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# Measuring Fear & Greed

The "Fear & Greed Index," a creation of CNN Money, measures investor sentiment. It aims to quantify the equity market's current position on a continuum between the two human emotions that drive investment decisions: fear and greed. As a guide to investment decisions, it assumes that if the needle points to "greedy," stock prices will be rising, while a fearful reading signals dropping prices.

This interest in the emotional tenor of investors rests on the understanding that markets can be affected by the very human tendencies to flee from danger and run towards reward. (In fact, there are animal equivalents of these innate drives.) Emotions impact our decisions especially when we are under pressure. As a result, stock prices can rise well above anyone's reasonable estimate of fair value during a market boom, and fall excessively during a rout.

Most investors wait to jump into a market that is rising until they reach a level of comfort with the direction, and then, belatedly, they want to jump in. Typically they have missed most of the rewards and joined the party in time to participate in the downhill slide. Investors also are slow to bail out of a slumping market, hating to sell at a loss. They wait to reach a level of pain that they can no longer tolerate and then sell at an even greater loss.

These patterns explain why market timing generally does not work and why most investors trail the market. Some investors who have a greater than average comprehension of how the financial markets behave, and a greater than average control of their emotions, do better. A contrarian investor, Warren Buffet is quoted as saying, "Be fearful when others are greedy and greedy when others are fearful," so a sharp and elongated rise in stock prices prompts him to sell, not jump into the market.

We have two levels of response to situations. Reflexive responses occur nearly automatically when a situation seems urgent or a decision is hurried. Fear and greed hold greatest sway in such a context. Reflective responses, more deliberative and analytical, take more time. Studies show that given a longer window of time, we are better able to control our fears and moderate our greed. Long-term investors, therefore, are more impervious to their emotions, while day traders may be less so.

A closely related behavioral factor influencing our financial decisions is "recency bias," our tendency to give greater weight to more recent events. Thus, a declining market amplifies our sense that markets are dangerous (increasing fear) while a rising market encourages our confidence (promoting greed).

The Fear & Greed Index was designed to be used as a contrarian indicator, warning us to retreat when the masses are feeling greedy and confident, and to invest when they are fearful. The index is calculated by measuring how far 7 different factors have veered from their average level, relative to how far they normally deviate. Each factor is given a score between 0 and 100 and is assigned an equal weight in the overall index.

GREED

Those factors include 1) the "safe haven demand" or the difference between returns for stocks and returns for Treasury bonds. 2) market volatility, 3) stock price breadth between the advancing and declining volume in the New York Stock Exchange

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## Fear & Greed continued


4) demand for junk bonds (what investors demand to take a risk), 5) market momentum, or how fast investors are committing their capital, 6) stock price strength (% of stocks hit -ting 52 week highs v. 52 week lows), and 7) the volume in puts (a bearish indicator) versus the volume in calls (bullish).

There are other ways people try to measure investor emotions. For example, the FGI (Fear Greed Index) seeks to guide investors in the Indian equity market, encouraging them to "sell to the greedy and buy from the fearful." They assert that "remaining calm in the midst of fear and greed is the foundation of good investment returns." An app called Ayaxia measures and analyzes trader' emotions through biofeedback (oxygen saturation, heart and respiratory rate, etc). The app tries to help the trader identify and maintain control over emotions in order to reach optimal "flow" and peak performance. Well, OK.

While the CNN Fear & Greed Index, the FGI, and even Ayaxia may help you to control the destructive impact of emotions on investment decisions, there's another way to protect your portfolio. By using a disciplined asset allocation approach, you never make market timing decisions in the first place. Fear and greed aren't even given a chance to harm your performance. At Assabet Advisors, we feel the pull of fear and greed but our strategy generally immunizes the portfolios from their influence.

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## Playing it Safe

Even if we weren't earnestly concerned about safeguarding our clients' personal information from financial predators, it would be hard for us to ignore our responsibility. Currently, we are regulated by the Massachusetts Securities Division but we tend to pay close attention to any notice from the Securities and Exchange Commission that relates to Registered Investment Advisers. Recently, the SEC has been particularly interested in cybersafety. Meanwhile, just this month we completed a survey about our cybersecurity practices for the MA Securities Division and we fully expect to see new regulations as a result. Our compliance consultant MarketCounsel keeps us up to date on any new requirements. Finally, any organization conducting business with Massachusetts residents is required to meet the standards detailed in 201 CMR 17.00: Standards for the Protection of Personal Information of Residents of the Commonwealth.

