Comprehensive Investment Management, LLC
Fee Only Personal Financial Planning
Mid Winter 2024

Stocks Continue To Rise, While Bonds Stumble

Despite expectations to the contrary stocks prices have continued to climb. For the past twelve months the return of the S&P 500 is 24% and has already exceeded a level that many predicted for the end of 2024. Big tech companies are primarily responsible for the outsized gains.

Vanguard's large cap funds for the past year are up double digits 19.2%. The large cap stock allocation for CIM clients is in the mutual funds, Vanguard's Wellington Fund and Fidelity's Puritan Fund. Those two are balanced funds with allocations of 65% stocks and 35% bonds. The funds don't report the performance of the stock portion separately, but the overall return closely approximates a blend of 65% of the S&P 500 and 35% of Vanguard's Intermediate Bond Index Fund. The Puritan fund has 33% of its stock in tech which is higher than the S&P at 31%. Wellington's tech is at 27%.

What have bonds done for us lately? Not much. It's easy to forget but back in November bonds had their best month since 1985 and in December the third best month ever. Rising interest rates cause bond prices to fall. As bond mutual funds replace maturing bonds the new bonds pay the higher rates. It takes time, but the bond funds will recover. Bonds are not as volatile as stocks and thus provide stability to a portfolio. That said, we continue to look forward to normalcy when bond returns can be expected to be twice what they have been since the 2008 crisis. That is a long time.

The markets over optimistically continue to anticipate interest rate cuts by the Federal Reserve. When there is any indication of continuing inflation, those hopes are dashed and the markets react. This has been going on for over a year. In an election year the Reserve doesn't like to do anymore more than what's necessary because of potential political consequences.

The economy continues to hum along, consumers are doing their part, unemployment is low, and the worst inflation increases are apparently behind us. Expectations of a recession that were so prominent six months ago have diminished. The private sector continues to be as innovative and vibrant as ever. Congressional chaos isn't going to diminish, so we await the next threat of a government shut down. The stated aims of the two leading candidates for the presidency couldn't be more different. We'll have to see how that plays out.

Average Annual Returns of Select Mutual Funds

As of February 16, 2024	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
Large Cap US Stocks	3.5	19.2	7.7	12.1	12.0	14.7
Mid & Small Cap US Stocks	2.5	11.5	-1.4	8.7	10.0	15.0
Foreign Stocks	.3	4.0	-9.0	5.9	5.7	7.4
Intermediate Bonds	-1.6	3.3	-2.6	1.5	1.9	3.5
High-Yield Bonds	-.3	9.4	1.3	3.9	4.2	7.3
Balanced Funds 65/35 bonds/stocks	3.2	16.6	5.3	9.8	8.6	10.8
Balanced Fund 35/65 bonds/stocks	-1.2	4.2	1.4	4.7	5.2	7.5

Over the past 15 years $100,000 in the 65/35 funds would have grown to $502,000 vs $307,000 in the 35/65 fund.

Which is the Better Benchmark, the Dow or the S&P 500

As an investor you probably have often asked yourself, should I be more concerned about the Dow Jones Average or the Standard & Poor 500 Index. Both provide a benchmark for large US companies. Neither includes foreign countries, although most large companies get a significant portion of their revenue from foreign operations. As one example, despite all the Golden Arches we see around us, 70% of revenue for Dow member McDonald's come from outside the US.

The Dow Average has been around since the late 19th century and is the most well recognized index globally. Since there are almost 4,000 publicly owned US companies, a good question is how can the performance of just 30 super large companies, all rated blue chip for high quality, be meaningful? Dow members are chosen by sector to try to mimic the economy but a big flaw is it is weighted by share price. At the close of each business day the share prices of the 30 companies are totaled. The total is then divided by a number that currently is around 0.151727, less than one which means it's actually a multiplier. Why is there a need for a divisor, and why such a crazy number? The divisor is needed to "normalize" the average. It smooths out impact events like stock splits, spin offs and dividends. For example, Walmart is about to split shares three to one. The per share price will drop by 67% even though there's really no change in value. The divisor's craziness is due to the accumulative effect of offsetting the impact of such events over the years.

