NORTHSTAR FINANCIAL PLANNERS INC.

MAY 2020

FINANCIAL PLANNING NOTES

CLIENT NEWSLETTER

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THE DAY I ALMOST OPENED AN OIL STORAGE FACILITY

April 20, 2020 was a very interesting day in the commodities markets. May Crude opened at $17.73, fell steadily to about $11 by noon, and then went into a tailspin. At around 1 p.m., it was trading below $5 a barrel, and for the first time since I became a financial planner, I gave serious consideration to making an investment in something other than a boring old diversified, low-cost mutual fund.

Contracts for 200 barrels, I figured, would cost $1,000, and the worst-case scenario would be losing the whole grand, with an upside possibility of making a couple of thou if the price bounced to something normal.

Then I thought of a worse-than-the-worst case scenario, and that's what stopped me. If I was unable to sell the contracts, which expired that day, I'd end up receiving a shipment of 8,400 gallons of crude oil. I considered how several times over the previous couple of weeks our internet went out, once for the whole day. So thanks to Comcast, I didn't pull the trigger.

It is very rare you will ever hear these words: "Thank you, Comcast." Of course, what I'm really saying is "Thank you, Comcast, for being so awful and unreliable you inadvertently stopped me from making a big mistake." They probably get that a lot.

In the end, it wasn't a wonky Wi-Fi connection that would have hurt me. Yep, there was a worse-than-the-worse-than-the-worst-case scenario. About an hour later, I clicked over to Yahoo Finance, and oil was trading at **negative $35 a barrel!**

How can something trade at a negative value? It's a question we considered only in theory until 2020, but here we are. If I had been holding those contracts for 200 barrels, I would have had to **pay someone $7,000 to take them off my hands** or else start clearing all the furniture out of the house to make room for a really big delivery.

My $1,000 maximum loss could have been $8,000. Or more.

This is what was happening in the commodities market that day: Investors were dumping their May contracts en masse and rolling their money into June deliveries. With OPEC failing to curtail production for weeks into the economic freeze, and with demand at rock bottom as people have been staying home, gas stations haven't been taking deliveries from refineries, leaving shippers, pipelines, and refineries over capacity. No one in the supply line wanted one more barrel coming and were willing to take a massive loss on the sale of their contracts to cancel May deliveries.

It all makes perfect sense. Or at least it does now. Before April 20, this had **never happened in history.**

This year marks a quarter century since I earned my MBA in finance, and 13 years as an Investment Advisor Representative. What all that education and experience should have taught me is I don't know anything! Just when you think you're clever and have come up with a "safe" risk, there is always a scenario worse than the worst one you can imagine. Or even worse than that!

Meanwhile, back in the boring world of diversified, low-cost mutual funds, April has been a better month than March (at least as of the day I am writing this). Rebalancing has been an effective means of putting our clients in a good position when markets recover. We still don't know if that's sooner or later, or if more pain awaits us first, but the elimination of diversifiable risk is an effective strategy to avoid a worse-than-worst case surprise. Speculating on commodities is an almost entirely diversifiable risk. I'll leave it to the stronger hearted.

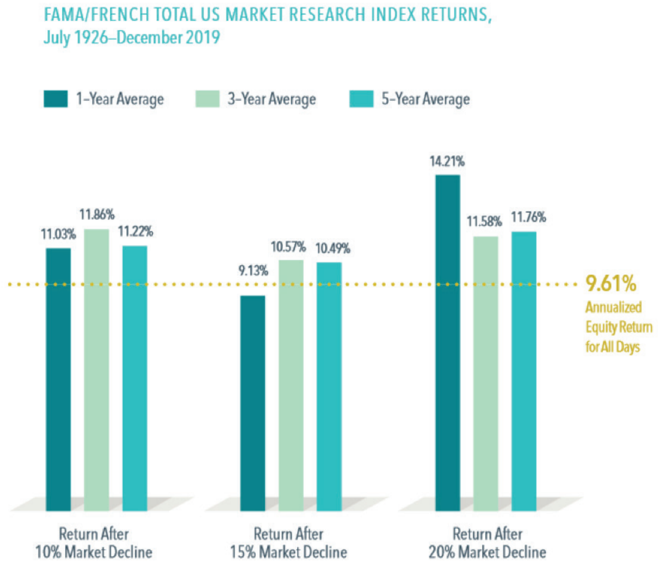
—Steve Tepper

NOW WHAT?

Between February 21 and March 21, 2020, the S&P 500 tumbled 35%. Since then, major indices have been bouncing around like pachinko balls. What will happen next?

