

# The Great Noise

*presented by* Lyn Adams, AIF, CFP® - October, 2015



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# Agenda

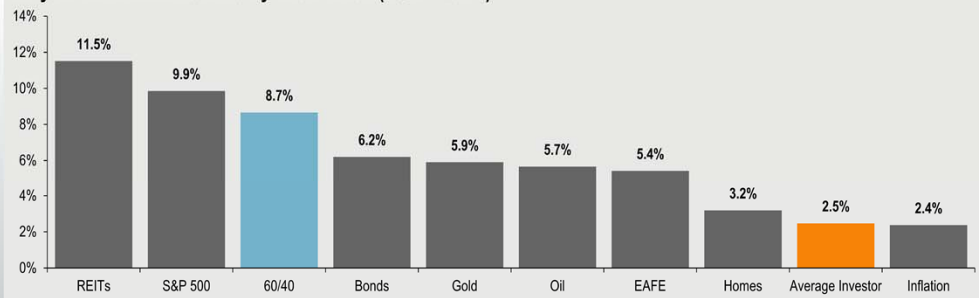
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1. The “Noise” effect on investments
2. Behavioral economics
3. Profiting from the “hype”
4. The Social Kicker
5. NetSertive Technology
6. Implications / What to pay attention to



# The “Noise” Effect

20-year annualized returns by asset class (1995 – 2014)



What contributes to such low returns for average investors?

Source: Morningstar Direct, Dalbar Inc., JPM. Indexes used are as follows: NAREIT Equity REIT Index, EAFE: MSCI EAFE, WTI Index, Barclays Capital U.S. Aggregate Index, Median sale price of existing single-family homes, USD/troy oz, CPI. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized.



There are many things that contribute to this phenomena. Today we are going to discuss the “noise” effect and its impact on investors.

# The “Noise” Effect

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When we hear something that triggers an emotional response, it tends to stick with us. If the response is strong enough, we tend to

- 1.) Pay closer attention to see if it may be real
- 2.) Act on it to change the potential outcome
- 3.) Share it with people that we want to protect



# The “Noise” Effect

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EXAMPLES:



# The “Noise” Effect

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EXAMPLES:



## The “Noise” Effect

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How we respond to what we hear can harm ourselves.

**BE CAREFUL WHAT YOU LISTEN TO.**



# Behavioral Economics

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The advanced study of how human emotions impact our financial decisions.

It has yielded many conclusions that help wealth managers / advisors to better serve and communicate with investors-

*not necessarily help them to identify, buy, sell, securities, but to better COMMUNICATE with their investors*





# Behavioral Economics

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Behavioral economics demonstrates that we all feel significantly more negative emotion when we lose, than positive emotions when we gain the same amount. These emotions are a part of human decision making.

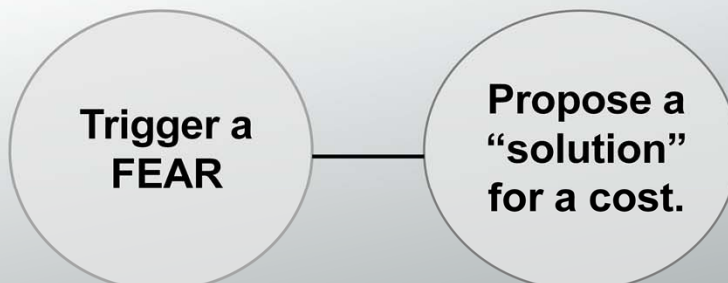
Example – the 50/50 bet, how much more would you have to win to risk it all?

FEAR will tilt this bet as it gets larger.



## Profiting from the hype

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The mechanics of fear selling the investment business are simple and timeless. Typical products for sale are “white paper research”, newsletter service, guide to investing in hard assets, end of the US economy books, market timing subscriptions, etc.



# Profiting from the hype

Watch: Ron Paul's Message to Americans

## The Truth About the Economy is Terrifying

Former U.S. Presidential candidate & 22-year Congressman predicts the next huge disaster for America—worse than 2008, Black Monday and Great Depression—and reveals for the first time ever, the #1 step you should take to protect yourself, your family and your retirement...

What response do we have to this type of communication?



