BAIRD

Private Wealth Management

# DIGEST

NEWS AND PERSPECTIVE FOR GROWING AND PRESERVING YOUR WEALTH

SPRING 2016


## THE PSYCHOLOGY OF WEALTH MANAGEMENT

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# PERSPECTIVE

## GREEN SHOOTS

It was a long winter this year – not as cold as some or snowy as others, but one that seemed to hang on even though the groundhog didn't see his shadow in February.

In the heart of winter, everything looks smooth with a white blanket covering the landscape. But as the snow retreats, the dirt of the season comes through as the debris of winter storms and all the stuff we forgot to put away last fall is revealed. Unfortunately, springtime often isn't as pretty as you expect it to be.

This also felt like a long winter for the market. After autumn brought us our first legitimate correction since 2011, the markets retreated and convulsed violently during the darkest months of the year. Radio ads stoked fear and loathing in those listening to financial programming and a parade of negative news headlines marched to the drumbeat of doom.

Interestingly, despite all the gyrations in the market, the fevered, tilted pitch of the political season and other forecasts of doom and gloom, what investors found by St. Patrick's Day was a growing economy. Slow growth, to be sure, but with strong trends in employment. While data remained somewhat volatile, green shoots of growth seemed to be finding their way up amidst the not-as-pretty-as-we-might-prefer financial landscape.

Your Baird Financial Advisor can help you identify those signs of growth – and any portions of your financial yard that might need tidying before the summer barbecue season begins.

## IN THIS ISSUE...



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Additional information is available at **bairddigest.com**, or contact a Baird Financial Advisor at **800-RW-BAIRD**.


OUTLOOK

# A COMPLICATED RELATIONSHIP

## WHY YOU SHOULDN'T JUDGE THE ECONOMY BY THE MARKET'S MOVES

There's a common piece of wisdom related to investor sentiment: Investors like certainty. But if the first few months of 2016 have demonstrated anything investors can be sure of, it's that volatility made a comeback. And judging by their collective behavior, knowing that hasn't been of great comfort.

After many saw disappointing returns in 2015, investors seemed to adopt a shoot-first attitude in 2016. Economic surprise indices (which are real things) showed some economic data reports falling short of their forecasts and, for a time, investors' worst fears seemed to be coming true. But just as quickly as stocks sold off over the first six weeks of the year, they rallied into March. By midmonth, the S&P 500 was almost back to where it began the year.

While the spring rally may have eased many investors' top-of-mind concerns, the likelihood of continuing market volatility can still be unnerving. Could such a wildly fluctuating stock market be sniffing out trouble for the U.S. economy? Does pronounced volatility indicate a recession on the horizon?

**THERE'S NO GUESSING A RECESSION** It's important to acknowledge that the stock market isn't a reliable indicator of an imminent recession. For example, cyclical bear markets (conventionally defined as a peak-to-trough market decline of 20% or more) have accompanied each of the last seven U.S. recessions. However, there have also been six bear markets over that ▸

