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The Opening Bell

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Cash, Bonds, and Happiness

by Forrest Bell, CFP®, Sr. Investment Advisor, Financial Planner

Cash can make you happy, at least according to an article from the *Wall Street Journal* titled "Money and Happiness: A Surprising Twist," published last year. The article cites a study by a team of researchers from the University of California at Riverside and the University of Cambridge in the U.K. that focused on bank account balances. While plenty of academic studies have explored the relationship between one's income and happiness or one's level of consumption and happiness, few have studied the impact of cash on a person's happiness. This study did just that, and it shows there is a correlation between bank account balances and life satisfaction. The idea that cash brings additional life satisfaction, even controlling for things like income levels and net worth, will certainly inspire more research of this kind. For now, it helps explain why some investors keep so much of it. Cash is not just a way to avoid investment risk; it can help make you happy.

> ***Cash is not just a way to avoid investment risk; it can help make you happy.***
> — Forrest Bell, CFP®

Unfortunately, creating happiness is not as simple as holding hoards of cash. The more cash you have, the more muted its effect becomes. For example, increasing a bank account balance from $100 to $1,000 has a larger impact on life satisfaction than increasing the balance from $1,000 to $10,000. And at some point, piling more cash into the bank does nothing to boost happiness. There is also the matter of inflation, which has a famously erosive effect on cash.

Impact of Inflation

While year-over-year inflation has remained tame at around 2%, it will rise at some point. But even if it doesn't, the return offered on cash in banks still falls below even this modest inflation rate. In many years, the impact of inflation is subtle, but over time the incremental erosion becomes dramatic. There are very important strategic reasons to keep emergency cash reserves. But those with excess cash reserves should consider investing in bonds. Bonds help fend off the effects of inflation through a steady stream of interest payments. And although bonds lose value in some years, the losses are much tamer than what investors experience in the global stock market. The chart below shows the last three calendar years in which the global stock market lost value.

MSCI All Country World Index: last three years in which the global stock market lost value

2008	2011	2015
-42.2%	-7.4%	-2.4%

Compare that to the last three calendar years in which the U.S. bond market lost value.

Bloomberg Barclays Capital U.S. Aggregate Bond Index: last three years in which the U.S. bond market lost value

1994	1999	2013
-2.9%	-0.8%	-2.0%

Bond Indicies Reduce Risk

The Bloomberg Barclays Capital U.S. Aggregate Bond Index is a well-known representation of the U.S. bond market. Indices such as the Bloomberg Barclays can be a useful way to diversify away the risk of individual bonds. With individual bonds, there is always the risk that the issuing entity will become insolvent. In these cases, the individual bond can default and lose some or all of its value. Indices reduce this risk by holding hundreds of individuals

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bonds so that no single bond dramatically spoils results. And while we like the diversification of bond indices, there are even better ways to diversify away the risk of individual bonds.

Indices tend to work best when the universe of investments is constrained. The U.S. stock market is a good example. The number of stocks listed on the U.S. stock exchange peaked at the height of the tech boom at around 6,000. With the disappearance of many of those tech companies and other companies consolidating through mergers and acquisitions, the number of stocks listed on the U.S. stock exchange currently sits around 3,500. That is a relatively constrained investment universe.

"Investable Grade"

Unlike the stock market, the bond universe is in a constant state of formation. Every month, billions of dollars of bonds are created, and billions of dollars of bonds reach maturity. It can be a real challenge for a bond index to incorporate these ongoing changes. So the indices rely on the work of the three major rating agencies: Moody's, Standard and Poor's, and Fitch. As bond specialist Carl Pappo put it: "Not until a bond issue is warranted 'investment grade' by two of the three major agencies will the Barclays Capital U.S. Aggregate Index agree to admit it to listing."

The work of these rating agencies, though, is not always timely. Take bonds from Puerto Rico for example. After being deemed investment grade by the rating agencies, the price of Puerto Rican long-term bonds peaked around May of 2013. It wasn't until February of 2014 that agencies changed the ratings of these bonds from investment grade to junk, thereby expelling the bonds from the Bloomberg Barclays index. The expulsion, unfortunately, came after their price had fallen by 31%.

Capitalization-Weighted

Another problem with bond indices is that they are weighted by capitalization. The article "Read the Footnotes," published in *Grant's Interest Rate Observer*, explains the problem of capitalization-weighted bond indices. The more bonds a borrower issues, the more of those bonds the bond indexer is obligated to buy. Yet the more bonds a borrower issues, the less creditworthy it becomes, all other things being equal. In essence, bond indices require investors to own more and more debt of companies and countries whose situations are becoming more and more precarious.