# Profiting from the hype

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## **The End of the USA Coming in September?**

Many indications of the downfall of the United States of America as the free, sovereign nation that we have thought it to be all of our lives appear to be converging in September this year. The massive Jade Helm domestic control military exercises are now being conducted on American soil and are scheduled to end in September. The last of the Blood Moons phenomena will occur in September. Many are predicting a collapse of the US economy in September. Through surveillance of bank and phone records plus Internet usage and communications, the US government has already collected complete profiling and tracking information on virtually all US citizens. With training camps all over the nation, Islamic terrorists appear to be poised to unleash their fury on the American public. And now, on September 15, the Pope, who recently embraced Islam, is scheduled to speak to the UN, some say to announce the establishment of the New World Order. — *unknown e-newsletter writer*

How about this one?



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Here is  
one more:

## Your IRA/401(k) Is Already Worthless, You Just Don't Know It Yet

September 8th, 2015

Just a few months ago, governments and central banks from all over the world met at the G20 Summit to decide the fate of your savings account should the worlds banks crash. Their decision? **Your savings account is up for grabs.**

[Little Known IRS Loophole Is The Only Way To Protect Your IRA/401k](#)

What's worse, is they may have their eye on your retirement accounts next. **That's right, every dollar that you've worked so hard the past 30, 40 or 50 years to save, could be taken from you.** It would be completely legal, and there would be nothing you could do about it.

[Get Your FREE, No Obligation, Precious Metals IRA Guide Now!](#)



# The Social Kicker

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For the past 2 decades, we have observed a dramatic increase in the velocity of information distribution.

Until about the last 4-6 years investors have experienced more information overload, but not nearly as much subjective endorsements as you see today.



If we happen to read a random article in a magazine, our mental process for deciding on how relevant or valid the point may be to us is primarily based on the facts presented, the reputation of the publisher in our view, and the style in which the information is presented (is the presentation clear, understandable, actionable, etc.)

However, if we get sent that same information from a trusted friend, advisor, or other knowledgeable center of influence, human tendency is to associate the credibility of the sender with the credibility of the actual content. So we give the content more credence.

Today's media technology, is built to deliver information peer to peer and it is causing a seemingly much more intense "noise" all around us on all sorts of financial fronts- but especially on the fear based topics.

# NetSertive Technology

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Today this technology is at work in “The Great Noise” phenomenon.

All it takes is just one click on just one link and suddenly your entire web browsing experience becomes altered years..



NetSertive is a local company that was started a few years ago with a focus to be come the most effective internet marketing resource in the industry. They have state of the art technology capabilities to make each individual internet user “experience” a complete targeted web surfing experience that is uniquely targets their personal buying triggers (for a profit of course, paid by NetSertive’s thousands of customers)

Today this tech is at work in “The Great Noise” phenomenon. Once you click on just one link to “see the latest white paper” or “listen to the doom and gloom commentary” or subscribe, or else.. one click, and your unique web id gets loaded into targeted ad systems like NetSertive’s algorithm, and you have then opened the door to a never ending barrage of similar focused content- all completely sharable and packaged to suggest to you that you do so.

# The “Noise” gets LOUDER

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Review the 3 outcomes we observe when people receive information that invokes a negative emotional response

- 1.) **Pay closer attention** to see if it may be real
- 2.) **Act on it** to change the potential outcome
- 3.) **Share it** people that we want to protect

Example – recent junior advisor email experience, Ron Paul case study, any online purchase scenario





# Implications of “the noise”

Greater potential for non-justified large market moves



Too much noise makes it hard to listen to what matters



We would all like to think that the investment implications to this phenomena would be subdued and would ultimately not have too much of an influence on the process of funding the capital structure of great companies. Unfortunately it does not look like that is going to be the case on many fronts –

1.) non-justified large market moves are much more likely because investors can act quickly (electronic trading triggers) on emotions and to some degree, irrationally, for longer than some of our client's investment time horizons. This poses a risk that we have built a process to hedge against.

2.) too much noise makes it hard to hear the truth – Owning stocks for the long term is an investment in companies' ability to earn profit in the future

Generationally, the Baby Boomers were largely profitable investing in companies that produced earnings for decades. They learned that profits are worth investing in over time.