## A COMPLICATED RELATIONSHIP

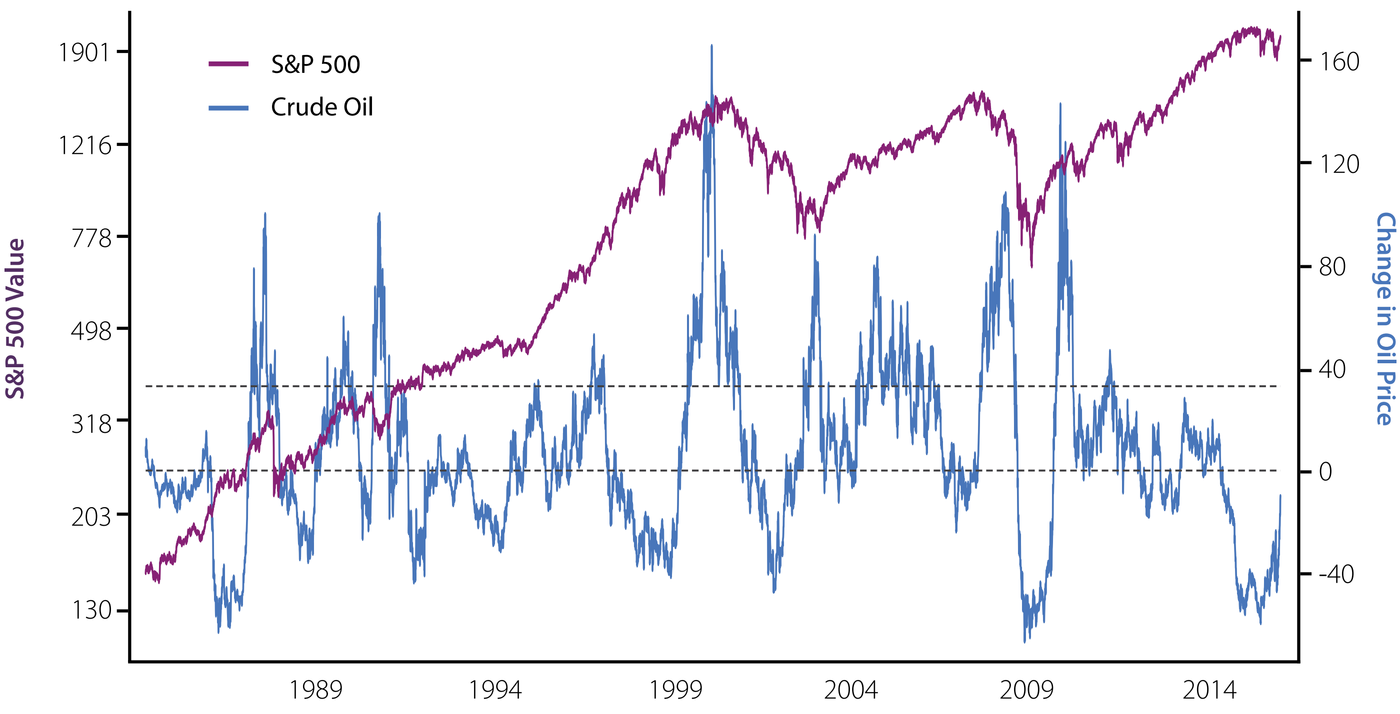
*continued from page 1*

time during which the economy did not go into recession. Put another way: While every rainstorm is accompanied by clouds, not every cloudy day turns into a rainy one. In both cases, there are other hard-to-see factors at play.

The behavior of the stock market and other financial markets can provide some insight into the health of the economy, but it almost always comes with noise that can be difficult to filter in real time. A disciplined investment approach that emphasizes risk management can provide the breathing room you need to put market-moving and macro-related developments into useful context.

Here are some of the louder disconnects that have occurred between market and economic data so far this year: ▶

As the below chart shows, there has been no historical correlation between changes in the **S&P 500** and changes in **oil prices** since March 1984.




**S&P 500 VS. CRUDE OIL MOMENTUM AND CORRELATION**

S&P Dow Jones Indices

## 1 MIXED ECONOMIC SIGNALS

As mentioned earlier, some indices have shown generally disappointing economic data in recent months. This led to something of a self-reaffirming cycle as investors began to believe (and subsequently made stock and bond markets behave as if) a recession were just around the corner. As it turned out, the disappointing data had more to do with overly optimistic expectations than evidence of actual economic weakness. The single best real-time economic data point – initial claims for jobless benefits – remains near its 40-year low, and even some of the weaker areas of the economy (primarily those dealing with oil and overseas trade) have shown some evidence of increased stability in recent months. The best evidence suggests economic conditions are improving, not pointing toward a new recession.