Actively-Managed

Actively-managed bond mutual funds, on the other hand, do not have to wait for the pronouncement of rating agencies to decide which individual bonds to hold. They can act on their own analysis and focus on the parts of the bond universe where bonds look most reliable. Government and corporate bonds tend to dominate bond indices, but active bond managers can focus on any of the bonds in the bond universe including municipal bonds, mortgage-related bonds and foreign bonds, all of which improve diversification.

Have a Plan

Before investing in bond funds, it is important to have a thoughtful plan about cash. Every investor should have an emergency cash reserve in the bank, and it is worth doing the work to determine what that amount of cash should be. But for investors with excess cash reserves, bonds can be more than ballast to a portfolio during stock market corrections or crashes. In the last three decades, bonds have not underperformed cash for more than three consecutive years. With time on your side, they are a better way to keep up with inflation. Cash makes people happy but preserving purchasing power does too. ■

Back to School/Back to Work

by Bonnie Bell, MA, MDiv., Principal, and Director of Career/Life Coaching

I always forget how much I love the Fall until October, when everything starts moving toward winter, and something makes me feel like sautéing sliced apples with cinnamon and butter for breakfast and walking to the Cal stadium for a football game. The trees are definitely losing their leaves, and the days are getting shorter, despite the sunny weather hanging over past its prime. Nonetheless, here we are again, hurtling toward the holidays, cold weather or not.

The Phone Calls

My phone rings more insistently right about now: *time to change jobs, time to change careers, time to go back to school, time to do something different.* Whatever factors have brought you to this moment, and no matter how ready you are for a change, it turns out not to be a simple snap of the fingers that makes it happen in the exact timeframe you wish you could. Before you jump, you'll have to stop, look, listen to yourself, and reorient and get clear about the next step that makes sense in your career evolution. Your next step should improve upon your previous step.

> ***To get clear about where you are headed, you have to do some thinking about where you have been.***
> — Bonnie Bell, MA, MDiv.

What's Your Story?

To get clear about where you are headed, you have to do some thinking about where you have been. Allow your self-knowledge and wisdom guide you as you reflect on your work and life experiences to this point. You will recognize what is working by how you feel about each item on your list. They are the things that bring you satisfaction, pride, enjoyment. You want to keep doing those things and even make more room for them, if you want to raise your satisfaction quotient.

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"The Shortfall in Inflation is a Mystery": Janet Yellen, Federal Reserve Chair

by Jim Bell, CFP®, President and Founder, Chief Investment Officer

Changes may be afoot at the Federal Open Market Committee, which meets every six weeks, to assess the health of the U.S. economy. For years now, Chair Janet Yellen has emphasized that the Fed is "data-driven" in how it makes decisions about interest rates. One of the main data points the Fed watches is the rate of inflation, which is defined as an increase in overall prices; 2% annual inflation is the target rate the Fed has adopted as its goal. The Fed has the ability to change short-term interest rates up or down or keep them steady, depending on how the U.S. economy is growing or not. Low interest rates help an economy that is struggling, and high interest rates rein in an economy that is overheating.

Price Stability

One of the Fed's mandates is price stability, and the way to achieve this is to produce price changes that are not too fast and not too slow. In the data-driven model, the Fed has been waiting for inflation to reach 2% and hold steady. U.S. inflation was above 2% earlier this year, but now it has drifted lower. Instead of waiting for inflation to stabilize at 2% or above, the Fed is now poised to raise its benchmark interest rate for the third time this year in mid-December whether or not inflation reaches the 2% target. **This is a significant change from the data-driven model.** Dr. Yellen now believes that the U.S. economy is strong enough to deal with gradually rising interest rates and that inflation will catch up as the economy strengthens and interest rates return to normal levels.

Problem: Low Inflation

In response to the 2008 financial crisis, the Fed dropped its benchmark interest rate to zero in order to stabilize the economy by encouraging borrowing and risk-taking. Now that the economy has been growing slowly and steadily since 2009 and the labor market is tightening, it is time to gradually raise interest rates, reduce the stimulus, and allow the economy to stand on its own. The problem with low inflation is that it keeps interest rates low and limits the Fed's ability to respond to economic downturns as it did in 2008. At the beginning of the financial crisis in 2007/2008 the Fed Funds Rate was at 4.25%, which gave the Fed plenty of room to cut rates and stimulate the economy. With this benchmark rate now at 1.25%, there is little room to respond effectively to a crisis.