What difference has this deluge of oversight made in our practices?

1) In response to a Massachusetts regulation in 2011, Assabet Advisors developed a "WISP" (Written Information Security Plan) that guides how we handle "personal information (PI) ." PI includes any document in which both a name and a number (social security, account, for example) appear together. Thus, we freely email an Assabet Advisors quarterly report to a client because it shows only the name. However, when we want to email something more sensitive, we use Sharefile.

2) Sharefile is a cybersecurity product which through SSAE 16 audited datacenters and AES 256-bit encryption seeks to ensure privacy of confidential files during transfer and in storage. Sharefile uses a vault with separate files for each client. Some of our clients have experienced Sharefile delivery and so far, we've received no complaints.

3) New policies. The SEC and FINRA (Financial Industry Regulatory Association) have issued regulatory notices requiring advisors to have a policy aimed at protecting clients from fraud involving transfer of client funds. The threat is particularly acute when advisors receive email instructions from a compromised email address to transfer client monies. Although this is a very common crime, requests for wire transfers are rare for Assabet Advisors. However it happened as we were writing this article. Had the email been fraudulent, we might not have known. We followed our policy of calling the client to confirm the request, and confirming for ourselves that we were talking to the client. We also spoke to the receiving bank to confirm our client's account.

We're doing our best to protect our clients, with a lot of encouragement from our regulatory friends.

# Economic and Financial Overview

"Don't argue with success," yet the continued success of the stock market rattles many investors. The S&P 500 index is in its longest winning streak since 1998. It returned +5.2% for the quarter. The Dow Jones Industrial Average hasn't had a correction (>10%) in over 2 years, and hit 17,000 on July 3. Among the factors sustaining the long bull market are persistently low interest rates which can support business earnings and make stocks appear to be the only game in town. The stable inflation outlook and the shrinking federal deficit also help. The S&P 500 is close to its highest valuation in 4 years, but at a 16.6% price to projected earnings ratio, is only slightly higher than the 15 year average. Most foreign stock indexes kept pace with the US market and emerging markets did even better.

Yields on bonds remain historically low.. Expecting stronger economic growth and higher inflation, analysts were surprised by stable yields and strong returns during the second quarter. Treasury bonds rose by +1.26%, buoyed by support from global investors seeking safety and higher interest rates than those available in other major debt markets. Corporate bonds returned +2.5%. The Fed has kept a steady hand on policy, looking for more job growth and higher inflation before changing course.

The GDP fell by -2.9% in the first quarter but recent economic indicators have been encouraging. Labor market reports are particularly good; pending home sales and house prices have risen, and consumer sentiment has improved. But with slow wage growth, and rising costs for fuel and food, consumer spending has been at its weakest level in 5 years. Consumers are wary. Hikes in stock prices and property values benefit the wealthy more than lower-income households. Strong participation in the economy by recent college grads is limited by difficulty in getting a job or a mortgage, and by college loan burdens.

Economic growth remains slow and inflation is still low in many developed economies. Like our Fed, other central banks are trying to determine when and how to shift away from an easy money policy.

# Do You Know What You're Paying? (We Do)

A recent survey found that nearly 63% of financial advisors don't know what they are charging their clients in fees[1]. No wonder that most clients don't know what they're paying! If you're confused, this summary may help:

A **fee-only** advisor (like Assabet Advisors) is paid entirely by fees coming directly from the client, usually debited from the account. Our fees are based upon a percentage of the assets we manage for you and range from 0.80% to 1.20% annually. Our fee level is calculated based on the total asset size, the growth potential and the number of individual accounts. "Fee-only" means that we cannot receive compensation from any other source including mutual fund companies that would be paid to us as a commission for using their products in your portfolios. It also means that when your assets increase, our revenues grow accordingly, and when they decline, we share your pain. A **fee-based** advisor may charge an asset-based fee *plus* commissions from products chosen for your portfolio. Both fee-only and fee-based methods are legal and reasonable. We prefer fee-only because it gives us no incentive to favor one investment option over another apart from what's best for you.