Gen Y, however saw their future inheritance evaporate in the Great Recession and still have strong disdain for stock ownership because of a brief period of excess leverage in the U.S. housing market. The pain they observed during the unwinding of that leverage has made this generation predominantly unwilling to invest in the future earning potential of corporations because of its potential downside in periods of economic decline..

Millennials seem very intrigued with investing, spending an average of 6 hours per month reviewing their investments (according to a study WMU). For the large majority of their investment lifespan, the stock market has fundamentally been going up (since 2008).

What are implications of these widely varying views? Lots of conflicting opinions leading to no singular trade momentum,...lots of activity and lots of noise.

## What's Next for Our Clients?

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We continue to base our investment process on long-term financial precepts, but adapt to hedge against or take advantage of new trends in the investment landscape.



We still believe in diversification, and tactical overweight/underweights to own more securities with attractive valuations. We believe in global diversification, but are prone to avoid hot spots as we realize that volatility creates emotional responses in our clients that can statistically lead to destructive investment decisions.

We believe in active portfolio rebalancing, which the process itself creates a natural course of buying at lower prices and selling at higher prices.

We believe in the philosophy of “win by not losing”. Larger losses require so much more risk taken to drive returns to recover from large drawdowns. It is important for our team to always seek to minimize downside participation in market selloffs. One bad decision on the downside will require years of good decisions to make up for it later.

# Enduring Values

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20+ years serving in our community  
teaches some enduring values –

Regardless of the noise, or generational  
differences, there are a few professional  
abilities that are always a real value to  
those we serve-



# Enduring Values

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- We want what is best for our clients; relationships matter
- If all else is the same, cheaper is better- we work diligently to keep costs down. But, sometimes all is not the same.
- Its not what you make, its what you keep - tax implications really matter.
- Estate planning is part of every plan - tomorrow is not promised to any of us.
- We help you hear what matters through the noise.



# Where are we Today?

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As Mark Twain put it, “history does not repeat, but it tends to rhyme”.

We see some patterns that are well inside the classic market framework of fear, hope, and greed cycles at work with investor behaviors as of late.



# The Cycle of the Markets



**Greed**, market moved rapidly higher in early parts of the year on zero anticipated earnings growth (in fact forecasts were for slowing profits due to increased value of USD), driving P/E ratios to very top band of “normal” long term prices. Then..

**Fear** on collapse of Euro, fear on Fed rate hikes, fear on the potential collapse of the USD, fear on slowing Chinese economy and the accuracy of China data – all converging in the midst of the “summer doldrums” triggering market to drift down to 200 day moving averages. Then automatic hedge’s are triggered at institutional and hedge fund levels to sell equities to protect against capitulation- then we get capitulation and the market settles lower.

**Hope** - Following weeks of increased volatility and a 14% correction from top to bottom., market data and earnings provides price support and investors tip toe back in, then hedges fall off after market moves above hedge points, then market rally’s on anything it can find to justify why we should all own stocks when they are priced at or below full value.

# A Look Beyond the Noise

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## PROS:

- U.S. Corporate Earnings
- Drivers for our Economy
- Much Improved Federal Budget
- Valuations are normal
- Unemployment approaching 40 yr low



Lets have a look at some meaningful data about our economy and current stock valuations.



# A Look Beyond the Noise

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## CONS:

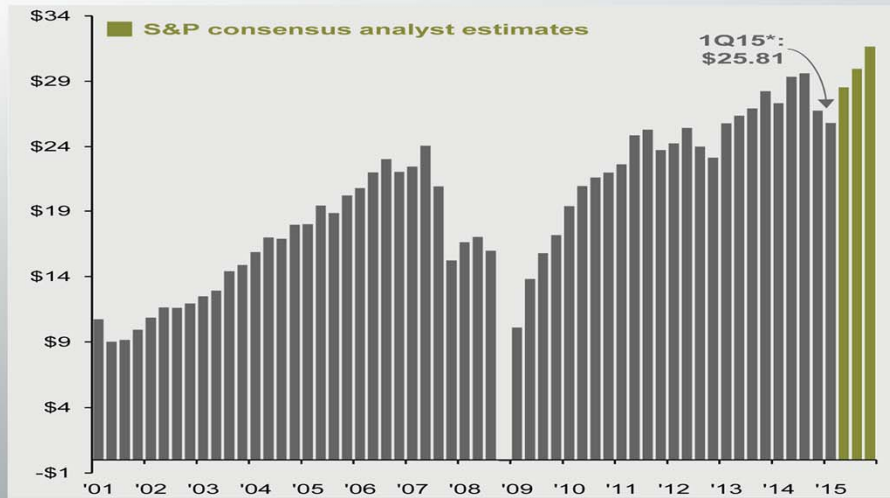
- Energy drags on S&P earnings
- Emerging Markets are slowing
- USD is so high, it is hurting U.S. exports
- U.S. cannot produce high growth without larger employment pool
- Fed acting to pre-empt wage inflation



