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JANUARY 2020

The Dow Theory: Curbing Emotional Investing

In addition to starting the company that publishes *The Wall Street Journal*, Charles Dow (1851–1902) also lent his name to one of the most popular U.S. stock market indexes (the Dow Jones Industrial Average) and created a theory regarding major shifts in stock market trends. While neither Dow nor those who refined the Dow theory after him believed they were creating a sure-fire way to beat the market, they did believe that following its principles could at least avoid the mistakes associated with greed and fear.

Three Assumptions

Behind the Dow theory is a set of assumptions about how the stock market works:

✔ **The stock market moves in broad cyclical trends.** According to Dow, there are primary trends, which are long-lasting (from months to years), and minor trends, which don't last long and run in the opposite direction of the primary trend. Primary up trends are bull markets and primary down trends are bear markets — these are marked by peaks and troughs in price charts. Within these broader trends, there are secondary (minor) countertrends called corrections, which can retrace anywhere from 33% to 67% of the primary trend's movement. Of course, no one ever knows in advance how long trends will last. And since market prices fluctuate from day to day, it's dangerous to make too much out of a single day's movement.

✔ **Primary trends can't be manipulated.** The Dow theory holds that the primary trend in the stock market is driven by forces much bigger than any single event.

✔ **The stock indexes reflect all available information.** The Dow theory believes that everything

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Fun Ways for the Entire Family to Save

Most people don't think saving money is fun, but there are ways to make it fun for the entire family. Check out these ideas:

Make It a Competition — You and your spouse or two of your teenagers can challenge each other to a "save-off." Set a time frame and a savings metric to determine the winner. Make sure the prize doesn't claim everything you've saved.

Create a Savings Thermometer — This is a great way to save when you have younger children. Let the kids create a large thermometer out of poster board, then write a saving goal at the top and hang it somewhere in the house where everyone can see it.

Have a Family Garage Sale — A great way to clean out your house is for everyone to find clothes, toys, and other household items they no longer use or need. Let your children help run the sale.

Find Inexpensive Family Fun — Not every outing with your kids has to include spending money, especially with younger children. Go to a local park, plant a garden together, or play a family game of baseball or volleyball. ❍❍❍

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FR2019-0715-0081

The Dow Theory

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there is to know about a stock and the economy at a given moment is factored into the prices of stocks. Unexpected events can occur, but usually they affect the short-term trend, creating what are called reaction rallies.

Three Primary Trend Phases

According to the Dow theory, major trends consist of three phases of varying length:

Stage 1: Accumulation or distribution. In this phase, the smart money — typically large institutional investors like investment banks, pension funds, mutual funds — start major buying or selling programs. Initially, this looks like a secondary countertrend, but trading volume on the major exchanges noticeably increases on up days, while volume tends to be lighter on down days.

Stage 2: The big move. In this phase, there are many more days in which the indexes move in the direction of the primary trend than in the opposite direction. In bull markets, there are strings of up days, followed by shorter strings of down days, reflecting the spread of enthusiasm for stocks. In bear markets, the opposite occurs, as anxiety and pessimism mounts. The result is a significant, long-term increase (bull markets) or decrease (bear markets) in the market averages.

Stage 3: Excess. The final phase of a primary trend is marked by extremely high levels of emotion — enthusiasm in bull markets and pessimism in bear markets — which are signs that the primary trend is about to change. These extremes can be seen in the behavior of individual investors: in bull markets, even the most conservative investors are buying stocks. On the other hand, in the excess stage of a bear market, everyone is concerned about safety of principal, while those who bought stocks at high prices have finally given up and sold at a loss.

The Indexes Confirm the New Trend

For Charles Dow, the primary trend was reflected in the Dow Jones Industrial Average, which today comprises 30 stocks. But Dow also looked to another index to confirm the emergence of a new trend. In his day, that was the Dow Railroad Index. Today, it's the Dow Transportation Index of 20 companies engaged in the shipping and transportation of manufactured goods. The idea was that a true change in the trend of business activity in the big manufacturing firms would show up in business for the companies they hire to move the goods they make.