You also pay fees deducted from the mutual funds in your portfolios, sometimes referred to as "hidden fees" because they are simply a reduction of the fund performance, not invoiced or recorded on your brokerage statement. A fund might have a "*front end load*" or sales charge, perhaps as high as 4%. (Our clients don't have such funds.) All mutual funds have *expense ratios* which across the industry range from under 10% to over 200% but have a simple average of 1.37% for equity funds, 1.51% for world funds and 1.00% for bond funds[2]. (The expense ratios on the funds that we chose for client portfolios range from 0.08% to 0.75%) Securities purchased individually do not have expense ratios. There are *transaction fees* charged by the broker whenever a fund is bought or sold. (There is no way to avoid these but because we are not "active" investors, our clients' transaction fees are minimized by how infrequently we make transactions.) There may be an annual "*account fee*" or "*custodian fee*." (Our clients don't pay those.) There could be a "*12b-1 fee*" (between 0.25% and 1.00%) that reimburses the fund company for certain marketing expenses. (Only one of the funds we use has a 12b-1 fee).

All of these fund related fees are legal and (more or less) reasonable, but it's possible to manage portfolios as we do, with a very close eye on costs. By keeping fund fees very low, we aim for our clients' TOTAL costs (fund fees plus our fee) to approximate the cost of an average priced equity fund.

1. Peak Advisor Alliance and Cerulli Associates 2. Investment Company Institute Facts 2014

# Recession Proof

Are there products that you could not live without? Your Starbucks? personal trainer? XM radio? I have seen enough budgets developed during a financial setback to know how different we all are in defining "necessities." However, in studying consumer purchasing patterns, analysts always are looking not for differences but for trends or commonalities.

Not too far beyond the Great Recession, and still mired in a relatively imbalanced recovery, those who study spending consumer behavior are interested in the fortunes of various products from 2007-2009. By "recession-proof," they mean those products that either thrived in the face of economic pressures or seemed immune. Consumer buying patterns are significant because consumer spending is such a large (although not stable) percentage of GDP. In 2013 consumer spending rose to 71% of GDP.

During the most recent recession, there were a few major trends. In sum, they seem to indicate that during an economic downturn, consumers find comfort although at not so great a pricetag as in good times. Candy consumption soared. Hershey Corp's profits rose by 20% in the first quarter of 2009. SPAM and Kraft Mac & Cheese also had strong sales. In some cases, consumers changed behaviors in order to reduce the cost of comfort items. Liquor sales held up yet consumers altered their lifestyle in order to have their favorite drinks. "In house" sales in bars and restaurants declined while a lower quality of wine, whiskey, rum, vodka and gin were purchased for home consumption.

Pet care spending also persisted. Both the company of pets and "babying" our pets are obvious sources of comfort. They also are protected by relative low expense (once you already own the pet). After all, I can spend $4 and delight Jester and Glory with a new toy while a new iPad for myself may seem out of reach.

Specialty food items proved a hard habit to break and held their own during the recession. Any of us who have known periods of financial constraint likely have allowed ourselves periodic treats in the form of favorite foods. It's associated with the "small indulgence" trend in the 2008-09 recession in which people who were postponing the new car or other larger purchases, opted for items that were low-price but high-glam. An example is higher quality nail polish in the latest colors. (She might not have a new suit but her nails are smashing!) This drift to small indulgences was memorialized during the 2001 recession by cosmetic leader Leonard Lauder who cited the "lipstick index" as a harbinger of economic decline. Observing the spurt in lipstick sales, he speculated that women substituted lipstick for purses and dresses during times of economic hardship. This particular index did not work in the recent recession. Mr. Lauder explains that nail polish and mascara succeeded lipstick as the affordable luxury of choice.

If we can explain some of the recession proof product lineup, there are others whose success is not as obvious. Just for fun:

- Hunting and fishing equipment sales rose during the period. Was that because people who lost jobs had more free time? Or were they supplementing the grocery shopping? Camping gear also rose, perhaps as a substitute for more glamorous vacations.
- In the 3 months ending January of 2009, sales of handguns rose by 27.5%. My guess: people were arming themselves in fear of looting. Wayne's guess: People were planning to rob others. (He's joking.)
- Tupperware prospered. Were people more inclined to save leftovers?
- Exercise equipment (DVDs, yoga mats, running shoes, etc) rose. Were people giving up gym fees to work out at home?
- Laxatives. Anxiety leads to health problems?
- Match.com. It's easier with 2 incomes?
- Condoms. Never mind.

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