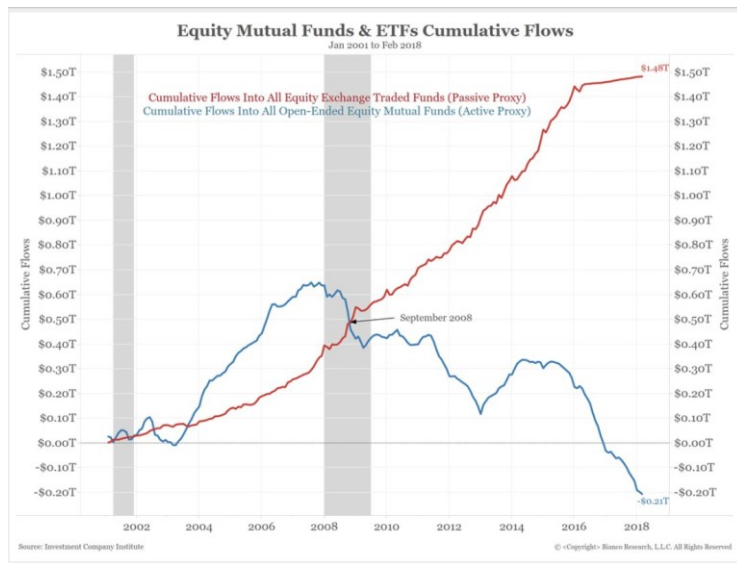


Active & Passive

This is a debate that has gone on forever. The world is pushing for active lately and it has been the place to be for the past few years. The chart below shows just how big the difference in money flow has been between active and passive allocations by investors for the past 20 years.

I'm a value guy who looks for a margin of safety, none exists now in passive indexes in America. Many of these indices are trading at massive premiums to "fair value" ranging from 20% to 150% depending on what we're talking about.



As you can see since September of 2008 the money flow had been going into both camps equally, but since it's been overwhelmed by passive ideas. This is a once in a lifetime situation for a contrarian who likes the idea of a margin of safety. I've only seen this a few times in 25 years. I've read about it, it's happened a handful of times. These are fat pitch opportunities that if you're paying attention to, can result in outsized opportunities with risk adjusted returns that just don't come around much.

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3. Noteworthy News; ? & Answer; A Brother's Hand
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A Brother's Hands

Back in the fifteenth century, in a tiny village near Nuremberg, lived a family with eighteen children. Eighteen! In order merely to keep food on the table for this mob, the father and head of the household, a goldsmith by profession, worked almost eighteen hours a day at his trade and any other paying chore he could find in the neighborhood. Despite their seemingly hopeless condition, two of Albrecht Durer the eldest children had a dream. They both wanted to pursue their talent for art, but they knew full well that their father would never be financially able to send either of them to Nuremberg to study at the Academy.

After many long discussions at night in their crowded bed, the two boys finally worked out a pact. They would toss a coin. The loser would go down into the nearby mines and with his earnings, support his brother while he attended the academy. Then when that brother who won the toss completed his studies, in four years, he would support the other brother at the academy, either with sales of his artwork or, if necessary, also by laboring in the mines. They tossed a coin on a Sunday morning after church. Albrecht Durer won the toss and went off to Nuremberg.

Albert went down into the dangerous mines and, for the next four years, financed his brother, whose work at the academy was almost an immediate sensation. Albrecht's etchings, his woodcuts, and his oils were far better than those of most of his professors, and by the time he graduated, he was beginning to earn considerable fees for his commissioned works.

When the young artist returned to his village, the Durer family held a festive dinner on their lawn to celebrate Albrecht's triumphant homecoming. After a long and memorable meal, punctuated with music and laughter, Albrecht rose from his honored position at the head of the table to drink a toast to his beloved brother for the years of sacrifice that had enabled Albrecht to fulfill his ambition. His closing words were, "And now, Albert, blessed brother of mine, now it is your turn. Now you can go to Nuremberg to pursue your dream, and I will support you."

All heads turned in eager expectation to the far end of the table where Albert sat, tears streaming down his pale face, shaking his lowered head from side to side while he sobbed and repeated over and over, "No ... no ... no ... no."

