systematic and scalable manner.

An alternative approach is to start by accepting that prices are fair and reflect the collective expectations of market participants. While information frequently changes, this is quickly built into prices. Competition among buyers and sellers is such that it's not possible to consistently outguess the market.

The second step is to see that fairly priced securities can have different expected returns. And we can use market prices and security characteristics to identify those securities that offer higher expected returns.

The third step is to build highly diversified portfolios around these broad drivers of return, while implementing efficiently and managing the cost of buying and selling securities.

The final step is to apply discipline and rebalance your portfolio either to stay within your chosen risk parameters or to adjust for changes in circumstances.

Ultimately, the market is like a giant information processing machine. All the influences mentioned above are constantly being assessed by millions of participants, and prices adjust based on those collective expectations.

The returns we expect from investing do not necessarily show up every day, every week, every month, or even

every year. But the longer we stay invested, the more likely we are to capture them. So, rest assured that even when prices are falling, people are still buying. The market is doing its job, and we believe the rewards will be there if you remain disciplined.

## THE STORM AFTER THE STORM: HOW TO PROTECT YOURSELF AGAINST NATURAL DISASTER SCAMS

Whether you live on the hurricane-prone East Coast, earthquake and fire country on the West Coast, or Tornado Alley in between, natural disasters are always a risk. And the recent hurricanes in Florida and the Carolinas have highlighted that the risks don't end when the winds and rains abate.

In the wake of any widespread disaster, the lives of people in affected areas can be turned upside down. From the lucky ones who have to deal with only a temporary power outage and maybe some light debris cleanup to those left homeless or possession-less or with lost loved ones, recovery can prove to be a much longer and more painful process than the storm itself.

On the plus side, many people and communities show their best selves following disasters, with people unaffected or less affected rushing to the aid of those in the direst need.

Many people, but not all.

For some, disasters represent an opportunity, and inevitably shams and scams pop up. Some are directed at survivors, and others are directed at charitably minded people who want to help.

### If You Are Affected By a Disaster

If you are affected by a natural disaster, you should know the kinds of fraudsters who may be contacting you. The Federal Emergency Management Agency says on its website: "The most common post-disaster fraud practices include phony housing inspectors, fraudulent building contractors and charging for free services."

The bigger the disaster, the more repairs to buildings and other structures will be needed, and the more people in the construction trade will flock to the affected area. We should assume most of them are honest and reputable.

Others will come to town looking for a quick, and not so honest, cash grab. They'll take your deposit money and never be seen again. They'll sell you phony services. How can you tell the difference? They drive a pickup truck with lots of tools in it. They have a card with a licensed contractor number. And you may have no internet connection to vet them. But you have a gaping hole in your roof that you'd like to get plugged before the next rain comes.

How do you protect yourself? It can be tough depending on the level of damage to your property and surrounding infrastructure such as phone lines and cell towers.

**If you have internet access:** Use online resources such as Angie's List, Yelp, the Better Business Bureau, and even Sun Florida to make sure a Florida business is, in fact, a company registered with the state.

**If you have a phone line but no internet:** Remember, that box you never put down that connects you to the universe is also, believe it or not, a phone! Sometimes you have no Wi-Fi or 4G, but you still can make a call. Do it! In fact, make several!

Contact your insurance company. You'll want to do that as quickly as possible anyway to start your claim, and they may have a contractor they use and can vouch for, or can help you identify a reputable licensed contractor. If not, try local real estate agents and mortgage lenders. You might also try local building materials suppliers.

Additionally, you can contact the Better Business Bureau at 703-276-0100 to see if any complaints have been filed against the contractor.

**If you have no phone or internet:** Work with someone local, and verify they have an in-state license plate, if possible. This can be beneficial beyond lowering the risk you will be ripped off. Area contractors should be more familiar with local building codes and permit requirements. Even a reputable out-of-state contractor could end up costing you big if the work fails inspection and has to be redone.

Try to get several bids, and be wary of a bid that is substantially lower than all the others. That can be a teaser to get your down payment and run.

Don't pay anything until you get a complete, detailed written contract. Do not pay with cash, and do not pay any more than a reasonable down payment until the work is completed. Don't sign a contract with blank

spaces because you don't know what the contractor will put in those spaces after the contract is signed.

**Last note:** If someone in a FEMA shirt or jacket shows up, look for an identification badge with a photograph. Clothing, no matter how official looking, is not identification.

### **If You Aren't Affected but Want to Help**

At no time is American generosity more evident than following a tragic event like a disaster. Millions of dollars flow to charities that offer support and relief to victims. And that flood of money is an attractive target for scammers.

Detective DiCristofalo with the Fort Lauderdale Police Department recently forwarded information from the Federal Trade Commission (FTC) on [nextdoor.com](http://nextdoor.com), warning of scams that appeared following Hurricane Florence's devastating landfall in the Carolinas. No doubt the destruction left by Michael in the Florida Panhandle will produce more of the same.

Following Florence, websites popped up accepting donations on behalf of victims. Some claimed a relationship to well-known charitable organizations like the Red Cross, some made claims on how the money was going to be spent, and some didn't provide any details about how the funds would be used. In any event, those sites gave no clear way to confirm their validity.

There are many resources online to check out a charitable organization, including the Better Business Bureau's Wise Giving Alliance, Charity Navigator, Charity Watch, and GuideStar. Go to these sites to research an organization. Don't just trust the organization's claims or messages posted on social media.

If you use your phone to donate via text, confirm the number with the source before you donate, and specifically designate how you want your donation spent. Otherwise, even with a reputable charity, the donation could end up in a general operating fund.

Finally, if you think you've identified a scam, report it to the FTC at [ftc.gov/complaint](http://ftc.gov/complaint).

—Steve Tepper

#### Sources:

"Top Hurricane Home Repair Scams" by Jamie Gold, [www.forbes.com](http://www.forbes.com), September 14, 2018.

"Charity Scams Follow Hurricane's Wake" by Detective DiCristofalo, [Nextdoor.com](http://Nextdoor.com), October 18, 2018.

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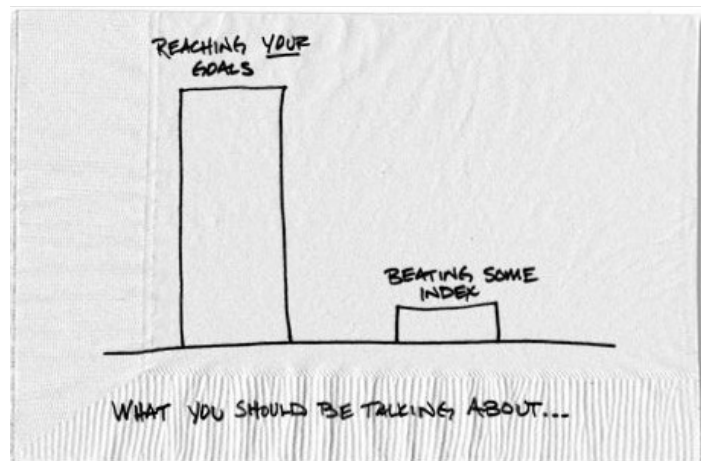
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## FROM CARL RICHARDS' NAPKIN BLOG



## FINAL THOUGHT



"You told me I invested enough money to enjoy a comfortable retirement. But my back aches, my knees hurt, I have leg cramps...YOU CALL THAT COMFORTABLE???"

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