thoughts

HANSON+DOREMUS
INVESTMENTS AND PLANNING

FROM HANSON+DOREMUS

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Some thoughts from the Paris Olympics...

In August, I had the pleasure of attending the Summer Olympics in Paris. Over a delightful but very hot week there, a few thoughts popped into my head—observations about the event from someone who spends too much time over-analyzing everything.

The commercialization of sports is nothing new, but the resulting proliferation of sponsorships at the Olympics meant fewer choices at venues. Every drink offered came only from the Coca-Cola family (which was fine with my Coke Zero habit). What's more, attendees could only pay in cash or with a Visa card. Cards from MasterCard, American Express, UnionPay, or any other credit card network were refused point-blank by vendors at every Olympic venue. Even for online ticket sales, Visa and its logo received prominent placement at checkout. Every other network was relegated to "other cards" status. Visa has long-term deals with the Olympics, so anyone considering the 2028 games in Los Angeles should plan accordingly.

The Olympics also transformed Paris into a demonstration of extensive and not-at-all subtle security measures. Authorities went above and beyond in their attempt to secure the Games and the city from any type of attack with large displays of force, including military planes, helicopters, and drones to patrol the skies. Security cordoned off all the venues for blocks, and the police blocked off many roads, disrupting commuters from across town and the suburbs. While these precautions limited our use of taxis or Uber, the excellent, albeit not air-conditioned, Paris Metro helped us get around town. As we look out to the upcoming Summer Games in LA, the lack of widespread underground public transit could be a tremendous impediment to attendees in a city that already suffers from traffic woes.

Source: Neil Macker

While the excitement surrounding the Olympics was palpable around the center of Paris and at official venues across the city, other areas seemed unaffected. Many Parisians simply went about their daily lives. As my travel companions and I wandered around, we were struck that apart from a smattering of Olympic signs, many neighborhoods appeared as they would during a normal Parisian summer. Even finding a place to watch the Olympics while getting a drink was harder than we expected due to the lack of TVs in many bars and cafes – an interesting contrast with the abundance of sports bars across America.

While the lack of TVs was a slight disappointment, the traditional Paris nonchalance towards profit maximization was a welcome respite. In our post-pandemic world, it feels like restaurants and cafes in the U.S. are even more focused on turning over tables than prior to 2020. In Paris, the opposite remains true as the staff would allow customers to linger well after clearing the last plate. Even in busy neighborhoods near Olympic venues, it took much longer for our table to both receive the check and pay than back home – occasionally causing slight panic as we attempted to rush off in time for the next event.

- Neil Macker

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FINANCIAL PLANNING

By Julie Won

"Most people can't go water-skiing in their nineties"...

"Everyone's health generally declines with time, and sooner or later we all die, so the question we all must answer is how to make the most of our finite time on earth."

". . . if you knew you were going to die tomorrow, you'd spend today one way, and if it was two days from now, you would spend today slightly differently – because you'll still have tomorrow. The same is true for three days from now, four days from now, or 20,000 days from now. . . But when we're talking about thousands of days – of years and decades – people tend to forget this logic altogether and act as if 20,000 days is the same as forever."

These quotes, along with the title of this page, come from Bill Perkins' book *Die With Zero* to remind us that none of us have forever. We all die eventually. Those of us blessed with long life will certainly see our health diminish, and unfortunately, some of us will face downright misery in our last days.

It's a grim message, Perkins acknowledges, but also a reality we must embrace if we're to plan our finances better – and he thinks many of us are getting things all wrong.

