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Conspicuous Bravado

There are many reasons why someone purchases an extravagant item. He may love the product or crave the prestige it provides. A highly expensive car may offer incomparable safety measures or exclusive add-ons. Or it might cost enough to signal great wealth. A lovely and well-fitted dress may make a lady feel beautiful, or she may pay an extreme amount for an ugly gown, flaunting the designer's name.

Thorstein Veblen's The Theory of the Leisure Class, published in 1899, discussed the practice of acquiring extremely expensive goods in order to achieve celebrity and esteem. The concept of "conspicuous consumption" derived from his philosophy. Veblen focused on consumption patterns of the 19th century, yet the purchase of lavish merchandise to demonstrate wealth, neither began nor ended with that period.

Status-seeking consumption has long been the practice of wealthy and powerful rulers. Picture the castles and elaborate costumes of French Bourbon kings. Louis XIV's outfits were signals of wealth, not garments for comfort. Massive wealth, demonstrated by the Palace of Versailles, exhibiting what the monarch could have simply because he wanted to. It is a clear mark of power to do whatever you desire. Centuries ago, Emperor Caligula (who died in 41 AD) rolled in gold, much like Scrooge McDuck.

In fact, gold has been a common illustration of conspicuous consumption in our own times, from gold home decor to gold cuisine. If you plan to visit upper east side Manhattan soon, dine at Serendipity 3 where $200 will get you French fries scalded in champagne, and sprinkled with truffle salt and gold. The Opulence Sundae" once sold at $1000, contained "Tahitian and Madagascar vanilla ice cream, edible gold leaf, Grand Pasion caviar and more. Gold food is neither tasty nor nutritious but it's impressive for its showy expense. The restaurant's chef and creative director said: "We need to have some fun now." Other everyday items sold at huge prices also serve to display wealth, for no other purpose. Gold plated toilet paper, or bars of soap with gold dust, costing $2,800, also must offer some chuckles.

Ostentatious purchases in the categories of real estate, boats, jewelry and jets, continue to be made by super affluent individuals. Some show their ability to afford superfluous items such as golden cars, mansions for pets, or enormous doomsday bunkers. Yet for several reasons, conspicuous consumption has also moved into far lower economic levels. These days, many people can swagger with their shopping bag. Goods that symbolize wealth are more available, cheaper and exceptionally well marketed. Credit cards help make them obtainable. Online purchases can be impulsive. Even as economic inequality has increased, lavish handbags, shoes or watches, for example, remain acquired by consumers well beyond their reasonable budget. The association of wealth and importance remains a powerful belief. Brands, which make status symbols obvious, raise an object's price, whereas just four decades ago, the logic was, "Huh? Why should I pay more for *wearing* a commercial?!"

Clearly, people of very low incomes cannot compete in the conspicuous consumption contest with the 1-percenters. But those of any economic rank who wish to flaunt wealth, tend to aim at *relative* wealth...by wearing, driving or living in something a notch above that of their own social group.

Psychologists who study conspicuous consumption at all levels of prosperity, observe various behaviors. Some brandish luxury in competition with others, trying to show superiority. Some consume conspicuously to camouflage their insecurity, and to enrich their public image. Some attempt to intimidate others with their financial clout.

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Conspicuous Bravado, continued

Some pay for luxuries as a personal reward for an accomplishment. Psychologists presume that in general, spending great amounts of money in order to gain attention and admiration is not rewarding. It tends to identify insecurity. Ego strength which depends upon "recognition by others" has far less support than a well-developed self-esteem. Guided by your ego and not your true financial capacity, you can suffer fiscal failure. Mostly people are not admired by what they buy but by their personal traits. These drawbacks are as debilitating for the super rich as for those without much to spend. Everyone plays to their own level.

While conspicuous consumption has moved into low-income social levels, one type of consumption is largely limited to the affluent. One author states that since 2007, while the middle income spends more on material goods, the top 1% spend less in general, yet more on education, retirement and health. They invest in inconspicuous consumption that gives familiarity with social norms and networks, which then offer social mobility into next generations. This can't be bought online, with credit.

