# The Quarterly Report

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INSIDE STORY

## RESOLUTIONS

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# RESOLUTIONS

**It is as much of a holiday tradition as turkey on Thanksgiving and presents under the tree Christmas morning: New Year's resolutions.** Lose weight, exercise more, read more, be on time for a change, and manage my money more wisely. It is all good stuff, but does it work? According to Psychology Today, resolutions work for about two weeks. Most people are back-sliding by February and by the end of the year they are right back to making the same old resolutions. This is the year I will save more in my 401(k).

So why do we fail? Part of the reason, according to psychology professor Peter Herman, is that many of us have "false hope syndrome." We pump ourselves up with unrealistic expectations and then we get depressed when we don't meet them. So, we quit.


This isn't just about resolutions. Any goal-setting can often become a trap. Peter Bregman, writing in the Harvard Business Review Blog Network, argues, "When we set goals, we're taught to make them specific and measurable and time-bound. But it turns out that those characteristics are precisely the reasons goals can backfire. A specific, measurable, time-bound goal drives behavior that's narrowly focused and often leads to either cheating or myopia. Yes, we often reach the goal, but at what cost?"

For as long as I can remember we have been told that we need to set goals to be successful. Yet more and more, I hear about successful people not setting goals. Two years ago I saw a Ted Talk given by a gentleman named Brett Ledbetter. Ledbetter, who runs a basketball camp, was talking about what drives success on the basketball court. When he started his quest, he interviewed as many successful coaches as he could. He spoke with people like Boston Celtics coach Brad Stevens, Duke coach Mike Krzyzewski, Kansas coach Bill Self, and many others. To his surprise, coach after coach told him that they do not set goals.

Ledbetter defined a goal as a result to which effort is aimed. The problem with goals, as most of the coaches he interviewed saw it, is that the focus is on the result and not the effort. They wanted their players focused on the effort, or what most of them called the process. That is a word that has become closely associated with Nick Saban, the head football coach of the Alabama Crimson Tide.

The Alabama football team has been in the national championship semi-finals or finals in six of the last eight years, winning four championships. The big question the media keeps asking is, how do they stay so consistent? Saban answered as follows, "I think the first thing is the way we approach competition. We don't talk a lot about winning. We talk a lot about what do you have to do to play your best on a consistent basis…" In other words, he talks about the daily effort, or process, that one needs to be his best. Sure, they want to win – one could say that winning is the goal – but that is not their focus. Their focus is on the effort it takes to win.

This may seem like a small difference but it is not. Results-based goals can provide positive (or negative, for that matter) motivation and focus, but eventually one of two things happens: one either achieves the goal, or fails. Then what? The "experts" say at this point we are just supposed to set a new goal. However, in real life the vast majority either get depressed over their failure or complacent with their success.

This is why we marvel at what teams like Alabama, the New England Patriots, the San Antonio Spurs and the Golden State Warriors have accomplished. They seemingly reach their goals but just keep going, and when they do fall short, they just pick themselves up and keep going.

This phenomenon is not just in sports. Companies like Google have done away with goal-setting because they believe it dampens creativity and creates false incentives. What is true in sports and in companies like Google is also true when it comes to financial planning. We see this all the time when people make financial goals. It is reinforced by planning programs that project out very detailed visions of the future. It is reinforced by the industry in how they advertise. The company Voya (formerly ING) used to have a commercial that asked if you knew your number? The number they were referencing was the very specific amount of money that one needed to have to retire.

Before I go further, let me be clear: Retirement goals are useful. It is good to have a vision of where one is heading. We run these projections for our clients often. We are careful, however, to make sure the client understands that they are just projections. They give us an idea of what might be, they are not concrete numbers that you can walk around with like the characters in the Voya commercial.

While these projections are helpful in making current decisions, they also have pitfalls that should be known. One of these pitfalls is the illusion of accuracy. Benjamin Graham and David Dodd wrote a book called Security Analysis, which was originally published in 1934. It is like the bible of my industry. In fact, it is thicker than the actual Bible; that is how detailed Graham and Dodd were in their analysis of investment opportunities. Yet the first chapter of this book is basically a warning: No matter how much analysis one does, the future is still uncertain. Graham and Dodd knew that the biggest trap for the professional investor is over-confidence. My model says this is what will happen so I "know" this will happen. Unfortunately no one knows what is unknowable.

One can be as detailed as one wishes in financial planning, but eventually life happens. Jobs that were thought to be secure are not. Health which was taken for granted is no longer certain. Markets surprise us in both directions. No matter what we plan, the odds of our plan working out in exact detail are simply astronomical. In the meantime, over-confidence in our plan can lead to significant problems with the effort, or process, that drives the plan. This is especially true for those who have done well until now. They have saved and invested prudently and now the computer says the goal is on track. Then they start to stop doing the things that got them in good shape from the start. They reduce their savings rates or do imprudent things in their investing. They may take undue risk because they figure that they have their goals met or they might get too conservative thinking they no longer need growth from their portfolio. More often than one might believe I have had the conversation with people in this situation and had to convince them that there is no such thing as having too much money to retire.