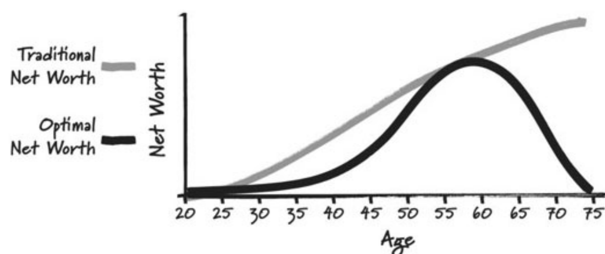
Here's the thing: Most of us are terrified of running out of money before we die – and we should be because it's a terrible prospect. It's why a whole financial planning industry has risen up to address it and why we work hard, save, and prepare for end-of-life medical expenses we hope we never have to pay. But Perkins says many of us take things too far. We save way past the optimal point and die with too much, which is a "terrible waste" because it means we didn't get to enjoy what we worked so hard for. Instead, what we should be striving for is completely exhausting our wealth and fulfilling the title of his book: to die with zero.

If that strikes you as a crazy and irresponsible idea, hear this out: First, Perkins is very clear that his book is not for the many who struggle to earn enough to save at all. Nor is it for the spendthrifts who live far beyond their means. It is for those who keep saving way past when they should because they are on autopilot.

Second, dying with zero is not about being selfish or forgetting your kids or charitable giving. Instead, Perkins advocates giving while you're alive, when your heirs and charitable causes are most likely to make the most of your gifts – and because it's far more generous to give intentionally while alive than to leave a random leftover amount at the random time of your death.

WHICH NET WORTH TRAJECTORY DO YOU PREFER?

Accumulation of Net Worth



Traditionally, people continue to increase their net worth until they stop working, and are afraid to dip much into their principal even after retirement. But to make the most of your hard-earned money, you must crack open your nest egg earlier (starting to spend down your savings sometime between 45 and 60 for most people) so that you end, theoretically, with zero.

Source: Graph and caption from *Die With Zero* by Bill Perkins, First Mariner Books, 2020

What dying with zero is really about is changing the question from "How can I make sure I don't run out of money?" to "How can I maximize my enjoyment without outliving my savings?" For Perkins, it's a question of optimization. You check the mortality tables, count your likely years left, and multiply that times the amount of money you need to live each year. Then you plan your spending by allocating resources to gifting and the experiences you want to have while you're still healthy enough to enjoy them. And being healthy enough is critical – because most people in their nineties really don't water-ski much – or do grand trips, attend the Super Bowl, or whatever it is they always hoped to get to someday.

While figuring out how to die with zero can sound like a cold and mechanical calculus, it's surprising that more of us don't do it. Perkins says many of us have the best of intentions to spend more but avoid doing so because we hate thinking about the finite number of years we have left. We act like death is never coming. "It's just some sort of mystery date in one's future when we expire." And too many of us see ourselves as staying in our twenties or thirties on an ongoing basis – a fantasy. The consequence is that "We keep putting off wonderful experiences, as if in our final months we can easily squeeze in all those experiences that we had put off all our lives. . . it's totally irrational."

Obviously, dying exactly with or close to zero is unlikely for any of us. And perhaps it's not for everyone. But the concept is really about balancing the present with planning for the future, and as Perkins says, "if we fail to look at our death date at all, we act as if we will live forever – and then there's no way are we going to get the balance anywhere close to right." Making sure you don't outlive your savings is only half the question. "So," Perkins asks, "what's the plan for spending down your money so you don't die with leftover assets and a pile of regrets?"

By Anne Doremus

It's mine, you can't have it!...

Standard economic theory holds that rising demand leads to higher prices and falling demand, lower prices. When supply exactly matches demand, a "clearing" price or fair value is reached. In the real world, however, things do not always work out this way. In some cases, prices fail to adjust to shifting supply and demand because consumers lack the information they need to make rational decisions. But sometimes, other, more psychological forces can influence how prices are set.

Back in 1990, behavioral economists Daniel Kahneman, Jack Knetsch, and Richard Thaler found that something called the endowment effect could also influence price adjustments. Their work included a study in which Cornell students were asked to buy and sell coffee mugs. Half the students were given mugs for free, and they were paired with students who weren't given mugs to find a fair price. But buyers and sellers could not agree. While standard economic theory would have predicted a mutually agreeable price in most instances, sellers demanded approximately twice the amount as buyers were willing to pay, and most trades did not get done. In other words, the students who received a gifted mug assigned a higher value to it simply because they owned it.

