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THE NEW ROBIN HOOD

The legend of Robin Hood dates to English folklore of the 13th or 14th century. There have been some variations in the storytelling over the years. Sometimes a nobleman, sometimes of lowly birth, but always the same basic story: the heroic outlaw robbing from the rich and giving to the poor.

But now we have a new version of the legend. In this telling, Robin Hood pretends to be on the side of the poor but is actually stealing from them and giving to the rich.

The Robin Hood I'm talking about is **literally** Robinhood, the online trading platform used by millions of "little guy" stock traders to buy and sell stocks at no cost (or so they think).

Perhaps stealing is too strong a word, and I only say that to avoid a defamation lawsuit. And, apparently, what they are doing isn't illegal.

One of Robinhood's largest revenue sources is selling its users' data to high-speed traders. Say, for example, a large buy or sell order is placed by a Robinhood trader or several traders. The company will sell that information to another company that can exploit the information by "jumping the line," getting into the trade before the Robinhood order is filled and taking advantage of a buy/sell imbalance that might push the price of the stock up.

It might be only a couple of cents, but that's enough to make a nice profit when you're trading thousands of shares. The Robinhood investor, on the other hand, ends up buying the stock at an inflated price. Suddenly, that $10 trade fee they saved doesn't seem like such a good deal.

And now Robinhood has announced their IPO. Yep, they're becoming a public company, spreading their dream of making the stock market accessible to everyone (and fleecing them) across the globe.

When you rob from the rich and give to the poor, the sheriff makes it their life's work to catch you. When you rob from the poor and give to the rich, you get an IPO.

Now more than ever, **investors need to be careful who they invest with** and what technology they use—and beware of hidden costs.

—Steve Tepper

INFLATING FEARS

U.S. consumer prices were up by 5.4% for the year ending June 2021, the largest annual increase since August 2008.[1] Naturally, inflation is at the center of attention for many U.S. investors.

Inflation Outpaced

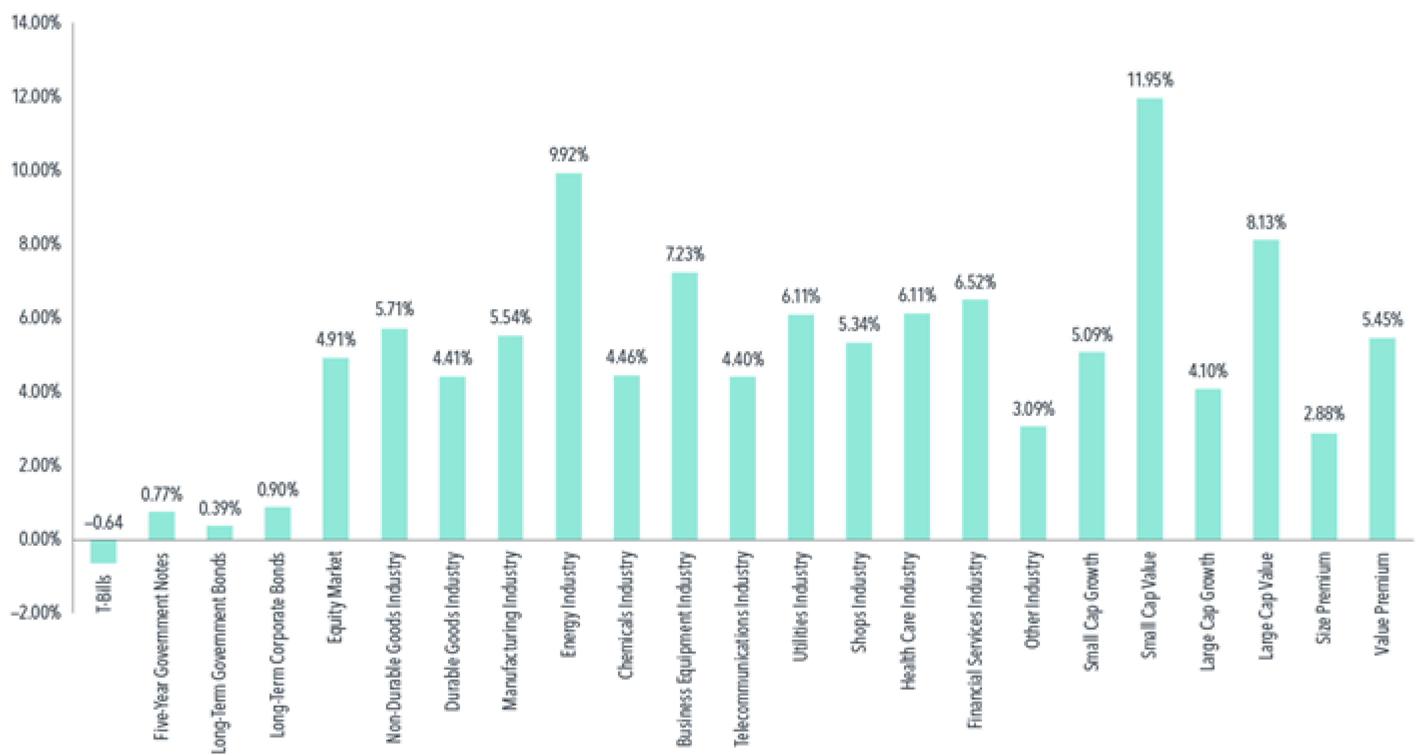
Exhibit 1 shows average real returns (that is, returns net of inflation) to different asset classes in years with high (above-median) inflation from 1927 to 2020. We consider a total of 23 U.S. assets that span bonds, stocks, industries, and equity premiums. Over this

