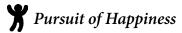


# FOCUS

Confidence through Education

**SUMMER 2017** 



# MILLENNIALS: Half the Money & Twice the Happiness

by Bob Swift

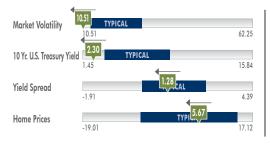
Pretend you are about 25 again (ahhhh, no aches, no pains, no kids, whole life in front of you, etc.). Now imagine yourself sitting in a classroom with 19 other goodlooking young people for the first of four classes on personal finance and investment management. Real life stuff, not the glossary version.

As the class begins you also know that you get a \$1,000 award deposited into your Roth IRA if you learn the material well enough to pass the test that is given at the end of the series. You settle in, check out the other millennials, grab one of the provided sandwiches, put your continued on page 6



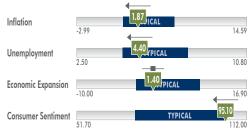
#### MARKET SNAPSHOT

MOST RECENT



#### **ECONOMIC SNAPSHOT**

TYPICAL RANGE



ACTUAL RANGE 🔙

**NUMBERS** 

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## Is Indexing getting too Big?

#### by TCI Investment Committee

Every so often we see an article questioning whether the increased use of index funds could actually harm the market. Take this passage from a New Yorker column last year:

"Depending on how you count, as many as twenty percent of stocks are now owned by indexed funds... As the number continues to rise, some scholars, economists, and investment professionals have begun to wonder anew how high it can go, and whether, as passive investing grows, it is having harmful effects on the economy as a whole. It stands to reason that beyond some threshold, a market that has more passive than active investors will behave differently than markets have in the past."

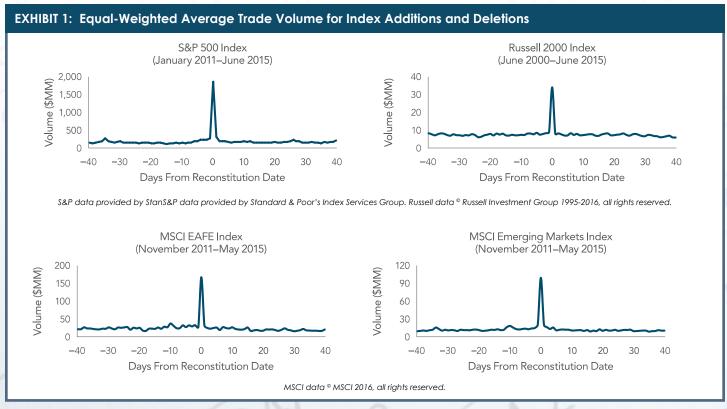
It is certainly a question worth exploring and in doing so, we arrive at three main things to keep in mind:

1. If index investing gets "too big" then it stands to reason that markets would become inefficient and more active investors would jump in to take advantage of those inefficiencies. Those inefficiencies would then disappear as active investors rushed to take advantage (as in

- today's market) and the market would eventually reach some equilibrium balance between passive and active.
- 2. We do not think you need that many active investors to make markets efficient. A real estate transaction settles on a pretty fair price, for example, but there are only a handful of people involved. If you and I are both expert art dealers, how many more people do we really need to come up with a fair price for the Picasso painting?
- Most importantly, we are not using traditional index funds and some of the trading strategies employed by your investments already take advantage of traditional indexing inefficiencies.

Let's explore that last point a bit further. An index fund manager's strict adherence to an index comes at a cost in the form of reduced discretion around trading.

Most indices revise their list of index constituents periodically (e.g., annually or quarterly), at which time securities may be added or deleted from the index. This process is commonly referred to as index reconstitution. For example, the annual reconstitution of the widely tracked Russell indices occured on June 23, 2017. Index fund



**EXHIBIT 2: Effect of Delaying Reconstitution Month** 

	Rebalanced in June			Rebalanced in September			Difference Between Delayed and Actual		
	Russell 1000 Value Index	Russell 2000 Index	Russell 2000 Value Index	Delayed R1V	Delayed R2	Delayed R2V	R1V: Delayed – Actual	R2: Delayed – Actual	R2V: Delayed – Actual
Average Monthly Returns, January 1990–July 2015									
All Months	0.87%	0.92%	0.98%	0.90%	1.02%	1.10%	0.02%	0.09%	0.12%
October-June	1.13%	1.33%	1.35%	1.13%	1.33%	1.35%	0.00%	0.00%	0.00%
July–September	0.09%	-0.30%	-0.15%	0.18%	0.07%	0.34%	0.09%	0.37%	0.49%

Russell data © Russell Investment Group 1995-2016, all rights reserved. Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

managers tracking Russell indices bought additions and sold deletions in order to minimize tracking error\* relative to the index. Any deviation of the fund from the index, over days or even hours, could result in different returns from the index.