For the second index to confirm the first, the Dow theory looks for both averages to be moving in the same direction. New highs or lows in one index are accompanied by highs or lows at the same time or shortly thereafter in the other.

The Dow theory is designed to tip off long-term investors to changes in the trend, so they can shift their money from stocks to another asset class.

Please call if you'd like to discuss this in more detail. ❍❍❍

5 Reasons to Start Saving

If you're interested in getting started with savings or want to save more, here are five reasons to help keep you motivated.

1. You'll Be Prepared for Emergencies — Here's an alarming fact: most Americans don't have enough money saved to cover even relatively small unexpected expenses. Without cash on hand to cover these irregular but inevitable costs, you're more likely to turn to credit cards or loans when the need arises. Plus, the more debt you have, the more difficult it is to save. The result? A downward financial spiral that can be difficult to pull yourself out of.

2. You'll Be More Independent — With a healthy amount of savings, you can feel more free to take risks, like starting your own business, heading back to school to train for a new career, purchasing a home of your own, or moving to a new city. Plus, without savings, you're living on the financial edge.

3. You'll Be Able to Reach Your Goals — We all have goals. Maybe you simply want to enjoy a comfortable retirement one day. Or perhaps you're dreaming of a second home by the lake, sending your kids to college, or starting your own business. Whatever your dreams, they likely have one thing in common — they probably require some money to become a reality. Few of those dreams are achievable if you don't save for them.

4. You'll Be Able to Earn More Money — Saving isn't just about setting aside what you've already earned. It's also about putting your money to work for you. Depending on where you save and invest your money, you can earn more just by being diligent about saving. Because of the power of compounding earnings, even relatively small amounts can grow significantly, provided you don't touch your principal.

5. You'll Be Happier — Money isn't the only thing that can make us happy. But there's evidence that *saving* money, even in small amounts, can make us happier. In contrast, having debt (often a consequence of a lack of savings) tends to lead to unhappiness. ❍❍❍

The Psychology of Saving

Saving money sounds simple. You set aside a portion of what you earn on a regular basis and watch your money grow. As a result, you're more prepared for emergencies, feel more financially stable, and are better able to achieve what you most want.

But in reality, saving is a little more complicated. Sometimes, our own minds work against us when it comes to setting aside some of the money we earn. A basic understanding of the psychology of saving can help you overcome roadblocks and achieve your goals.

Why It's Hard to Save

What is one of the biggest obstacles most people face when saving? We tend to prefer the certainty and immediate gratification of short-term rewards over the potentially greater — yet perhaps more uncertain — benefits of longer-term rewards. One study found that most adults would prefer to have $50 today rather than $100 two years from now, for example.

Part of the difficulty with saving for long-term goals is that people may tend to think of their future selves as different or separate from their current selves. That disconnect can make it hard to prioritize saving for the future.

Researchers studying this issue looked at whether encouraging people to think of saving for retirement in terms of a social responsibility to their future self, rather than in terms of their basic self-interest, would lead them to save more. The study found that the former appeal led to higher savings rates. In a related vein, another group of researchers found that seeing pictures of their future selves encouraged people to save more.

In fact, there are a number of studies that suggest changing our mentality might allow us to set aside more money.

A recent study found that people who adopted a cyclical mindset to saving, where they focused on making saving routine in the short term, saved more than people who set more ambitious longer-term goals. Those with a traditional linear mindset saved about $140 over two weeks, while those with a cyclical mindset saved $223 over the same time period. Overall, the evidence seems to suggest that if we can change the way we think about the future — and our future selves — we may be able to boost our savings rates.

The Psychological Advantage of Saving

Once you commit to savings, there's a good chance you'll see a psychological boost from doing so. In 2013, a survey by Ally Bank found that 38% of people with a savings account reported being extremely happy, compared to only 29% of people who didn't have a savings account.

That same survey found that 82% of people reported saving made them feel independent. Those feelings of success, well-being, and independence may in turn lead to even more saving. In fact, feeling powerful and having high self-esteem can lead people to save more, perhaps because increasing their net worth and financial stability helps people maintain their powerful feelings.