## 2 UNUSUAL CORRELATION BETWEEN OIL AND STOCKS

The price of oil and the most popular stock market averages have been tied at the hip since late 2015 and through most of 2016 so far. When oil has fallen, stock prices have followed suit, and when oil prices have bounced, stocks have rallied. The concern seems to be that weak oil prices automatically signal weak economic growth. But history shows that – where there's any relationship between oil prices and the economy – it's typically the opposite of what we've seen lately. Past periods of flat to declining oil prices have actually been good for overall economic growth. While we may not immediately notice the benefits of paying less at the pump, they do seem to accumulate over time and spur growth. And this close correlation in day-to-day price changes is a historical anomaly. Looked at over the course of years, there is essentially zero correlation between day-to-day price changes in oil and stock prices.

## 3 POLITICS AS UNUSUAL

Uncertainty will often weigh on stocks in even a traditional election year – and so far the 2016 presidential primary season has been anything but traditional. Add to that the geopolitical uncertainties around the world – a potential British exit from the eurozone, the refugee crisis in Europe, attempts to broker a peace deal in Syria and renewed tension on the Korean peninsula – and the future probably feels anything but certain for your average investor. A longer view almost always provides much-needed perspective. Take the presidential election: As heated as debate will undoubtedly be, history suggests that once a winner has been declared, stocks will move higher – regardless of who that winner might be.

## 4 WEIGHT OF THE EVIDENCE

Our most important takeaway: The stock market is impacted by a variety of factors – from unemployment rates to global headlines to consumer enthusiasm – and by itself is an unreliable gauge of a recession. Turn to "The Weight of the Evidence" on page 4 for a breakdown of the indicators we look at when taking the market's temperature. D

*Continue to "The Weight of the Evidence"* ▶

## ABOUT BAIRD'S INVESTMENT AND MARKET EXPERTS

**BRUCE BITTLES**
CHIEF INVESTMENT STRATEGIST

The author of Baird's market commentary and a frequent contributor of expert insight to national media outlets, Bruce has been Baird's Chief Investment Strategist since 2002.

**WILLIAM DELWICHE, CMT, CFA**
INVESTMENT STRATEGIST

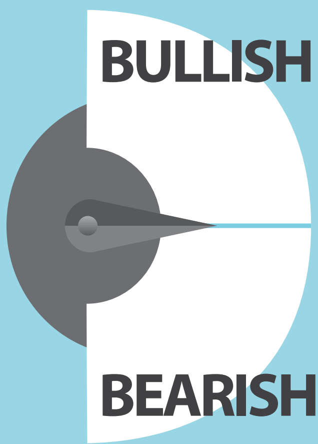
Before joining Baird in 1999, Willie worked briefly as a researcher at the Committee for Economic Development in Washington, D.C.

You can follow Willie's insights via Twitter @WillieDelwiche.

THE WEIGHT OF THE EVIDENCE

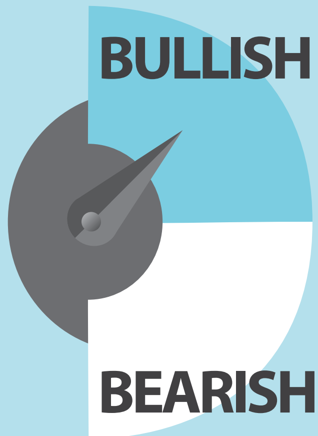
# REASONS FOR OPTIMISM AS WELL AS CAUTION

## FED POLICY



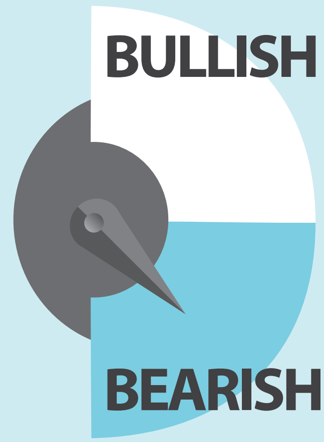

All indications point to slow and gradual interest rate hikes.

## ECONOMIC FUNDAMENTALS



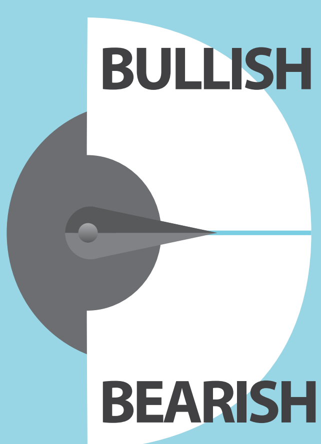

The rally off of February's lows is backed by a strengthening market.