Lets have a look at some meaningful data about our economy and current stock valuations.

# U.S. Corporate Earnings

Estimates as of 9/30/15

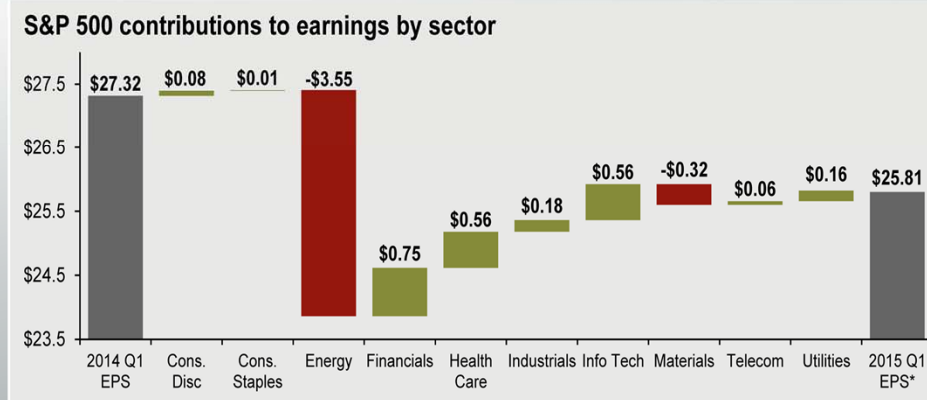


Source: BEA,  
Compustat, FactSet,  
Standard & Poor's,  
J.P. Morgan Asset  
Management.



# U.S. Corporate Earnings

Estimates as of 9/30/15



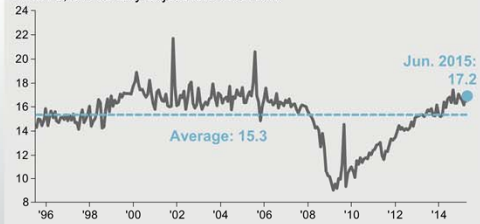
Source: BEA,  
Compustat, FactSet,  
Standard & Poor's,  
J.P. Morgan Asset  
Management.



# Drivers for U.S. Economy as of 9/30/15

## Light vehicle sales

Millions, seasonally adjusted annual rate



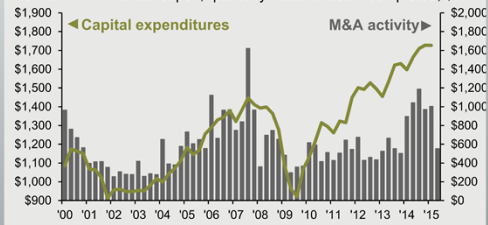
## Housing starts

Thousands, seasonally adjusted annual rate



## Corporate growth

Nonfarm nonfinancial capex, quarterly value of deals completed, \$bn



## Household debt service ratio

Debt payments as % of disposable personal income, SA



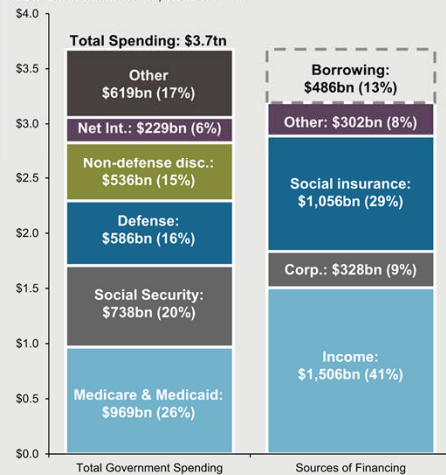
Source: BEA,  
Compustat, US  
Census Bureau,  
FactSet, Standard &  
Poor's, J.P. Morgan  
Asset Management.