More frequently we see the problem of the goal being too big. "There is no way I can ever retire so why try?" This is the problem of failing to reach artificially specific goals. I needed to lose 30 pounds and I only lost 15, therefore I'm a failure. That is nonsense of course, but this is the downside of being so focused on the goal. Anything that can be saved for retirement is better than nothing. Sure, one should start as early as possible, but there is no such thing as too late. So many people look at the size of their "number" and just lose confidence. Losing confidence is one step from giving up.

Part of this is unrealistic goals. When the Germans invented the concept of

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## REVIEW *of* ECONOMY

**The third quarter GDP** growth came in at 3.5 percent. That is the highest reading since 2014. The 4th quarter is not thought to be that strong but still nicely positive. There is optimism that pro-growth policies could be coming and faster growth may be ahead.

The official unemployment rate dropped to 4.7 percent in December. Jobs growth has picked back up after slowing during the summer.

Inflation has been flat with CPI coming in at 0.2 percent again in November. The Fed has started to raise rates. Thus far that has gone along with greater optimism. Time will tell if that continues. +

## REVIEW *of* MARKET

**The third quarter rally paused** in October and then took off again in November. For the quarter the S&P 500 was up 3.8 percent. Value investors did better with the Russell 1000 value up 6.7 percent and small company stocks were the best place to be up 8.8 percent as measured by the Russell 2000.

Bonds were down as interest rates rose. The Barclays U.S. Aggregate Bond index ended down 2.98 percent. High yield bonds ended the quarter up 1.85 percent. The search for yield and a more stable economic mood translated to big returns for the high yield market which ended the year up 17.34 percent.

International stocks did not participate in the rally. The EAFE index finished down 0.68 percent and the MSCI Emerging Markets index ended the quarter down 4.08 percent. +

MARKET *forecast*

**The long-awaited rotation** to beaten down areas of the market arrived in the third quarter and has continued. The question is, have we gone too far too fast? Perhaps, a pause would seem in order but we are optimistic for 2017 as a whole.

Emerging markets look attractive as do small company stocks. Large company stocks look expensive to many but that is skewed due to the FANG outliers. Overall stocks are attractive.

Bonds remain our biggest concern over the long term and will until the yield on the 10 year treasury exceeds 3 percent. The run in high yield bonds will likely slow down, but not stop. +

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retirement age with the world's first government-sponsored retirement program, they decided it should be 65. Life expectancy was 62. If we were to invent retirement today, we would be looking at an age near 80. Yet we are programmed to believe that we need to retire at 65, and of course no one wants to be average, so really we all want to retire early. For many people that is not realistic, which isn't a bad thing. Retirement for many people is not what they thought. This is a topic for another newsletter, but work does not give one just a paycheck. It gives purpose, it gives social interaction, it gives a sense of accomplishment. One must have a plan for replacing these things. The successful retirees are those who not only saved a lot, but also found ways to stay connected to the world. For many that means going back to work.

One may not be able to reach the goal, but if he could get half way, and then cut his work hours in half, that could be a great retirement for many people. However, if the knowledge that the "goal" is out of reach leads to just giving up, then that won't happen.

For some the goal seems bigger than it is. This is especially true among those who are still 20 or so years away from retirement. One of the great mysteries of life is the magic of the compounded return. Today my industry uses computer programs to project the future, but when I started my career we had something called the rule of 72. If one knows the rate of return that she can expect on her retirement portfolio, then she can divide that into the number 72 and the answer tells her how many years it will take for her nest egg to double in size. My first boss had an expression, "It is the last double that gets you there." What did he mean? It takes the same amount of time for $1,000 to turn into $2,000 as it does for $500,000 to turn into $1,000,000. Nest eggs do not grow in straight lines. They begin by growing slowly from a dollar perspective, which is how most people view their savings. Then as they grow, the growth becomes faster and faster. An 8 percent return on $10,000 is $800. The same return on $100,000 is $8,000. So people in their 40s who have been saving for several years often look at what they have and say this is just not growing. How could it reach that goal? What they don't understand is that it is the last double that gets them there.

The variances of life are out of our control. The reason people like Nick Saban focus on the process and not on winning (the goal) is because real winners focus relentlessly on what they can control. If a goal is what Ledbetter says it is – a result at which effort is aimed – then the people who focus solely on what they can control will be focused on the effort. Instead of goal-oriented, they become process-oriented. Instead of living and dying with every result, they focus on progress. They don't ask, "Are we there yet?" Rather they ask, "Are we headed in the right direction?"

This is what we try to do at Iron Capital: Focus on what we can control. Help our clients save as much as they can, not just what a computer says they should. Help them make prudent investment decisions, not drift in and out trying to find the fast lane to some goal. We say it this way: We strive for perfection, we make progress. That is what keeps one humble when goals are met and keeps one going when they are not. Save all you can and invest it prudently – that is the best financial resolution one could ever have.

Chuck Osborne

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