For a long time our economy has grown on consumption-based models: encouraging people to overspend and desire more, built-in obsolescence which encourages more purchasing, and money poured into the system enabling consumers to spend. Some researchers doubt that the consumption-based economic model can be maintained going forward.

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Retirement in Reverse

Home owners are reasonably acquainted with mortgages paid before retirement. Yet "reverse mortgages," a type of home equity loan available to owners 62 and above, cause confusion. The complexity has resulted in financial misfortune for some, and the general suspicion that reverse mortgages take advantage of vulnerable seniors. Scams and misunderstandings produce regrettable losses, but government regulations over time have made a difference.

HECM (Home Equity Conversion Mortgage) represents most of the reverse mortgage market. Insured by FHA (Federal Housing Administration), it is a loan by a lender with the borrower's home as collateral. It allows the borrower to stay in the home while tapping the home equity to meet expenses. Unlike a home equity loan, the loan balance plus interest (100% deferred), is not paid monthly but as a single balloon payment when the borrower leaves the home by moving or dying. The loan can be dispensed as monthly, a line of credit, or as a lump sum (discouraged by the government by a reduced payout rule).

It is an expensive way to borrow money, with an origination fee, interest charges, servicing charges and the FHA annual insurance premium. The borrower must stay in the home, promptly paying property taxes, home maintenance and insurance premiums. At the borrowers death or relocation, the borrower (or heir) pays the total debt usually by selling the home. Interest, often at a variable rate, accumulates monthly, and can reduce equity severely. If the sale price of the home exceeds the full loan balance, the surplus goes to the borrower or heir. Another positive note: A loan is not taxable.

In the past 2+ decades, Americans have been living longer, with rising health costs, declining employer pensions, and a financial crisis. HECMs increased considerably between 1999 and 2008. Following the crisis, borrowers used loans in more risky ways, and scams multiplied. By 2014, 10% of borrowers had defaulted, nearing foreclosure. The government responded with a series of new rules that included limits on early loan amounts and withdrawals, and, most important, a requirement that potential borrowers meet with a counselor from a government approved counseling agency. There *are* good strategies for the use of reverse mortgages by well-informed seniors who have substantial equity and who can reasonably expect to age in place for a very long time.

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OUR RECENT READING: Consult www:goodreads.com for reviews

Wayne: The Fifth Risk by Michael Lewis. Lewis illustrates how our government, through many departments and agencies, has been designed to keep the country running safely, protecting us from alarming risks. Most of us don't understand all that the government does, or the dangers caused by a botched administration transition in 2016. This is an interesting and important book.

Robert: The Last Traverse by Ty Gagne, This is a (true) account of a 2008 hiking disaster and rescue in the White Mountains. It's a rich coverage of the event: science, psychology, climatology, personal trauma, and complex details of hiking and mountain rescue techniques. This book is stirring and sad, especially recommended for serious hikers.

Economic and Financial Overview

The economic outlook was positive in the 2nd quarter as growing activity and employment suggested that the pandemic wave had passed. The speed and scope of government fiscal stimulus, including individual benefits, as well as healthy corporate profits, led stocks to new highs. For Q2, the revised rate of real GDP was +6.7% the highest since Q4 2019. Fed Chairman Powell was reassuring, recognizing the economic improvement, but not yet ready to tighten short term rates. Ideal.

Many Americans tended to pursue pre-pandemic opportunities such as jobs, travel, recreation and such. However, although in much of the 3rd quarter, Powell quietly implied that the economy would continue to grow and inflation growth would not persist through 2022, things did not progress as expected, largely because of two key factors. There was the resurgence of COVID-19, with rising infection from Delta variant plus crowding hospitalization, and a supply chain bottleneck. Some people left work from fear of the viruses or to serve as home caregivers. Supply shortages caused price hikes and climbing inflation. These weakened economic expansion and further reduced consumer confidence.