The endowment effect is one manifestation of what Kahneman identified as loss aversion, or our tendency to experience the pain of loss much more than the joy of gain. Loss brings outsized regret, and we have a bias toward maintaining the status quo and not giving up our position.

Other research into price setting has suggested that the endowment effect results from the different ways in which buyers and sellers establish their price estimates. To avoid paying for more than an item may be worth, buyers will anchor on the lowest available price estimate. To maximize profits, sellers will focus on the highest available estimate when establishing a price. The resulting gap can gum up pricing in otherwise rational markets. While these cognitive biases likely play a role in all price-setting, they can become particularly pronounced in cases where there is more uncertainty as to the true value of the item in question.

Source: Made by HDIM with ChatGPT-4o

While the above research may seem esoteric, the behaviors associated with the endowment effect are all too familiar in many markets today. Consider the market for Taylor Swift concert tickets. In a *Wall Street Journal* column last month, James Mackintosh reported that tickets for Swift's Eras Tour were changing hands at well over $1,000 each or more than eight times face value. In an informal survey, he found that most existing ticket holders would be unwilling to pay the going rate because they felt it was too high. Irrationally, however, they also felt that the same elevated prices were insufficient to convince them to sell.

The endowment effect can lead to many unhelpful behaviors. The residential real estate market is, in many ways, quite different from the market for mugs discussed above. Price discovery is complicated by the fact that each house is unique, and transactions are typically emotional in nature. But the endowment effect also helps complicate the transaction process. This is especially true in weak markets, where sellers are reluctant to drop prices and sales cycles become extended. In the investment world, to avoid the pain associated with loss, individual and professional investors alike often hang on to losers too long and sell winners too early.

This can be particularly harmful given research which shows that stocks tend to experience price momentum over time. And in markets prone to volatility, the endowment effect can cause a "high water mark" problem where asset holders avoid selling as they anchor on past high valuations that may no longer prove realistic.

What can asset owners do to avoid falling prey to this cognitive bias? The best first step is to recognize situations where it may be present. Seeking out one or more objective valuation opinions or an "outside view" can also help identify when your expectations are overinflated. In our stock research work, for example, we often rotate research responsibilities among analysts to combat this very natural human tendency. Finally, reminding yourself of the "opportunity cost," or how else you might invest your funds, can also be helpful.

THE FEDERAL RESERVE

By Mark Andrews

Fed interest rate cuts – what do they mean for me?...

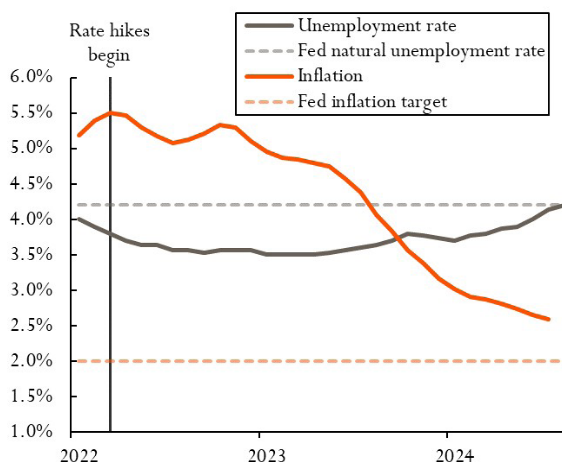
After an historically fast and furious campaign of interest rate hikes to combat inflation, the Federal Reserve is ready to cut at its meeting this week. Why are cuts coming now, and what do they mean for you and me?