There might even be a formula for spending and saving that could lead to more happiness. Ryan Howell, a professor of psychology at San Francisco State University, found that happy people tended to demonstrate a particular pattern of spending and saving, earmarking 25% of their money for savings and investments, allocating 12% to charitable giving or gifts to others, and spending about 40% on life experiences they considered meaningful.

While our mental quirks might make saving difficult, being aware of the obstacles our mind creates can help us conquer them. And that, in turn, may lead to greater savings and increased happiness overall. ❍❍❍

4 Reasons to Invest in Bonds

Bonds have a reputation as safe, stable investments. But writing off bonds as boring investments that are best for the risk-averse could be a mistake. Here are four reasons why you might want to have a portion of your portfolio in bonds.

1. Bonds are a way to diversify your portfolio. Many financial experts recommend diversifying your portfolio to include a variety of asset classes, including bonds. This is a concept known as asset class diversification. Because different asset classes tend to perform differently at different times, you may be able to create a portfolio that generates more stable returns by investing across asset classes.

2. Bonds are (usually) less risky than equities. If you are looking to dial-down risk in your investment portfolio (such as when you near retirement), increasing your allocation to bonds may be one way to do that. However, keep in mind that less risky doesn't mean risk free.

3. Bonds can provide a steady, predictable source of income. Stocks and other investments are unpredictable — you don't know with any certainty how well a given stock might perform in a certain year. Bonds are a bit different. They are debt investments, which means that you are essentially agreeing to loan an entity, like the government or a corporation, money for a certain period of time. The entity you are lending money to agrees to pay you a certain amount of interest (known as the coupon) over the time they have your money, plus repay your initial investment when the bond reaches maturity. That means that unlike some other investments, you have a pretty good idea of how much money you're going to see from your bond investments.

4. Bonds can provide valuable tax savings. Depending on the types of bonds you own, you may be able to save on taxes. While you'll pay normal taxes on corporate bonds, income from Treasury bonds (which are issued by the U.S. federal government) is free of state and local tax. Then there are municipal bonds, or bonds issued by state and local governments. You won't pay federal tax on money you earn on these investments, and you may also be exempt from state and local tax. For anyone who is looking to minimize their tax burden, especially retirees, this can be an appealing proposition. ❍❍❍

Can You Really Save 50% of Your Income?

It may seem like an extreme money saving idea, but some people can achieve saving half of their after-tax income, making significant financial gains quickly. If this sounds like something you'd like to try, here are a few tips:

Live on One Income — If you and your spouse both work, the easiest way to start is to live on only one person's income. You can first live on the higher of the two incomes while you are adjusting, and then later you can transition to living on the lower income.

Find Ways to Boost Your Income — If you make $100,000 a year, saving half is more achievable, but if you make $25,000, it will be much more difficult. In this case, you'll need to earn more money.

Focus on the Biggest Expenses — For most people, housing, transportation, and food are the largest expenses. You may need to move to a smaller home, which will also save on utilities and maintenance. Another idea is to rent out part of your home. You can save money on transportation by living close to work. To save money on food, you can avoid restaurants, clip coupons, and buy in bulk. ❍❍❍

Financial Thoughts

In response to a recent survey, 22% of the respondents indicated they plan to decrease their use/recommendation of individual stocks over the next 12 months while 44% plan to increase their use/recommendation of ETFs. 55% indicated that their clients had asked about investing in marijuana or cannabis stocks in the past six months (Source: *FPA 2019 Trends in Investing Survey*, 2019).

Approximately 15% of Millennials say they feel stressed about investing (Source: BMO Wealth Management, 2019).

In 2018, the average participation rate in company retirement plans is 85.6% for plans with auto enrollment and 43.7% in plans without auto enrollment (Source: T. Rowe Price, 2019).

The more time an individual spends working part-time or is self-employed, the more likely it is they will work after retirement. Relative job status and job changes were also found to increase the chances of working after retirement. Men who spent their whole careers at the same job had an 8.2% probability of working after retirement, while those who had more than 10 jobs had a 16.3% probability (Source: *AAII Journal*, June 2019). ❍❍❍