period, inflation averaged 5.5% per year in high-inflation years. While average real returns were mostly lower in years with high inflation compared to years with low inflation, the exhibit shows that all assets except one-month T-bills had positive average real returns in high-inflation years.

The analysis over 1927–2020 is useful because it covers periods with double-digit U.S. inflation (like the 1940s and '70s) as well as periods with *deflation* (like the Great Depression, 1929–32). But we find similar results over the most recent 30-year period (1991–2020), when U.S. inflation was relatively mild and stable. Over this period, we also expand our analysis to non-USD bonds, developed- and emerging-market equities, real estate investment trusts (REITs), and commodities. Overall, **outpacing inflation over the long term has been the rule rather than the exception** among the assets we study.

Exhibit 1: Keeping It Real

Average annual real returns in years with above-median U.S. inflation, 1927–2020



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

Inflation Hedged

Despite the reassuring findings presented above, emphasizing growth assets that have historically outpaced inflation may not be appropriate for everyone. If you're highly sensitive to inflation and have a low tolerance for market risk, you'll likely want some exposure to inflation-indexed securities (such as TIPS and inflation swaps), and with good reason: They are designed to provide inflation protection. While stocks from certain industries, REITs, commodities, and value stocks are sometimes considered "inflation-sensitive" assets, the data provide little support that they are good inflation hedges.

Nominal asset prices already embed the market's expectation of inflation. So inflation concerns are really about the negative impact of *unexpected* inflation on the real value of your invested wealth. An asset is therefore most useful as an inflation hedge when its nominal returns move closely with unexpected inflation. In the paper, we find mostly weak correlations between nominal returns and unexpected inflation. For the few exceptions where the correlations are reliable, such as for energy stocks and commodities over 1991–2020, the assets' nominal returns have been around 20 times as volatile as inflation, and more than half of their nominal-return variation has been unrelated to

inflation. **Exhibit 2** illustrates this by showing how the annual nominal returns to energy stocks and commodities differ dramatically from the annual realizations of inflation. If the goal is to reduce the variability of future purchasing power, it is questionable that hedging with something so volatile will effectively achieve that.

Exhibit 2. One of These Things Isn't Like the Others

Annual US inflation along with nominal returns to energy stocks and commodities, 1991–2020

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

Inflation Deflated

What will next month's inflation reading be? How will it compare to market expectations? Is the rise in inflation temporary or long-lived? Nobody has a crystal ball. Fortunately, we don't need a crystal ball to address inflation in our portfolios. The data suggest that **simply staying invested helps outpace inflation over the long term.** And for those of us who are particularly sensitive to unexpected inflation, the protection offered by inflation-indexed securities still appears to be the most effective.

—From Dimensional Fund Advisors

[1] Based on the U.S. Consumer Price Index for All Urban Consumers (CPI-U, not seasonally adjusted) from the Bureau of Labor Statistics.

Source: Are Concerns About Inflation Inflated? By Wei Dai, PhD Head of Investment Research and Vice President, and Mamdouh Medhat, PhD Researcher, July 13, 2021.

GOT INVESTING FOMO? HERE'S THE ANTIDOTE

Are you feeling it? It seems that everyone from grandmas to college kids are. They're watching the news, reading friends' social media posts, and hearing some fantastic stories about stratospheric investment gains. And it makes them feel like they're missing out. Maybe you're worried you're missing out too.