## STOCK PRICE VALUATIONS



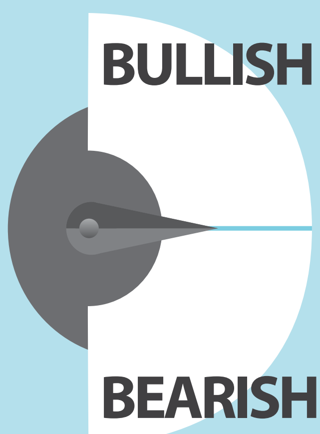

Stock prices are still elevated compared to their intrinsic value – better earnings would help.

## INVESTOR SENTIMENT



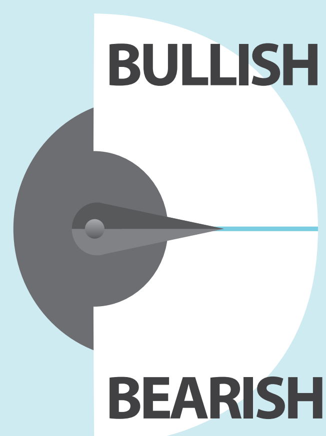

Excessive optimism often precedes a bear market. Investors currently tend to be neither optimistic nor pessimistic.

## SEASONAL PATTERNS AND TRENDS




Short-term momentum amid longer-term headwinds.

## STOCK MARKET BREADTH




The number of stocks experiencing an uptrend is expanding.

**TAKEAWAY:** Baird is neither bullish nor bearish at this time, but signs pointing to broad and sustained economic improvement are there.

GENERATIONS

# TALKING ABOUT YOUR GENERATION

## RISK MANAGEMENT AT EVERY STAGE OF LIFE: AGES 35 TO 55

Any strategy to building wealth incurs some measure of risk, no matter your age. Part two of this three-part series explores the financial risks Gen Xers may face as they enter their peak earning years.