# Improved Federal Budget Deficit

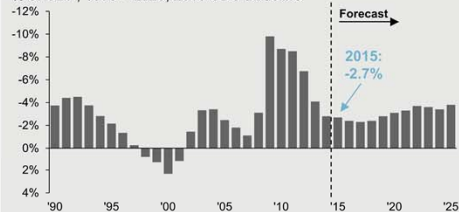
## The 2015 federal budget

CBO Baseline forecast, USD trillions



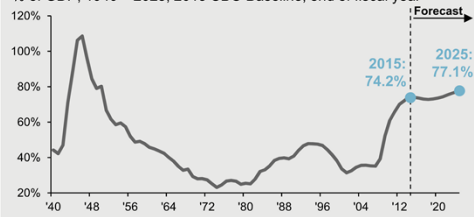
## Federal budget surplus/deficit

% of GDP, 1990 – 2025, 2015 CBO Baseline



## Federal net debt (accumulated deficits)

% of GDP, 1940 – 2025, 2015 CBO Baseline, end of fiscal year



Source: U.S. Treasury, BEA, CBO, St. Louis Fed, J.P. Morgan Asset Management.

2015 Federal Budget is based on the CBO's March 2015 Baseline Budget Forecast. Other spending includes, but is not limited to health insurance subsidies, income security, and federal civilian and military retirement.



# Valuations are Normal

S&P 500 Index: Forward P/E ratio



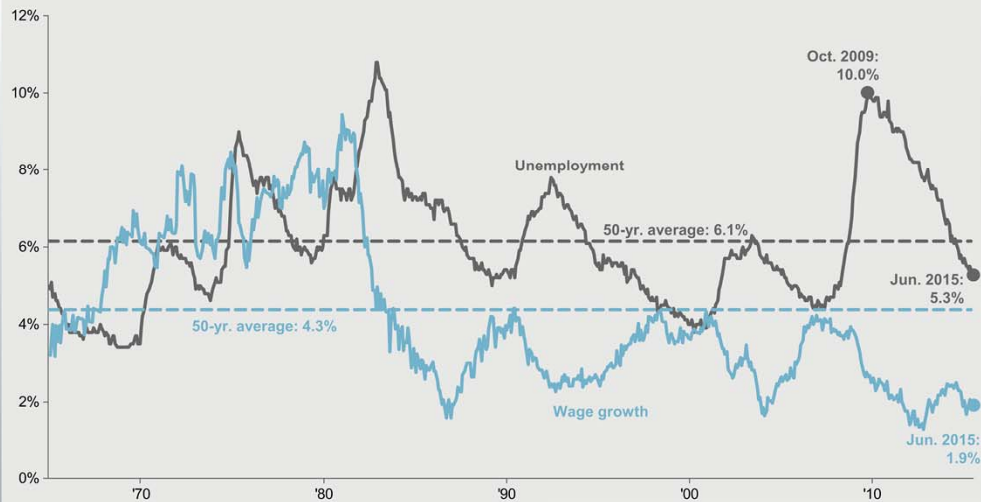
Source: FactSet, FRB, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.

Price to Earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months



# U.S. Employment Data as of 9/30/15

**Civilian unemployment rate and year-over-year growth in wages of production and non-supervisory workers**  
Seasonally adjusted, percent



Source: BLS, FactSet,  
J.P. Morgan Asset  
Management.