The effect on the volume of trades from index rebalancing is apparent in a huge volume spike on trade reconstitution day. Exhibit 1 illustrates average trade volume for additions and deletions in four major indices during the 80-day period surrounding reconstitution. Each of the charts show a marked increase in trade volume on the effective date of reconstitution relative to the surrounding days. The effect is pervasive across the market capitalization spectrum as well as geographic region.

For each index, this large liquidity demand tends to drive up the prices of securities with greater purchase demand (generally additions to the index) relative to the other securities in the index. It also tends to push down prices of securities with greater sell demand (generally deletions from the index) relative to the other securities in the index. Thus, for an index being tracked by a large amount of assets, the index has generally added securities at higher prices and deleted securities at lower prices than it would have if no assets had been tracking it. This phenomenon is the result of index managers' demanding liquidity on or around the index reconstitution date.

After the reconstitution of an index, as the liquidity demands of index managers decline, research shows this price effect tends to reverse. That is, additions tend to underperform the index while deletions tend to outperform. As a result, index managers' implicit trading costs can result in a performance drag on the index and, consequently, funds tracking the index.

A simple experiment in delaying reconstitution allows us to estimate how much this price pressure has impacted index performance. Exhibit 2 compares average monthly returns for two sets of Russell indices; one set is rebalanced on the June-end reconstitution date and the other three months later. As shown in the final three columns, delaying rebalancing improved average returns between 0.09% and 0.49% per month from July through September—the three months between the rebalance date of the standard indices and their delayed counterparts. For all calendar months, including October through June when holdings are identical for both rebalancing methods, this amounts to a performance benefit ranging from 0.02% to 0.12% per month, or approximately 0.26% to 1.46% per year.

Index funds may be a good option for investors seeking investments with low fees. However, in an attempt to match the returns of an index, an index fund manager sacrifices trading flexibility. Because of high liquidity demands around index reconstitution dates, index funds may incur high trading costs that do not appear in expense ratios but do affect net returns. The funds' goal of minimizing tracking error may come at the expense of returns. When considering investment options, TCI takes into account both expense ratios and trading costs. Interestingly enough, in the event of indexing taking up "too much" market share, the flexible trading strategies employed in your investments are likely to add even more value.

Let us end on this note: the simple fact that it is even a topic of discussion to think indexing is getting too big is a wonderful thing for the average investor. More and more investors are following the academic evidence that there is no value in trying to outperform the market through security selection and market timing and will thus have superior outcomes over time. That is something everyone can be happy about — well, except for those that were able to sell their alleged market "prowess" for absurdly high fees for so long, but there will be no tears shed for them. A

The TCI Investment Committee conducts on-going research and analysis that guides portfolio construction for TCI clients.

<sup>\*</sup> Tracking error is the standard deviation of the return differences between a fund and its benchmark.

## What is a Fiduciary and Why Should You Care?

by Mike Sullivan, CFA

Friday, June 9 quietly marked a historic day in the financial services world. Now all financial advisors providing advice regarding qualified plans are required to forego any sales agenda and give advice that would benefit their clients or customers — or, if they decide otherwise, to explain how and why they intend to give advice that instead primarily benefits themselves and their brokerage company. While this rule currently pertains to rollovers from a qualified plan like a 401(k) into an IRA, and to the investment recommendations for that IRA account, it may be a first step toward something larger, regulation that all financial advisors should be held to the fiduciary standard.

The polls consistently show that most Americans believe they already receive objective advice — called "fiduciary" advice by the profession and regulators. However, the overwhelming odds are that they do not. There are half a million brokers who frequently call themselves financial advisors who earn commissions if they can convince you to buy an expensive alternative to the thriftier, better-performing investment options on the market. That is more than 10 times the number of advisors who adhere to a fiduciary standard. Government research estimates that consumers lose \$17 billion a year to conflicted advice in the recommendations made by brokers and sales agents posing as advisors related to retirement plans.

At TCI, we have always acted as a fiduciary and even seek outside accreditation that assures our clients we hold ourselves to the highest ethical standards. TCI holds the CEFEX certification from the Center for Fiduciary Excellence; an independent organization providing rigorous systematic assessment to ensure certified firms are practicing fiduciary excellence. Think of it like the Consumer Reports of fiduciary practice for financial firms.



What does this industry jargon mean for you as our client? It means we are passionate about the fiduciary standard and support organizations and efforts which require all who hold themselves out as a financial advisor to adhere to these standards. We also think it is important for our clients to understand the term "fiduciary" and what it means.

The Department of Labor, who governs the world of 401(k)s and pension plans, defines a fiduciary as an advisor who is required to put their client's best interests before the advisor's profits.