**GENERATION X**

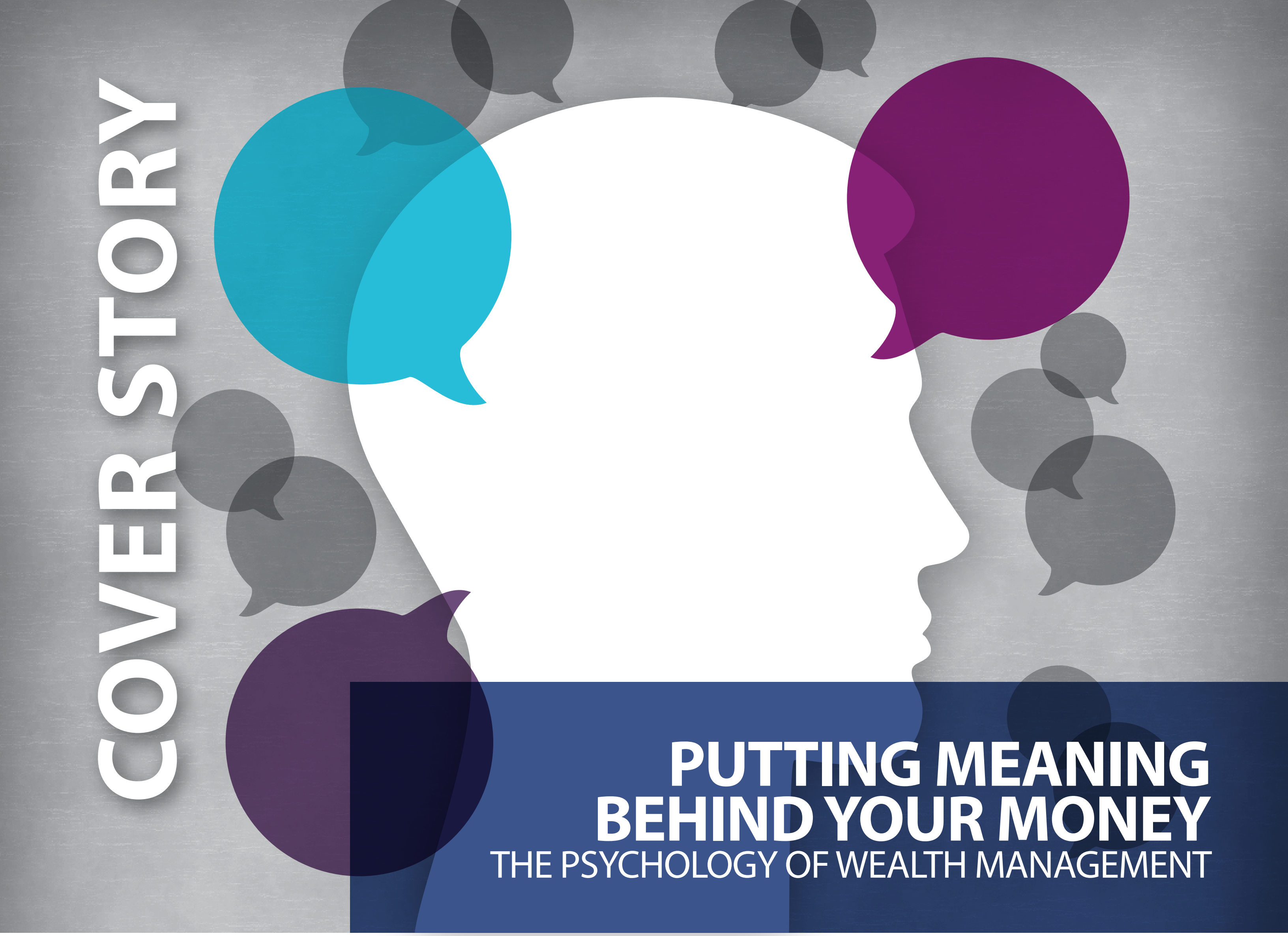
*Part Two in a Three-Part Series*

**TAKE A STEP BACK** If you count yourself among Generation X, consider how much your life has changed since college. While for many the biggest adjustment has been getting married and starting a family, you may also have traded rent payments for a mortgage, paid off your student loans and saw that entry-level job you took out of college blossom into a career. These developments may have added meaning to your life, but you now have more riding on your ability to provide a regular income.

**PROTECT YOUR INCOME** For most people, their mid-30s to mid-50s are their peak earning years – the point in their careers when they generate the most income. Protecting this income is vital: Not only may expenses also be at their peak, but money you put away for retirement now can benefit from years, if not decades, of compounding returns. Life and disability insurance policies could be crucial to your present and future well-being.

**TALK TO YOUR PARENTS** Now is also a great time to discuss with your parents the care they'll need as they age. Many seniors have not saved enough to cover their long-term care needs, or they assume this care will be paid by Medicare or Medicaid. However, Medicare is not long-term care insurance and provides extremely limited, if any, coverage, while Medicaid is available only to those with limited means. A Financial Advisor can discuss with you, your parents and siblings your options for care.

Though you may feel you're in the prime of life, don't underestimate the factors that can threaten your financial well-being. A Baird Financial Advisor can offer Gen Xers guidance on mitigating the risks that accompany this stage of life. In our Fall issue, we'll look at strategies to address the risks millennials may encounter as they first enter the workforce.



COVER STORY

# PUTTING MEANING BEHIND YOUR MONEY

## THE PSYCHOLOGY OF WEALTH MANAGEMENT

You've likely heard about the dangers of mixing emotions and investing. Experts will tell you that you need to be clinical and contrarian when evaluating opportunities and making decisions. That's because the same instincts that often serve people well in genuine fight-or-flight situations can and often do enable poor investment choices. Excitement over recent performance might entice one to buy a stock at or near its high point, and anxiety over unexpected losses could well result in sales that inadvertently lock those losses in.