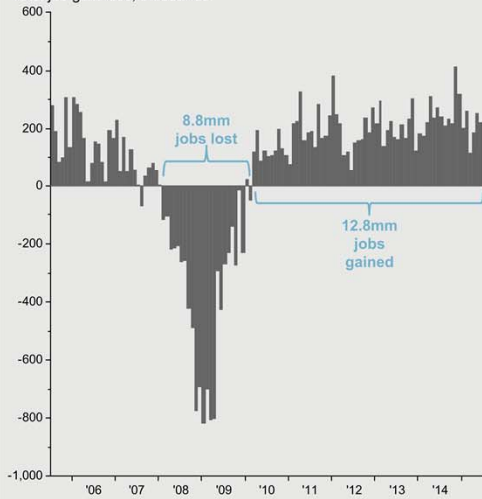


# U.S. Employment Data as of 9/30/15

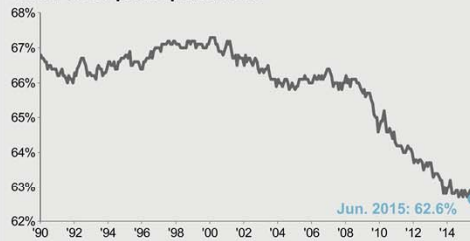
Source: BLS, FactSet,  
J.P. Morgan Asset  
Management.

## Employment – Total private payroll

Total job gain/loss, thousands



## Labor force participation rate



## Net job creation since Feb. 2010

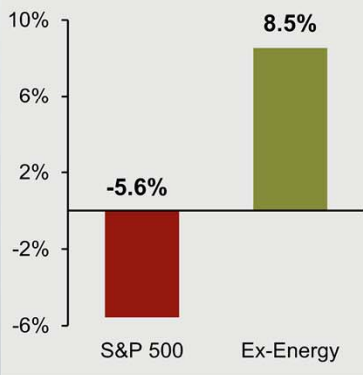
Millions of jobs





# Energy Drags on Earnings

**1Q 2015 EPS growth**  
Year-over-year



Revised earnings data from Q1 show year over year S&P500 earnings decline was all about energy profit losses.

Source: Compustat, Federal Reserve, S&P 500 individual company 10K filings, S&P Index Alert, Standard & Poor's, J.P. Morgan Asset Management.