The Fed is all about its "dual mandate" of price stability and maximum employment. They define a specific target for inflation of 2% and an unemployment rate that should be whatever is "natural" for the economy and supports stable prices – somewhere around 4.2%. When inflation took off in 2021 and 2022, unemployment was very low, and the Fed focused all its efforts on bringing inflation down by raising rates from 0.0% to 5.5%. Inflation has since fallen close to the 2% target, but a consequence of restrictive interest rates was that unemployment began to climb. *The chart on the right shows* the give-and-take of the Fed's dual mandate since it first raised rates.

Now the Fed wants to ease up on its policy to make sure the labor market does not weaken further, potentially causing a recession or unpleasant slowdown.

That means it is ready to cut rates. By how much is still an open question. Typically, the Fed hikes and cuts in 0.25% increments – and if that sounds small, it is! But more important than what 25 basis points (as 0.25% is called) might do for the economy is how the Fed proceeds with further rate cuts in subsequent months over the so-called "cutting cycle." Currently, the market is betting on a 0.25% cut in September, an additional 0.75% by December, and then another 1.5% over the course of 2025. That would bring rates down to around 2.75% over the next 15 months to just about where the Fed deems its policy is "neutral," neither restrictive nor accommodative for the economy.

THE FED'S DUAL MANDATE

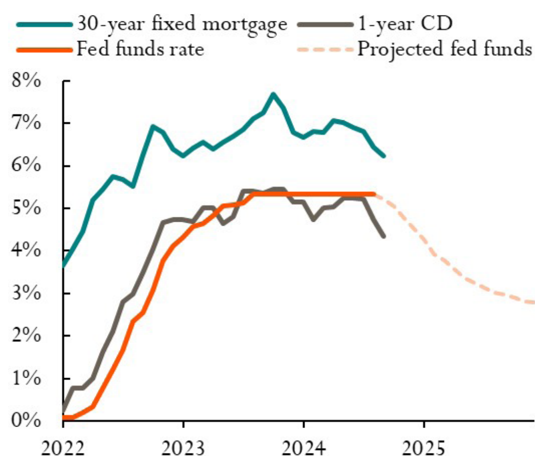


BLS, BEA, FRB; 3 month moving averages, core PCE

So how does that impact us? We can't take out loans from the Fed or deposit our savings there. Ah, but banks can. It is the very short-term rate – overnight, actually – for banks and asset managers that the Fed controls. And if banks can no longer earn 5.5% on money deposited at the Fed, they can no longer offer similar rates to us.

Lower yields on many consumer finance products are probably the first thing many of us will notice over the course of this rate-cutting cycle. High-yield savings accounts, money market funds, and CDs that have all earned around 5% since 2023 will drop with each Fed cut. Actually, CD rates have already come down, especially for longer terms. After all, a bank is not going to promise to pay you 5% for the next year when it might earn only 3% on that money by the end of the CD's term. Many who have been more heavily invested in cash may now turn to riskier investments like bonds or stocks for their higher return potential.

EXPECTED RATE CUTS HAVE ALREADY BROUGHT DOWN SOME RATES



Source: CME Group, FRED, Optimal Blue, FDIC

Just as savings rates will come down, so too will borrowing costs. Anything tied to the "prime" rate or SOFR (the new LIBOR) will also decline with Fed cuts – things like credit cards, student loans, home equity lines of credit, and adjustable-rate mortgages. Even 30-year fixed rate mortgages are affected, though the mechanism is much less direct. In fact, mortgage rates have already declined from around 7% at the start of the year to nearly 6% today. Lower mortgage costs could do much to stimulate the housing market and bring out some of the homeowners currently "locked in" to their homes at much lower, pandemic-era interest rates. *The chart to the left shows* how mortgages and 1-year CDs have moved with, and in anticipation of, Fed policy.

While we can talk with certainty about how some interest rates will adjust with Fed policy, there is no such certainty about the broader impact on the economy and outlook for recession. We're still digesting the impact recent rate hikes have had! Monetary policy is always a live experiment.

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