It doesn't happen that often but an adjustment to the divisor is needed when there is a change in the makeup of the 30 companies. In 2018 General Electric, the last original Dow member, was replaced by Walgreens. Imagine the impact on the average when a drugstore chain replaces a diverse industrial giant. In 2018 a GE executive noted that dropping GE was not surprising because its price was down some 55%. He said his company was dragging the Dow down with it. That raises the question of how meaningful is a benchmark which can be raised by changing one of its components.

The company with the highest Dow stock weight is Unitedhealth Group at 9%. Microsoft and Goldman Zachs are tied at 7%. In the S&P, Microsoft is at the same 7%, Unitedhealth at 1% and Goldman Sachs .3%.

The Dow Stock / Weightings

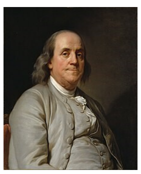
Unitedhealth	9	J P Morgan	3
Microsoft	7	Walmart	3
Goldman	7	J & J	3
Home Depot	6	P&G	3
Caterpillar	5	Chevron	3
Amgen	5	Merck	2
McDonald	5	Disney	2
Salesforce	5	Nike	2
Visa	5	3M	2
Travelers	4	Coke	1
Amer Exp	4	DOW	1
Boeing	4	Cisco	>1
Honeywell	4	INTEL	>1
Apple	3	Verizon	<1
IBM	3	Walgreen	<1

The S&P dates to 1957. It includes 470 leading US companies plus the 30 that are in the Dow. Obviously it has a bigger scope than the Dow and provides a better representation of the overall stock market. The S&P also needs a divisor to offset the same events as the Dow. It's based not on the stock price of its members but their market capitalization, which is the share price times the number of outstanding shares. The 500 companies make up 80% of the total US stock market capitalization. The Magnificent Seven (Apple, Microsoft, Amazon, Alphabet, NVIDIA, META and Tesla) are just 14% of the companies in the S&P but determine 28% of the index. Only the top 14 companies have a weight above 1%. GE is in the S&P and has a weight of .4%. At the bottom of the list of the 500 companies are Ralph Lauren and FOX Network weighing in at 1/100 of 1 percent.

Despite the differences in the makeup of two benchmarks and how they are calculated on most days the Dow and the S&P move in the same direction. Both hit all time new highs this month. Where there are differences is in the 10 year annual return, which for the Dow is 9.1% while the S&P is 12.5%. The Dow usually holds up better in a down market because of its super large blue chips, while the S&P usually does better in an up market because of a tilt toward growth versus value.

Compound Interest

Albert Einstein considered compound interest the "8th Wonder of the World." It is a powerful force for growing savings and grows more powerful over time. Interest is paid on the initial principal (the money you put in) plus the earnings, as long as they are not withdrawn, that accumulate over time. Simply stated by Benjamin Franklin: *"Money makes money. And the money that money makes, makes more money."*



Someday someone may give you this choice. Do you want to be given a million dollars or instead a penny. If you choose the penny, the next day you will be given 2 pennies. The following day 4 pennies and so on doubling the amount for the next 27 days.

As shown in the table, the wise choice would be to take the penny. Around day 20 the balance begins to really pick up and at the end of the thirty days you would have over 5.3 million dollars. An investment return of 100% every day is unlikely, but this example of compounding demonstrates earnings on earnings.

Day	Amount	Day	Amount
1	0.01	16	327.68
2	0.02	17	655.36
3	0.04	18	1,310.72
4	0.08	19	2,621.44
5	0.16	20	5,242.88
6	0.32	21	10,485.76
7	0.64	22	20,971.52
8	1.28	23	41,943.04
9	2.56	24	83,886.08
10	5.12	25	167,772.16
11	10.24	26	335,544.32
12	20.48	27	671,088.64
13	40.96	28	1,342,177.28
14	81.92	29	2,684,354.56
15	163.84	30	5,368,709.12

You Want Time On Your Side

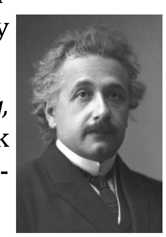
The following describes two long term saving plans, but the benefits of compounding apply to any time period.