Near the end of the quarter, other factors also contributed to concerns regarding the economy. The Evergrande debacle in China (A possible failure of a major real estate conglomerate in the world's second largest economy), triggered fears of contagion in global stock markets. A mounting uncertainty in the Congressional deadlock involving the debt ceiling, added to the market's volatility. Inflation is edging up. We have labor shortages at all levels, and rising jobless claims at the same time. Interest rates are headed up. The trade deficit climbed to $73.3 billion in August. But that gloomy picture is a very recent reality. Remember that the S&P 500 hit all time highs in September. Market confidence only gave way in the final weeks. We still have a high level of job openings, strong durable goods orders and pent up demand for supplies. For Q3 the S&P 500 returned +0.23% (with +14.68% YTD). Domestic small-caps lost –4.60% in Q3, with a gain of + 11.62% YTD.

Developed international equity markets dropped –0.45% for the quarter, with a YTD rise of +7.47%. Emerging markets fell –8.67% in Q3 bringing the YTD return to –2.18%.

You Can't Please Everyone

Please don't assume that this brief article will tell you all you need to know about your Required Minimum Distribution (RMD). For that, you'll need a barrage of experts, and even those may be baffled by the recent legal modifications. Here, we simply review the RMD factors which drive retirees to distraction. Ed Slott, a frustrated RMD expert, has noted, "They're a good way to keep seniors crotchety for the rest of their lives."

Elder frustration was not the goal when IRAs were introduced, offering a plan of tax deferred savings for later in life. Presumably, assets would grow over the earning years, and then be distributed to help meet life expenses in retirement. The RMD obligation requires the distribution each year of an amount calculated as the prior year's fair market value, divided by the applicable life expectancy. The time at which it must begin has moved to a slightly higher age in the early 70s. Two elements of RMD made people particularly crotchety: the nuisance factor and being reminded that the assets were tax deferred, not tax free. With the RMD, the debt to the IRS comes home to roost. The distribution must be essential to some for expenses in retirement, as 80% of those subject to RMDs withdraw more than their annual minimum. But others not needing the withdrawal begrudge transferring an amount to the IRS. In some cases, handing over the RMD amount increases the owner's tax bracket.

IRA account owners grumble, but the IRS has consistently offered changes to assist individuals preparing for retirement. The objectives are to bolster retirement savings and to have assets distributed over the owner's (or the couple's) lifetime. Another goal is to encourage payment of the deferred tax debt to the IRS. Changes in the laws address all of those targets, while causing confusion for IRA owners or their account custodians. Recognizing longer lifespans, the SECURE Act of 2019 (Setting Every Community Up for Retirement Enhancement Act) had 30 provisions, including the repeal of the maximum age of traditional IRA contribution, allowing contributions to continue. It also increased the starting age for RMDs from $70^{1/2}$ to 72. But one change was less appealing: If you inherit an IRA or 401(k) from someone other than your spouse, the SECURE Act likely impacts your retirement savings strategy. Until 2020, IRA beneficiaries could generally "stretch" their inherited taxable distributions out over their life expectancy. Now, the law requires most beneficiaries to withdraw assets from an inherited IRA or 401(k) plan *within 10 years* following the death of the account holder. The 10 year limit reduces the extent of tax-deferral and/or alters the tax bracket for some unhappy beneficiaries.

Responding to the Covid-19 outbreak, the CARES Act excused retirees from making their 2020 RMD. Among potential shifts, the 2020 SECURE Act proposes a raised catch-up contribution size for those aged 62 to 64, a gradual increase to 75 in the RMD beginning age, (discretionary) automatic enrollment to a retirement account and other attempts, and sanction for an employer to extend a company match to those with student debt to pay. These changes aim to promote retirement savings at different stages of life, while not obliging the IRS to subsidize the accounts. RMD is a nuisance and we all hate to pay taxes. Are you good at "crotchety"?