Mystery Debate

With a tightening labor market, low unemployment figures, and increasing wages, inflation should be on the rise. The mystery of low inflation has stimulated a far-ranging debate among Fed officials. Some believe that the low inflation is a sign that the economy is weaker than it appears. This is the minority interpretation. Dr. Yellen and her closest allies believe this low inflation is an aberration. Other economists including Dr. Martin Feldstein at Harvard believe that it really does not matter whether inflation is 1.6% or 2.0%. In the late 1970s, Dr. Feldstein experienced 10% inflation. His position now is that inflation at 2% or lower is just fine.

Household Net Worth

On September 22, the *Wall Street Journal* reported that due to the rising stock market and rising home prices, U.S. household net worth had reached an all-time high. Overall household wealth has risen for seven quarters in a row, and household debt is the lowest it has been since 2000. These healthy household balance sheets indicate that the economic expansion beginning in 2009 and the rising stock market may be far from over. I believe that one of the benefits of a slow and steady recovery is that it can last a long time, and outlast a dramatic boom —much like the tortoise and the hare. The economic strength of U.S. households is very important because 70% of the U.S. economy depends on consumer spending.

. . . gradually increasing interest rates even though inflation is below its target of 2% . . . is a vote of confidence in the economy and the continuing expansion.

— Jim Bell, CFP®

Conclusion

Janet Yellen is signaling that the Fed is ready to adapt its target inflation rate strategy by gradually increasing interest rates even though inflation is below its target of 2%. **This is a vote of confidence in the economy and the continuing expansion.** With steady job growth starting in 2009, a tight labor market, increasing wages, high household net worth, and widespread growth among the world's largest 45 economies, this is a time to continue the benefits of your long-term investment strategy. I applaud the Fed's willingness to adapt strategies in response to measurable dissonance. Let your animal spirits run! ■

UPCOMING EVENTS

WEBINAR (FOR CLIENTS ONLY)
Investment Committee Update
Wednesday, November 29, 2 – 2:30 pm

WEBINAR
2018 Preview and Year-End Review
Wednesday, January 17, 2 – 2:30 pm

Registration for these events is not yet open. Check bellinvest.com/events for updates.

Back to School/Back to Work
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Next, think about what is ***not*** working for you. Those things will tend to jump out at you and be very obvious because they are causing you pain! They usually "yell" at you and say things like, "I HATE this commute!", "I can't stand my boss!", "I am bored out of my wits!". The things you hate actually point to actions you can take to make your job more satisfactory and your life happier.

Clarity
Clarity is not exactly something to force into existence; it is something that will emerge as you enter into sincere thinking, reflection, conversation, self-acceptance, and desire to fulfill whatever is missing in your work or life. Allow the clarity that emerges to be your guide as you design a target that includes what you want, what you don't want, and where you want to go in the future. If you don't know what you are looking for, how will you go about finding it?

The Resume
It is important to get the resume right. It can't just tell the story of what you have done in the past; it needs to also tell the story of where you are headed in the future. You should be aiming toward the next step, and for you to be satisfied, it will probably require that you stretch a bit, not just look for another example of what you have already done. That's a good way to get bored, rather than growing toward the next step. The resume should tell the story of who you actually are and not be filled with empty "resume" language.

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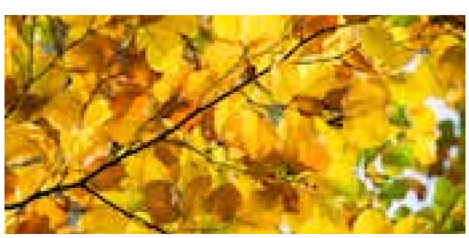
The Cover Letter
The cover letter is your opportunity to bring some personality into the imaginary conversation that goes on in your head when you discover an opportunity that wakes you up inside. What you put into the cover letter can and should be as authentic as you can make it. Do not simply say, "Enclosed you will find my resume. I am sure you will see that my background makes me a perfect candidate for the job." If that is all you have to say, forget saying anything at all. If, however, you have something interesting or notable to say about your experience that adds to your powerful narrative, then by all means say it.

The Search
I have heard good things about each of the following job sites from various clients over the last several years, but this year the one I keep hearing about is Indeed.com. Do explore this site and see all the ways that you can make use of it in your search. Other familiar sites include: LinkedIn, Monster.com, and opportunityknocks.org. ■



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September market analysis
bit.ly/mrkt-analysis