Over their careers siblings A and B took different approaches to saving for retirement. In the first ten years A deposited $10,000 every year into a ROTH 401k. After that she added nothing more to the account. In those first ten years B saved nothing, but seeing how well A was doing he decided to open his own ROTH. Every year for the next 30 years he added $10,000. So, A put aside $100,000 and B $300,000. Who will be the more successful saver?

Surprisingly, A will have 20% more than B, roughly $1.2 million to $1 million. A needed to be determined to be sure to put away $10,000 every year for ten years. B will need to be even more determined to save $10,000 every year for thirty years. A lesson here is that the compounding of savings is not only economically beneficial but it's easier than saving money. Do you think A or B is more likely to miss or delay a deposit?

Both accounts earned 7% each year. ROTH's grow tax free, so income taxes are not an issue. Saving $833 per month is not unrealistic, certainly not for everyone, but for many people. Deposits into a ROTH are with after-tax dollars, which makes it tougher than saving in a tax deferred account.

The siblings are just starting out. Someday parents, C and D, will expect them to get their own places. Is a mortgage a good idea? Most likely yes. Renting is ok for awhile, but in the long term mortgages build equity and are therefore a form of stealth savings. People don't miss mortgage payments, same as they wouldn't miss paying rent. Mortgages payments add to savings without even thinking about it.



Debt involves compounding as well. Again from Einstein: *"A person who understands compounding, earns it, a person who doesn't pays it."* To appreciate the impact of compounding on debt, take a look at your loan's amortization schedule. Especially in the early years you will be amazed how much interest you can save by doubling up on principal payments.

During that 40 year period A & B may have a choice between a ROTH deposit or making extra mortgage payments. That decision is dependent on circumstances, goals, etc. which for A and B may vary significantly. They would be wise to consult E, a financial advisor. Fortunately unpaid school loans are not a problem for them due to generous 529 education plan contributions from grandparents F, G, H and I. The 529 accounts grew compounded and tax free as well since they were used to pay for education.

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Why The Need For Tax Returns?

Q. Why do we have to do tax returns? Doesn't the IRS already have all the info? I don't have a business, so why doesn't it just send me a bill?

A. President Reagan promised a system that would cut in half the number of Americans who have to file a tax return. The Obama administration wanted to send already completed returns for our review. Neither plan came to be, nor did we get the postcard Donald Trump thought should be sufficient.

The IRS receives the great majority of reportable income from employers, businesses, banks, insurance companies, custodians, lawyers, realtors, title companies, federal and local governments, casinos, lotteries and just about any institution that pays what could be considered income. Even interest on a family loan is reportable. Since 2012 brokers and investment companies have been reporting not only the proceeds from security sales but the cost basis as well.

At least when it comes to income, the preparation of a tax return seems to be an aptitude test to see if all the appropriate amounts were reported correctly, entered on the right line and on the right form. Finally, was the math accurate and was the right tax rate applied.

The IRS computer will be in touch if you miss reporting any income. It can work both ways. The IRS will let you know if you didn't take credit for taxes paid or withheld and if you may be eligible for certain credits, for example, the earned income credit.

At least so far the IRS does not get direct information on deductions like medical expenses, donations, energy credits, or what kind of car you drive. It does get information from lenders about mortgage interest and from schools about tuition. Anybody who can access Zillow can look up your property taxes. In 2018 the standard deduction was raised, and now 87% of tax payers don't itemize.

With some exceptions most of the genius in taxation is in planning and strategizing not the preparation of the return. You can add to an IRA up until April 15, but generally December 31 is your deadline for taking action to reduce taxes.