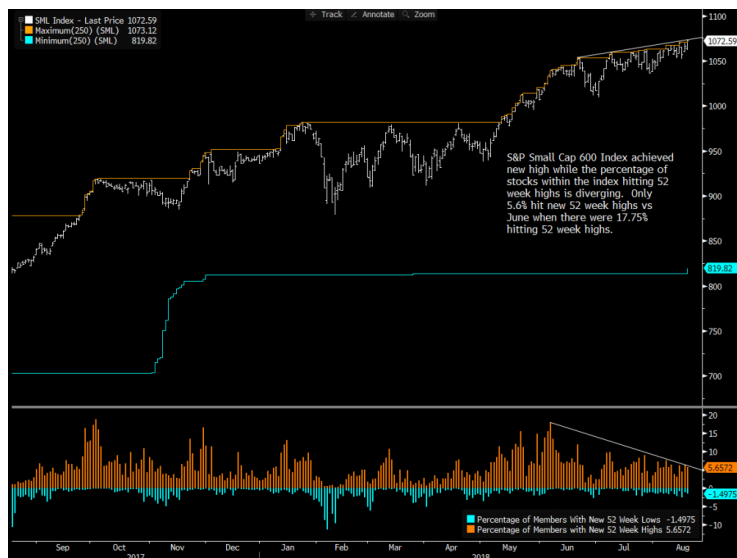
Finally, Albert rose and wiped the tears from his cheeks. He glanced down the long table at the faces he loved, and then, holding his hands close to his right cheek, he said softly, "No, brother. I cannot go to Nuremberg. It is too

Continued on page 3, A Brother's Hands

Active & Passive (cont'd from page 1)

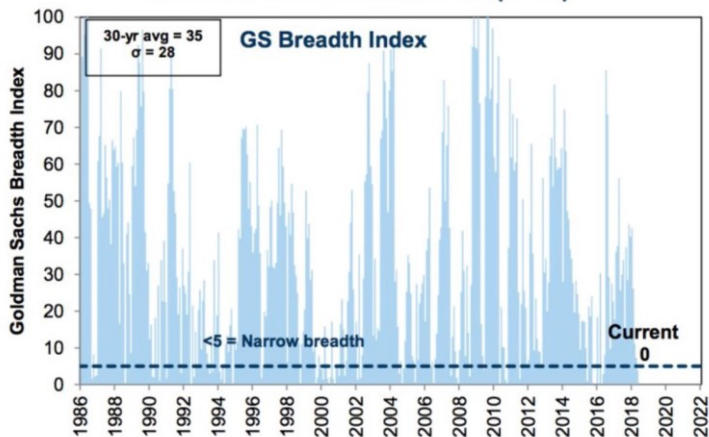
The thing with passive approaches is that they allow just a few popular issues to do all of the heavy lifting for an entire index, sector or whatever it is you're measuring. Here is just how lopsided the mix is on the S&P 600 today.

What this is showing is that as the Smallcap S&P 600 rises, fewer and fewer stocks are participating in that advance. In January 17.75% of the stocks were at all-time highs while the index was. In August we have 5.6% at all-time highs. A healthy market has 60-70% of the stocks advancing with the market in general.



Another view on breadth comes to us from our friends at Goldman Sachs, a pretty bright group of investors. This shows just how narrow the market has become. The average breadth on their measure is 35, today it is at zero. Folks this doesn't last. Who's paying attention to this? We are!

Goldman Sachs Breadth Index (GSBI)



Consumer Confidence Scam

This measure the government calls consumer confidence gauges peoples comfort level with how they believe their economic prospects are moving forward. The scam part of this measure comes in the form of how financial markets tend to perform in front of high levels of consumer confidence. Today we have people at the highest levels of consumer confidence we've seen in 20 years. The thing they don't tell the average person is that this should be considered a contrary indicator, not one that flows with financial markets.

As you can see below, whenever consumer confidence reaches very high levels, as indicated by the line on top, we see that the subsequent movement in the US GDP growth turns down. We're looking back almost 50 years here, as long as our friends at Bloomberg have the data and it is perfectly consistent. Top readings in consumer confidence indicate we're at the best reading for the cycle. Moving forward the needle will come down over time as the GDP growth of the country slows down.



Since financial markets are forward looking mechanisms, what we see is that people should use the consumer confidence survey as great tool to determine when to get in and get out of markets. When people are most pessimistic about their futures, that's when the right time to buy is, because prices are cheap and the outlook is poor from the consumers perspective. Conversely if people are happy, hot and bothered, as they are today, it is the time to be cautious and smart, taking risk levels down to anticipate the coming downturn.

The exact same relationship exists between the unemployment rate, which is also low today and I'll work on that in a separate article so you can see just how close these two indicators do a great job of what they are, contra indicators. The news media is running around talking about just how confident people are, at exactly the wrong time for investors. Know the difference, call with any questions this a wonderful topic and very insightful.

Noteworthy News!!!