Given comparable investment solutions for a client. a fiduciary would recommend the option with lower management fees. After all, if the investment solutions have similar risk and return expectations before fees, why not purchase the solution with lower fees thereby enhancing investment performance? This brings us to the standard to which commission compensated advisors (stockbrokers, registered representatives, insurance agents) are required to adhere, the suitability standard. In the above example, if all three investment options are suitable for the client, the advisor could recommend the one that pays the most to the advisor.

How would that look in a profession where we expect fiduciary standards such as your doctor or lawyer? Imagine your physician was paid by commissions from hospitals and drug companies and could recommend treatment that was "suitable" for you, not necessarily the best treatment, just suitable treatment. An outrageous thought but this is the way it works in most of the financial service industry.

Many think this is simply a "buyer beware" situation, that investors are responsible for being informed. TCI is a firm believer in education and financial literacy. We believe an informed, knowledgeable client is the best client. Unfortunately, in the financial services industry, complexity is often used as a way to justify higher fees. Given the complexity of many investment products, a "buyer beware" attitude puts the great majority of consumers at a severe disadvantage. Adding another layer of complexity, it is nearly impossible to identify a fiduciary from a non-fiduciary particularly by title. Anyone can call themselves a financial advisor, financial planner, or wealth advisor. The titles of Wealth Advisor and Financial Planner are used by Registered Investment Advisors who are fiduciaries (TCI, for example) and they are also used by nonfiduciaries such as insurance agents and stock brokers.

Non-fiduciaries argue that as long as they disclose their self-interest, the consumer has the information they need whether or not the transaction is of a fiduciary nature. This reminds me of one of my favorite quotes, "There is a big difference between what you have a right to do and what is right to do" – Michael Josephson, www. whatwillmatter.com.

At TCI we are a fiduciary by principle, practice, and regulation. This is a non-negotiable promise to our clients. TCI will always uphold the highest ethical standards for the financial industry and continue to spread awareness on conflicts facing the industry. A

Mike Sullivan, CFA is an Advisor in our Tucson office, as well as Director of Advisory Services and Shareholder for TCI Wealth Advisors, Inc.

## Maximizing the Benefits of a Health Savings Account

by Sam Van Denburgh, CFP®

Every year, open enrollments occur at companies and employees are given choices for health care coverage. Most employers now offer high-deductible health insurance plans with a Health Savings Account option. Health Savings

Accounts (HSAs) are a savings

vehicle which allow you to use pre-tax money to cover the higher out-of-pocket costs associated with a lower premium plan. As an individual, you can contribute up to \$3,400 (\$6,750 for families) to an HSA in 2017. What most people do not realize is there is not a "use-it or lose-it" policy associated with an HSA. Thus, they can actually be a powerful long-term savings vehicle. Additionally, HSAs have a triple tax advantage: contributions are pre-tax, the account grows tax-free, and all withdrawals for qualified medical expenses are tax-free.

To maximize the effectiveness of your HSA, rather than pay medical expenses from your HSA, consider covering your bills out of pocket so your account balance can remain invested and continue to grow tax-free for the long-term. That way it will still be available to you for the substantially higher medical expenses you will likely face in retirement. If you do not need it for medical expenses, once you reach age 65, all non-medical withdrawals are taxed at your current tax rate like a traditional IRA. If you withdraw money for non-medical expenses before you reach age 65, you will pay income tax on the withdrawal plus a 20% penalty.

Everyone's health care needs are different so a high-deductible health plan with an HSA may not be the best option. However, if you are blessed with good health (and youth), an HSA can be another investment vehicle to increase your tax-advantaged savings for retirement.  $\pmb{\Delta}$ 

Sam Van Denburgh, CFP® is a Support Advisor in the Scottsdale office.

ASPIRE is a program offered by TCI Wealth Advisors that provides young professionals access to sound financial planning and education in order to plan for long term financial success. To learn more about the program, visit www.aspirebytci.com.

## MILLENNIALS: Half the money and twice the happiness

continued from page 1

phone away (class rules!) and the class begins promptly at 5:30 p.m.

The following is what you hear from some old guy named Bob:

Welcome everybody! Whether you know it or not, you have a once-in-a-lifetime investment opportunity. I do not have it, Warren Buffett does not have it, and literally millions

of people have had it and totally wasted it. Every 60-year-old I have ever known talks about how when they had it, they really wish someone would have taught them how valuable it was.

This asset is given to everyone regardless of race, gender, income or IQ. However it is finite, it will go away. You have about 10 years to take maximum advantage of it. It is not unlike a top athlete. Athletes often have 10 great years of peak physical performance but age eventually slows their abilities and their athletic value ultimately diminishes. By now, you know what the asset is because you are here to learn and understand how to use it.

This asset is time, and learning how to use the next 10 years of your

life to maximize the wonder of compounding interest and returns, to set up your own financial plan that creates long-term security and peace of mind.