# Emerging Markets Lag as of 9/30/15

Global Purchasing Managers' Index for manufacturing

	Jul'13	Aug'13	Sep'13	Oct'13	Nov'13	Dec'13	Jan'14	Feb'14	Mar'14	Apr'14	May'14	Jun'14	Jul'14	Aug'14	Sep'14	Oct'14	Nov'14	Dec'14	Jan'15	Feb'15	Mar'15	Apr'15	May'15	Jun'15
Global	50.6	51.5	51.6	51.9	52.8	52.9	52.9	53.1	52.4	51.9	52.2	52.6	52.4	52.5	52.2	52.2	51.8	51.5	51.7	51.9	51.8	51.0	51.3	51.0
U.S.	53.7	53.1	52.8	51.8	54.7	55.0	53.7	57.1	55.5	55.4	56.4	57.3	55.8	57.9	57.5	55.9	54.8	53.9	53.9	55.1	55.7	54.1	54.0	53.6
Canada	52.0	52.1	54.2	55.6	55.3	53.5	51.7	52.9	53.3	52.9	52.2	53.5	54.3	54.8	53.5	55.3	55.3	53.9	51.0	48.7	48.9	49.0	49.8	51.3
U.K.	54.6	58.4	56.9	56.4	57.8	57.2	56.5	55.9	55.3	57.2	56.7	56.8	54.9	52.9	51.5	53.3	53.3	52.6	52.9	53.8	54.3	51.8	51.9	51.4
Euro Area	50.3	51.4	51.1	51.3	51.6	52.7	54.0	53.2	53.0	53.4	52.2	51.8	51.8	50.7	50.3	50.6	50.1	50.6	51.0	51.0	52.2	52.0	52.2	52.5
Germany	50.7	51.8	51.1	51.7	52.7	54.3	56.5	54.8	53.7	54.1	52.3	52.0	52.4	51.4	49.9	51.4	49.5	51.2	50.9	51.1	52.8	52.1	51.1	51.9
France	49.7	49.7	49.8	49.1	48.4	47.0	49.3	49.7	52.1	51.2	49.6	48.2	47.8	46.9	48.8	48.5	48.4	47.5	49.2	47.6	48.8	48.0	49.4	50.7
Italy	50.4	51.3	50.8	50.7	51.4	53.3	53.1	52.3	52.4	54.0	53.2	52.6	51.9	49.8	50.7	49.0	49.0	48.4	49.9	51.9	53.3	53.8	54.8	54.1
Spain	49.8	51.1	50.7	50.9	48.6	50.8	52.2	52.5	52.8	52.7	52.9	54.6	53.9	52.8	52.6	52.6	54.7	53.8	54.7	54.2	54.3	54.2	55.8	54.5
Greece	47.0	48.7	47.5	47.3	49.2	49.6	51.2	51.3	49.7	51.1	51.0	49.4	48.7	50.1	48.4	48.8	49.1	49.4	48.3	48.4	48.9	46.5	48.0	46.9
Ireland	51.0	52.0	52.7	54.9	52.4	53.5	52.8	52.9	55.5	56.1	55.0	55.3	55.4	57.3	55.7	56.6	56.2	56.9	55.1	57.5	56.8	55.8	57.1	54.6
Australia	42.0	46.4	51.7	53.2	47.7	47.6	46.7	48.6	47.9	44.8	49.2	48.9	50.7	47.3	46.5	49.4	50.1	46.9	49.0	45.4	46.3	48.0	52.3	44.2
Japan	50.7	52.2	52.5	54.2	55.1	55.2	56.6	55.5	53.9	49.4	49.9	51.5	50.5	52.2	51.7	52.4	52.0	52.0	52.2	51.6	50.3	49.9	50.9	50.1
China	47.7	50.1	50.2	50.9	50.8	50.5	49.5	48.5	48.0	48.1	49.4	50.7	51.7	50.2	50.2	50.4	50.0	49.6	49.7	50.7	49.6	48.9	49.2	49.4
Indonesia	50.7	48.5	50.2	50.9	50.3	50.9	51.0	50.5	50.1	51.1	52.4	52.7	52.7	49.5	50.7	49.2	48.0	47.6	48.5	47.5	46.4	46.7	47.1	47.8
Korea	47.2	47.5	49.7	50.2	50.4	50.8	50.9	49.8	50.4	50.2	49.5	48.4	49.3	50.3	48.8	48.7	49.0	49.9	51.1	51.1	49.2	48.8	47.8	46.1
Taiwan	48.6	50.0	52.0	53.0	53.4	55.2	55.5	54.7	52.7	52.3	52.4	54.0	55.8	56.1	53.3	52.0	51.4	50.0	51.7	52.1	51.0	49.2	49.3	46.3
India	50.1	48.5	49.6	49.6	51.3	50.7	51.4	52.5	51.3	51.3	51.4	51.5	53.0	52.4	51.0	51.6	53.3	54.5	52.9	51.2	52.1	51.3	52.6	51.3
Brazil	48.5	49.4	49.9	50.2	49.7	50.5	50.8	50.4	50.6	49.3	48.8	48.7	49.1	50.2	49.3	49.1	48.7	50.2	50.7	49.6	46.2	46.0	45.9	46.5
Mexico	49.7	50.8	50.0	50.2	51.9	52.6	54.0	52.0	51.7	51.8	51.9	51.8	51.5	52.1	52.6	53.3	54.3	55.3	56.6	54.4	53.8	53.8	53.3	52.0
Russia	49.2	49.4	49.4	51.8	49.4	48.8	48.0	48.5	48.3	48.5	48.9	49.1	51.0	51.0	50.4	50.3	51.7	48.9	47.6	49.7	48.1	48.9	47.6	48.7

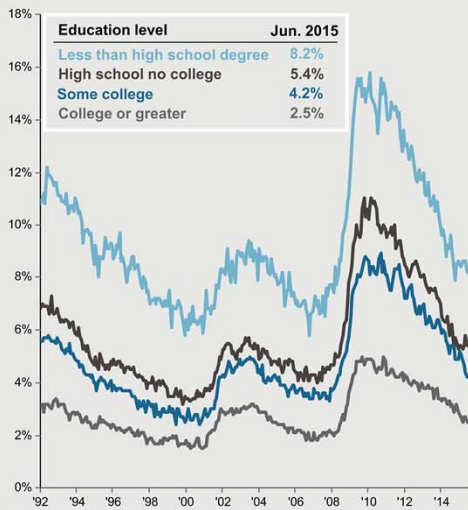
Source: Markit, J.P. Morgan Asset Management.

Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown.



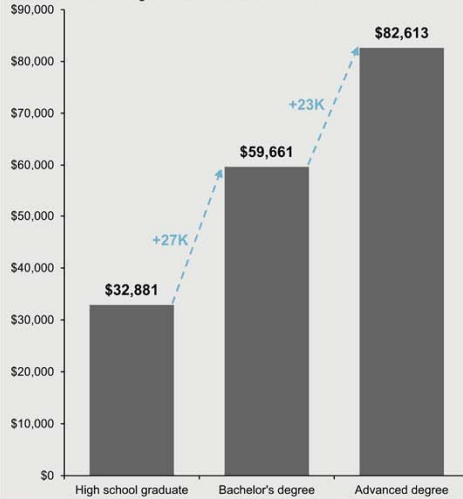
# Tight Labor Market will Slow U.S.

Unemployment rate by education level



Average annual earnings by highest degree earned

Full-time workers aged 18 and older, 2013, USD



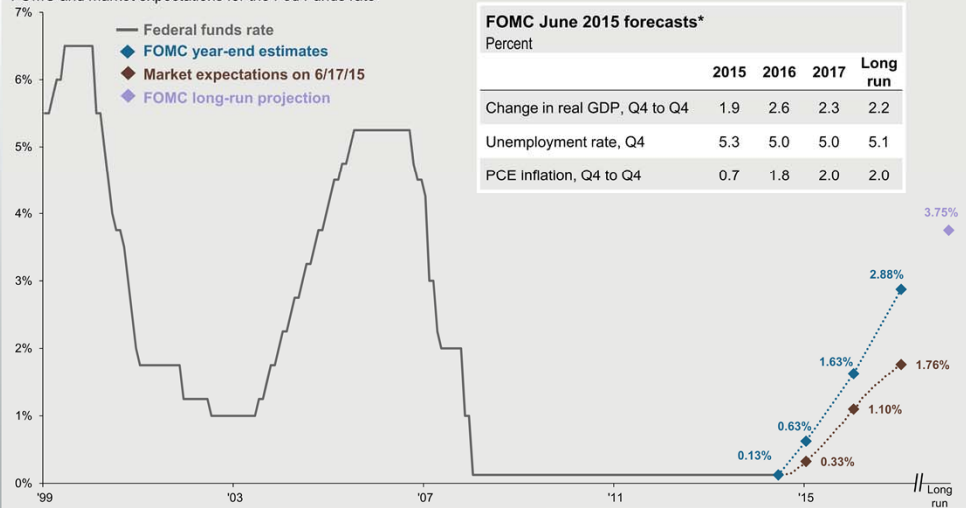
Source: BLS, Census Bureau, FactSet, J.P. Morgan Asset Management.  
Unemployment rates shown are for civilians aged 25 and older.



# Fed Seeks to Pre-empt Inflation

## Federal funds rate expectations

FOMC and market expectations for the Fed Funds rate



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.

Market expectations are the federal funds rates priced into the fed futures market as of the date of the June 2015 FOMC meeting.

\*Forecasts of 17 Federal Open Market Committee (FOMC) participants



## Conclusions

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- We anticipate slow growth and more volatility in the U.S. from here.
- We have slight bias to non-interest sensitive stocks so long as they are not too expensive and European stocks while valuations are lower than U.S.
- Stabilization in energy should provide for a limited boost to 2016 earnings; cheap energy will continue to boost consumer spending.



# Conclusions

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- Given stocks are trading on higher end of “normal” prices, we will continue to use defined risk strategies to hedge downside somewhat when market falls below its 200 day moving average.
- When inflation begins to measure higher, we’ll likely increase exposure to alternative “inflation asset” categories.
- Expect a bumpy ride through the Presidential Election period as mudslinging erodes investor confidence.



# The Great Noise

**Try to Tune it Out.**



# Required Disclosures

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- The S&P 500 ® is a market-value-weighted index of 500 stocks that is generally considered representative of the US large cap equity market. The index is unmanaged and not available for direct investment.
- The views are those of Lyn Adams, Jr and should not be construed as investment advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic and performance information is historical and not indicative of future results.





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# Questions

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