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A “Regrettable” “Distraction”

We live in a particularly sensitive period as the pandemic has produced several forms of suffering. An appalling number of deaths, as well as job losses, lockups and cultural hostility fill many of us with gloom or anxiety. This harsh environment trails a period of declining prosperity as college fees, medical costs and even food, loom beyond the budget of discouraged families. Inequality has expanded and the gap between the very affluent and the rest has become apparent, and disturbing. There is a tendency for anger and resentment towards government leaders, people who represent other parties, and, by the way, billionaires. (Some Americans believe that our entire economic system is rigged in favor of the wealthy.) In short, this would not be a good time for Federal Reserve members to raise any appearance of conflict of interest.

It was in this cynical climate that two Federal Reserve presidents became known to have traded actively in 2020, when the Fed was taking extensive policy moves to bolster the economy and the financial markets. Both Robert Kaplan, Fed President in Dallas since 2015, and Eric Rosengren who became President of the Federal Reserve Bank of Boston in 2007, joined the other 10 regional Federal Presidents in August in making the annual disclosure of their personal 2020 investment transactions. Because most Fed leaders had more moderate holdings, and reported little or no trading during the year, data from Kaplan and Rosengren’s disclosures got the attention of the Wall Street Journal and were made public.

To date, there is no official insinuation that their actions violated ethical guidelines through participation in the following transactions. Mr. Rosengren held shares in 4 real estate investment trusts, in addition to other investment trades. His dealings, while not illegal, caused some rebuke because he had publicly warned against the risks of commercial real estate. Mr. Kaplan’s investments were more extensive. These included 32 individual stock, fund and other types of assets, among which 27 were valued greater than $1 million at the end of 2020.

The news of these reports raised eyebrows and even criticism because of the Federal Reserve’s significant role in the financial system. As such, the Fed Presidents make decisions affecting long and short-term corporate debt, and have access to financial information in order to establish monetary policy. The proximity of some of Kaplan’s investments to the Fed’s current market interests triggered some notice. For instance, he purchased stocks of companies affected by the pandemic, as well as corporate bond exchange-traded fund, a fund generally purchased by the Fed. Also fomenting disquiet, was the fact that the Fed’s 2020 activities were engaged in the first year of the pandemic. Given those pressures, which threatened a possible market collapse, the Fed acted fast and aggressively to keep financial markets running. They were applauded for shielding the market. However, it was suggested that the policies elevated asset prices thus serving wealthy citizens, while small businesses and households were relatively rejected.

Kaplan and Rosengren performed within the specific Fed ethics. They did not trade within the “blackout period,” a period of time bordering Fed meeting. They did not hold stocks or funds in banks, or sell securities within 30 days of the buy, or violate other such rules. But they did disregard the Code of Conduct which said that they “should avoid engaging in any financial transaction inside information the timing of which could create the appearance of acting on inside information concerning Federal Reserve deliberations and actions.” And they didn’t rise above the current but outdated ethical limits that were composed long before the Federal Reserve began to operate with such considerable influence in the financial markets. The ethics system was criticized as describing an antiquated central bank model, even before this episode, when the optics clearly were became questionable. And now, in response, various people have loudly suggested far more stringent rules including limits on what active trades or personal portfolios, may be permissible for Fed Presidents. Lawrence McDonald (author, speaker and risk consultant): “Why in the name of God’s green earth did it take a public shaming on Twitter to inflict common sense?!”

Rosengren’s and Kaplan’s early responses seemed remarkably brash as they promised only to sell the individual stocks they own, moving the value into funds or cash, and to not trade further during their time in office. Said Rosengren (basically echoed by Kaplan) “Regrettably, the appearance of such permissible personal investment decisions has generated some questions, so I have made the decision to divest these assets to underscore my commitment to Fed ethics guidelines. It is extremely important to me to avoid even the appearance of a conflict of interest, and I believe these steps will achieve that.” That wasn’t sufficient to satisfy the critics. Mr. Rosengren resigned his post for medical issues. Mr. Kaplan has now left his job because “the recent focus on my financial disclosure risks becoming a distraction to the Federal Reserve’s execution of (their) vital work.” A “distraction.” Picky, picky.

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