*It is helping you understand concepts like the following:* 

- At age 21, it takes three cents to buy one retirement dollar at age 66 while at age 48 that same retirement dollar costs 24 cents; that is 800% more!
- Having \$60,000 by age 30, and never saving again, can give you \$1 million at age 66.
- A 25-year-old has to save \$250 per month to reach \$1 million by age 66. Someone TWICE as old (age 50) has to

save TEN times as much, about \$2,500 per month to get the same result simply because they waited longer to save.

You are going to learn that getting this done does take some priority shifts and a little deferred gratification. We are going to challenge the way you think about housing and even talk about considering the financial impacts associated in the decision of when to have children (I know... be careful Bob).

You are also going to learn, no surprise here, that Wall Street preaches short-term thinking with large doses of fear and greed. You will learn their real agenda is convincing you to move money around to generate fees and commissions. They spend millions and millions of dollars deliberately complicating what is actually a fairly simple process: diversify, keep costs low, and leave it alone.

Finally, before we get started with the first class, share a little dream with me.

Imagine how your world could change with a pro-active financial plan and the discipline to see it through? Imagine living within your means and maximizing the next 10 years by living thrifty and saving like crazy to take full advantage of long-term

money compounding? Imagine the effects and influence that plan could have on your current or future spouse? How about the messages that your children learn through the years? How much of a better employee do you become when your financial confidence is high? And how your employment opportunities increase without financial anxiety and stress.

At this point in your dream the concentric circle effect comes into play. How much does this financial security start affecting your friends? I know they notice. Ultimately, great financial plans create more money than you need thereby giving you the ability to have financial impacts within the community you live as well as your charitable interests.

The asset is time.

It is using the next

10 years of your life to maximize the wonder of compounding interest and returns, to set up your own financial plan that creates long-term security and peace of mind.



The dream ends now with the discovery that you are actually in control of your future. You made sure that YOUR financial house was in order, you actually end up with substantial opportunities to help others, and if I know nothing else about millennials, you have a strong interest in improving the world in which we all live.

Ok, that is my introduction speech at the beginning of our classes. I am guessing you would have really enjoyed attending those classes when you were 25. Over the last year and half, this is how we have started the Third Decade classes for almost 200 young people ages 18 to 35 of moderate incomes all over Arizona. One hundred and twenty young people have already graduated receiving the \$1,000 award to their Roth IRAs. We are already overenrolled for our Fall classes as well. There is a real geometric growth occurring as almost each graduating student is referring two more. Clearly we are meeting a big need with a large demographic.

You would also be pleased to know that our Executive Director, Laura Walton, has sat down with each student and set up detailed budgeting plans, a net worth statement, debt controls, and a very specific low-cost investment plan at Vanguard along with their employers 401k or 403b (where they manage it with their new knowledge). We then give them access to our services for up to four years after their class graduation at no cost.

I tell you all this because Laura and I are really discovering that our experiences with millennials are quite different from the conventional wisdom and many baby boomers perceptions. It has been said that millennials will be the first generation to "not do as well" as their parents. We are consistently told through traditional media how lazy

and entitled millenials are as they live at home, play video games and stay either unemployed or underemployed. We hear surveys that indicate that they feel their future has been taken from them so "why bother?".

Well, as usual, the extreme situations dominate the conversation while quietly under the radar there is a real big interest shown by millennials in taking control of their financial future. Maybe not to get rich, like the baby boomers mantra was in the early eighties, but certainly reaching a secure financial future. They also have less interest in accumulating things and more interest in having experiences and a work life balance. Finally, maybe even most of all, they are motivated to have the time and resources to make some real societal changes.

For Laura and I, this group is a pure delight to work with. They appreciate our efforts and are gaining experience and confidence in their financial plans every day. We feel better each day about this young generation. They are learning and practicing fiscal conservatism you would be proud of while maintaining a strong interest in social and environmental issues. I think this generation will surprise the prognosticators in a big way with a good chance of becoming the most significant generation ever as they shape the country in some very positive ways.

As my title says (Half the money, twice the happiness), maybe these millennials will not do as well as their parents if compared by net worth but I am betting their metrics of happiness and a life well lived will score much better. A

Bob Swift is an Advisor in the Tucson office and Shareholder of TCI Wealth Advisors. Bob is a co-founder of TCI and founder and visionary of the TCI Foundation.



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TCI NEWS

## **E-signatures**

TCI Wealth Advisors is pleased to announce the implementation of E-Signature technology; a technology which enables clients to quickly and securely access and sign documents online.

Both TD Ameritrade and Charles Schwab utilize this system. All that is needed is a valid cell phone number, email address and online account with either TD Ameritrade or Schwab.

We are very excited about this as it is a secure and much quicker process to get our clients the paperwork they need. Please contact your TCI Associate for further details. A