- Congratulations to Rich Grinvalsky on the birth of baby Jasper, grandbaby # 1! 😊
- Congratulations to Joel & Terri Nahari on the purchase of their new home in Colorado! 😊
- Congratulations to Shamon Antrum on his new job with Bishop McNamara Academy! 😊

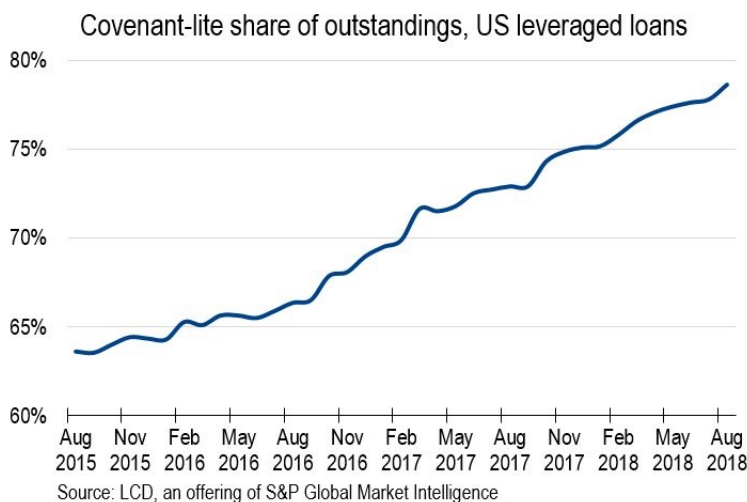
Question & Answer

Ask any financial question you have and we'll address it here.

Q: What are cov-light loans I'm reading about a lot lately?

Cov-light refers to covenants in loans made to borrowers. These covenants are basically terms of the loan that make the loan more secure for the lenders. Loans with more covenants tend to be safer loans and loans with fewer covenants tend to be riskier loans. We are on a cycle where the loans are coming out with fewer and fewer covenants lately. This is very reminiscent of the housing boom, where people were able to get mortgages with just a signature and a pulse. No job was required, no down payment nothing at all. After that we all know of the implosion that followed.

Fast forward 10 years and we're in a world now where the loans are again being easily dished out, not to homeowners that area is cleaned up a lot, but in many other areas now we're seeing just silly loans coming out to borrowers that are very risky. Here is a great graphic on just how the rise of covenant light loans are essentially taking over the loan complex in some areas.



Sustainable? Of course not, but in the bubble world things can go on and on for a long time before people wake up and realize that wasn't wise.

late for me. Look ... look what four years in the mines have done to my hands! The bones in every finger have been smashed at least once, and lately I have been suffering from arthritis so badly in my right hand that I cannot even hold a glass to return your toast, much less make delicate lines on parchment or canvas with a pen or a brush. No, brother ... for me it is too late."

More than 450 years have passed. By now, Albrecht Durer's hundreds of masterful portraits, pen and silver-point sketches, watercolors, charcoals, woodcuts, and copper engravings hang in every great museum in the world, but the odds are great that you, like most people, are familiar with only one of Albrecht Durer's works. More than merely being familiar with it, you very well may have a reproduction hanging in your home or office.

One day, long ago, to pay homage to Albert for all that he had sacrificed, Albrecht Durer painstakingly drew his brother's abused hands with palms together and thin fingers stretched skyward. He called his powerful drawing simply "Hands," but the entire world almost immediately opened their hearts to his great masterpiece and renamed his tribute of love "The Praying Hands."

--Unknown



Money Quiz



This month's challenge is on bad banks. Of the 536 bank failures during the last 15 years, which 4 states accounted for the majority of them? These 4 states had 51% of all bank failures. Perhaps they should find a better way to manage banks? Last month's quiz wasn't won, 2018 form 1040 will have 23 lines compared to the 79 lines on last year's form. . We'll see what AI and robots does to this statistic moving forward! Winner goes to Ruby Tuesday on us! 08/06/18: 6

Growth & Value

We discussed in another article how growth has been dominating for some time now in terms of money flows. Many reasons are behind this push, including group think, the proposed DOL rule that was shot down, expenses, target dating, algorithmic trading, generic financial prescriptions, etc. The interesting part about the concept is that it is being pushed hard when growth is at the most expensive point in history, or at least one of them depending on how we measure. Semantics really, things are brutally expensive out there, period for domestic growth stocks. Here is a great graphic showing just how extreme this is.

Figure 1: Value has nearly always outperformed growth - until recently



Past performance is not a guide to future performance and may not be repeated.

Based on monthly returns of the US Fama/French HML (High Minus Low) Factor. HML is the return on the "high" portfolio minus the return on the "low" portfolio, where the market is used as the value metric. Source: Kenneth French's Data Library and Schroders. Data from 31 July 1926 to 29 December 2017.