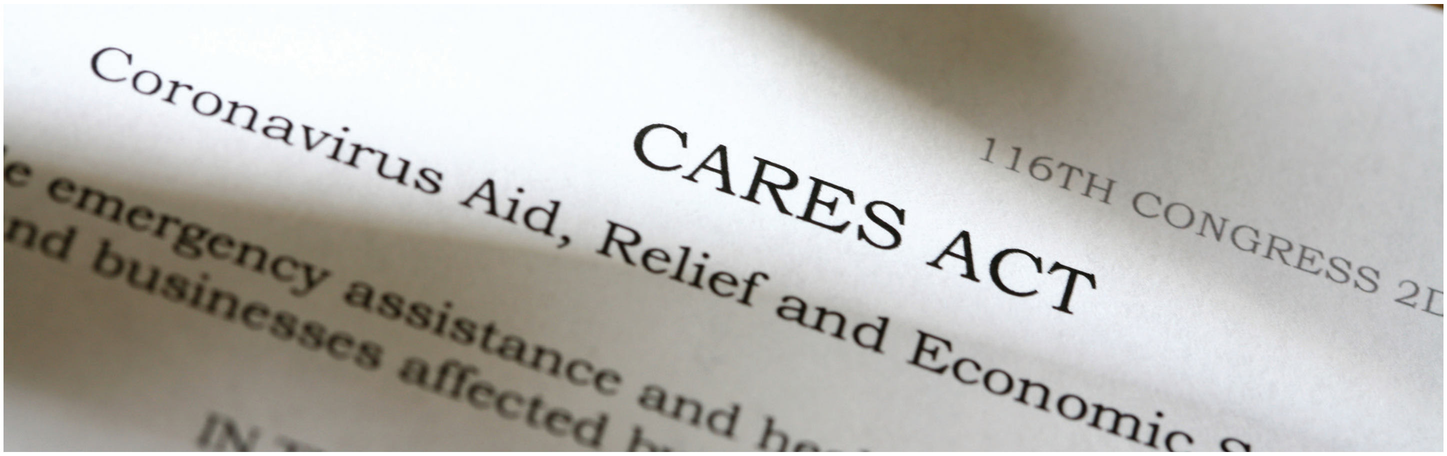
Not surprisingly to our regular readers, my answer is "I don't know."

While we've never seen stock prices tumble so far so quickly from record highs, we have certainly had market setbacks, and we have vast amounts of data that tell us what happened afterward. We know that past trends do not guarantee what will happen in the future. Nothing can. But past market behavior could give us some idea of what **might** happen, and even if we have to move forward in uncertainty, we don't have to fly blind.



Looking at the table, going back to 1926, total U.S. stock returns in the year following a 10% decline averaged 11.03%. The average annual returns over the three and five years following a 10% drop were also between 11% and 12%.

After a 20% market decline, the one-year numbers are even better, averaging 14.21%!



Market downturns are always to be expected. We don't know when or how far markets will fall, but history tells us the bounce back is often quick and robust. "Blink and you missed it" kind of stuff.

This is what makes market timing so challenging: You have two variables, and they are both working against you.

First, your signal to get out will often come after a good amount of the decline has already occurred. Think about it. When did people start talking about getting out of the stock market? It wasn't February 21. It was well into March. Markets were already at "bear" territory, down 20%.

Your second challenge is that your re-entry cue may come after the recovery is well underway. That's what the data in the chart is telling us. Do you want to wait a year and risk missing 11% or 14% of the market bounce?

These two market timing challenges could easily leave you with an exit point lower than your point of reinvestment. "Sell low, buy high" is not an effective investment strategy. "Faith, patience, discipline" is.

Keep faith that capital markets will continue to reward investors in the long run, patience to wait for the reward you deserve for the risk you take, and discipline to stick to a solid, proven investment strategy.

—Steve Tepper

Adapted from information provided by Dimensional Fund Advisors.

Past performance is no guarantee of future results. Short term performance results should be considered in connection with longer term performance results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Periods in which cumulative return from peak is –10%, –15%, or –20% or lower and a recovery of 10%, 15%, or 20%, respectively, from trough has not yet occurred are considered downturns. Returns are calculated for the 1-, 3-, and 5-year look ahead periods beginning the day after each downturn. Whether a period is considered a downturn is analyzed on a daily basis, and therefore the 1-, 3-, and 5-year look ahead periods are overlapping. The bar chart shows the average returns for the 1-, 3-, and 5-year periods following 10%, 15% and 20% downturns. For the 10% threshold, there are 3,442 observations for 1-year look ahead, 3,396 observations for 3-year look ahead, and 3,345 observations for 5-year look ahead. For the 15% threshold, there are 3,175 observations for 1-year look ahead, 3,167 observations for 3-year look ahead, and 3,166 observations for 5-year look ahead. For the 20% threshold, there are 2,561 observations for 1-year look ahead, 2,560 observations for 3-year look ahead, and 2,560 observations for 5-year look ahead. Peaks and troughs are patterns that are developed by the price action experienced by all securities. Peak is the highest point prior to a drawdown, and trough is the lowest point after the peak. Data provided by Fama/French. add back in available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

Investing risks include loss of principal and fluctuating value. There is no guarantee an investment strategy will be successful.

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

MORE ON THE SECURE AND CARES ACTS

Last month, I talked about changes to tax-filing deadlines and required minimum distributions (RMDs) from IRAs under recent federal legislation. Here are some more changes that might impact you.

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IRA Contributions After Age 70½

Previously, you could no longer contribute to a traditional IRA account after you reached the age of 70½, at which point you had to start taking money out of your account each year (RMD).

The SECURE Act raises the age that you have to start taking RMDs to 72 (provided you didn't hit 70½ in 2019 or earlier) and allows you to continue to make contributions to your IRA, as long as you have earned income. And as mentioned last month, under the CARES Act, nobody has to take an RMD this year.

Non-Penalty Distributions

The legislation adds several new provisions allowing you to withdraw money from an IRA account before age 59½ without incurring a penalty. Those provisions include:

- **Up to $5,000 for costs related to childbirth or adoption.** Note: You will still have to declare the withdrawal as a taxable distribution.
- **Up to $100,000 for coronavirus-related expenses.** These could be direct medical expenses if you or a family member contracts the disease, but can also be financial losses if you are laid off or the business you own suffers a financial setback.

  The money you withdraw under this provision is also taxable income, but you have the option of paying the tax burden over three years, and if you replace the withdrawn amount back in your IRA within three years, it will be considered a non-taxable rollover, with no taxes due at all.

Despite these enticements, taking money out of your IRA should remain one of your last options for income. Talk with your advisor to review other options that might be preferable based on your financial status and goals.

—Steve Tepper