The problem with fear of missing out (or FOMO) is that acting on it can hurt you.

What Is Fear of Missing Out?

The markets and economy are ripe for FOMO. Real estate is at an all-time high. Multiple market indices are soaring. And depending on the day you're reading this, cryptocurrency may be breaking another record (or it might have lost 50% of its value, which it also seems to do regularly).

If you feel like you're sitting on the sidelines while everyone's in the midst of the action and getting rich off it, then you might feel the impulse to jump in yourself. The impulse can be unbearable.

Some like to call it greed; others, exuberance. But whatever you want to call it, FOMO is a real thing. It's a drive to not be left behind. It's a push to keep up with the pack so that you're not eating crumbs while everyone else gets the pie.

Why Is FOMO So Bad?

FOMO affects us across all areas of our lives, but when it comes to investing, it can hurt our long-term financial success. It can lead to risky investments, which in this climate, is distressingly easy to achieve.

It seems that people are willing to invest in anything, from digital cats to Dogecoin, a cryptocurrency that began as a joke. There's even an exchange-traded fund called FOMO that aims to invest in trends like special-purpose acquisition companies (SPACs) and derivatives. Notably, its filing with the Securities and Exchange Commission states that its tactical approach and frequent trading can result "in a high portfolio turnover rate."[1]

No kidding!

FOMO short-circuits our logic and spurs lousy investment decisions. "Rather than buy stocks when they offer the most attractive risk-to-return ratio, investors are driven to

buy them to an even greater degree the less attractive they look technically," says James DePorre in "Understanding the FOMO Phenomena." "Our fear of missing out becomes greater the more the market continues to act in an irrational way."[2]

When many people jump on the FOMO bandwagon, prices climb, which heightens the fear of missing out. But the problem with emotionally driven decisions is that you can be left holding the bag when the same bandwagon panics and rushes to liquidate their holdings.

Are We in a Market Bubble?

When asset prices surge, the markets eventually reset. Many analysts say that we are in such a valuation bubble now and that investors should expect a drop.

We aren't fortune tellers here at Northstar Financial Planners, so we can't predict when a bubble will burst. But it's important to look at the fundamentals, and the *Forbes* article "Investors, Don't Succumb to the Fear of Missing Out"[3] has a telling one:

> *"The impressive stock market returns over the past decade have partially reflected corporate earnings growth, but a good portion of the gains have been the result of stocks becoming more expensive. One of the key metrics of relative expensiveness is the Shiller Price-to-Earnings ratio (also known as the CAPE). It currently sits at an eye-popping 35.8 times earnings, 50% above its long-term average and second only to the peak it reached during the dot-com boom. The market is expensive."*

Many of today's FOMO-driven investors are too young to remember the dot-com bubble of the late 1990s, but it also featured exuberant investors ignoring metrics like the P-E ratio. And when the bubble popped, many dot-com companies went under, and many investors lost a lot of money.

What's the Antidote to FOMO?

Since the fear of missing out can inspire irrational behavior, it's important to deal with FOMO, especially when it comes to your money. This is how we craft a comprehensive investment strategy that takes the risk of FOMO out of the equation:

- Rather than looking at "get rich quick" strategies like stock picking, have a long-term investment strategy.
- When markets go up, stick to the strategy.
- When markets go down, stick to the strategy.

- Own a diversified investment portfolio so that if a sector like tech stocks tanks, the damage to your portfolio is minimized.
- Learn about stock fundamentals, and use them rather than a friend's stock tip to evaluate a potential investment.
- Take a cooling-off period (e.g., 24 hours) before buying a "hot" investment.
- If you want to buy into a trend, use extra cash rather than money you earmarked for savings or retirement, like your 401(k) or IRA contributions. Make sure you're comfortable with the idea of volatility.
- Turn off the financial news. You'll feel a lot better.
- And of course, turn to your fiduciary, fee-only advisor if you have any doubts!

These tips may lack the adrenaline thrill of "buy, buy, buy," but in the case of investing, boring is good. Boring helps you sleep better at night and helps build wealth over the long term.

[1] https://www.bloomberg.com/news/articles/2021-03-10/a-new-etf-named-fomo-targets-everything-from-spacs-to-volatility

[2] https://realmoney.thestreet.com/investing/stocks/understanding-the-fomo-phenomena-15306150

[3] https://www.forbes.com/sites/johnjennings/2021/02/17/investors-dont-succumb-to-the-fear-of-missing-out/?sh=5dbdaa666349

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