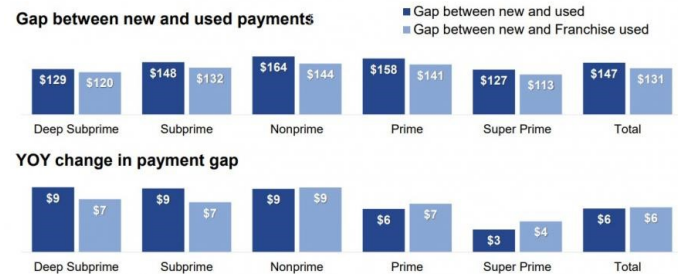
The last time we saw this type of outperformance was in the midst of the tech bubble, from 1998-2000 ish. That time around it wasn't anywhere near as extreme as it's been today in terms of outperformance, but valuations were equally crazy back then. In a few years as we look back, this era will end no differently, perhaps it'll be called the bubble era or the money printing era, whichever comes to be it'll be historic! ☺

Auto Price Insanity!

What people are willing to pay for new cars is reaching the point of sheer lunacy. The average car payment is now \$535.00 per month. The data recently out shows people are paying massive monthly payments for their cars. I LOVE cars, but as a financial person cannot get away from the fact that they're complete money pits. I tend to buy a super reliable car, about 5-8 years old that I've exhaustively searched for that is like new with very few miles. We employed the same search dynamics in finding cars for the kids when they turned 16 and each of them ended up with 2003 Toyota's with 30-40k miles and in great shape. Each cost about five thousand, and each of those cars should last them a good 10 years without any major issues. We're not chasing the newest and fanciest of course, but the value cannot be beaten.

Here is some recent data on auto loans from Experian's state of the automotive finance market report:

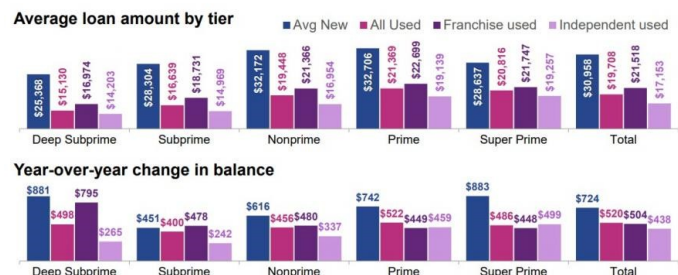
Gap between new and franchise used payments widen



Subprime loans are those to people with bad credit, as you move to the right credit goes up to higher levels as most of us have.

Now to how much people owe on their cars. Big numbers again, 30k almost on average for car loans.

Record highs for average used loan amounts



I just don't have it in me to pay that kind of money for something worth about \$5.00 at the end of the day. I'm happy to buy a good value, even something normally very expensive, if it can be had for a bargain. It may make sense to get that reliable used car undervalued and drive it a long, long time. It'll change your financial trajectory for sure! ☺

Inspirational Quotes

- Nothing is impossible, the word itself says "I'm possible!" Audrey Hepburn
- Age wrinkles the body, quitting wrinkles the soul, Douglas MacArthur
- There is no greater agony than bearing an untold story inside of you, Maya Angelou
- The first wealth is health, Ralph Waldo Emerson
- We can never obtain peace in the outer world until we make peace with ourselves, Dalai Lama
- Life isn't about finding yourself, It's about creating yourself, George Bernard Shaw
- In the practice of tolerance, one's enemy is the best teacher, Dalai Lama



**We can piece the puzzle together and
make your money work for you!**

Kids Corner

A philosophy professor stood before his class with some items on the table in front of him. When the class began, wordlessly he picked up a very large and empty mayonnaise jar and proceeded to fill it with rocks, about 2 inches in diameter. He then asked the students if the jar was full. They agreed that it was. So the professor then picked up a box of pebbles and poured them into the jar. He shook the jar lightly. The pebbles, of course, rolled into the open areas between the rocks. He then asked the students again if the jar was full. They agreed it was. The professor picked up a box of sand and poured it into the jar. Of course, the sand filled up the remaining open areas of the jar. He then asked once more if the jar was full. The students responded with a unanimous "Yes."

"Now," said the professor, "I want you to recognize that this jar represents your life. The rocks are the important things – your family, your partner, your health, and your children – things that if everything else was lost and only they remained, your life would still be full. The pebbles are the other things that matter – like your job, your house, your car. The sand is everything else, the small stuff."

"If you put the sand into the jar first," he continued, "there is no room for the pebbles or the rocks. The same goes for your life. If you spend all your time and energy on the small stuff, you will never have room for the things that are important to you. Pay attention to the things that are critical to your happiness. Play with your children. Take your partner out dancing. There will always be time to go to work, clean the house, give a dinner party, or fix the disposal." "Take care of the rocks first – the things that really matter. Set your priorities. The rest is just sand."

If anyone you love or care about would benefit from receiving our newsletter, tell us who they are and they will be included on our mailing list. They'll certainly appreciate you thinking about them and having their best interests at heart!

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