Emotions may have no place in investing, but investing is just one part of wealth management. Like specific financial plans and strategies, investments are a means to an end. Wealth management is all about ensuring those tools work toward the life and legacy you want – for yourself and those you care about. Emotional stakes don't get much higher than that.

**IT STARTS WITH THE HEART** It's human nature to let emotions guide our decisions. The good news is those emotions not only have value in a functional wealth management relationship, they're essential in setting the guide rails and goals that you and your Financial Advisor will work toward together.

This relationship begins during the initial discovery process. Before you ever talk about how much money you have and where it's being held, your Advisor spends time getting to know who you are. You talk about your hopes and aspirations, what you care about and what keeps you up at night. ▸

The understanding your Advisor gains from this process is the lens through which they'll focus all of their financial expertise and resources, including collaborative planning experts and industry-leading investment research. Your very personal emotional context helps to identify and prioritize near- and long-term financial goals while providing insight into your beliefs, preferences and comfort with risk – all of which shapes the advice you receive and influences any specific recommendations your Advisor makes.

**A CONTINUING JOURNEY** The discovery process is critical to successful wealth management, and it can't be a one-time occurrence. Life and your feelings will change over time, and many of the changes that can have substantial implications for your financial life – the birth of a child, the death of a parent, starting a business or transitioning into retirement – carry strong emotional connotations as well.

These are exactly the times when you need an Advisor who knows you well enough to understand what such changes mean to you. An Advisor who has remained in contact with you, checking in even when there isn't significant news to report on the performance of your investments or the progress of your plans, will be in the best position to offer both compassionate counsel and objective advice when you need them most.

**A MATTER OF TRUST** The nature and value of your Financial Advisor's objectivity are important. Because while your Advisor couldn't do their job without fully understanding and appreciating the way you feel about things, they wouldn't be doing their job responsibly if they didn't let you know when your emotions might be clouding your perceptions or leading you down a potentially unwise financial path.

This can involve difficult conversations, not unlike the kind that inevitably occur in any healthy relationship. There may be times when your Advisor has to tell you things you won't want to hear. And for that important part of their job to be effective, trust is essential. They need to trust that you value their perspective enough to listen, and you must trust that the advice they give comes from a place of expertise, understanding and genuine care for your best interests. D

## FINANCIAL PLANNING CALENDAR

**MAY**
Owners of Traditional and Roth IRAs will receive Form 5498, documenting the value of the account and any contributions, rollovers, conversions or recharacterizations for 2015.

**JUNE 15**
Estimated second-quarter income tax payments are due.

**JUNE 30**
The Free Application for Federal Student Aid (FAFSA) must be submitted by midnight CST. Individual state applications may be due before the federal deadline and do not replace filling out the FAFSA.

**JULY 1**
Preparing a projection of your 2016 tax liability at the year's midpoint can help you avoid any underpayment penalties.

**AUGUST 1**
Last day employers with calendar-year retirement plans can file Form 5500.

**SEPTEMBER 15**
Estimated third-quarter income tax payments are due.

TRENDS

# THE RISE OF SOCIALLY RESPONSIBLE INVESTING

## INVESTORS PUT THEIR MONEY WHERE THEIR VALUES ARE

Imagine a company whose stock provides consistently superior returns but whose values run counter to yours. Do you put your own moral code aside for the sake of portfolio performance? For investors who have embraced socially responsible investing, the answer may surprise you.

**BLAKE KARLS, CFA**
PORTFOLIO ANALYST

**WHAT IS SOCIALLY RESPONSIBLE INVESTING?** Socially responsible investing (SRI) is a deliberate decision to invest only in companies or organizations whose actions and policies have a positive environmental, social and corporate governance impact. Traditionally, SRI had taken a "do no harm" approach, where investors would simply avoid companies that did not meet ethical, social or environmental criteria, such as those with ties to pollution or health hazards. More recently, SRI has embraced a proactive approach to selecting investments, identifying companies whose policies align with the investor's values. Some investors have gone a step further through their participation in "green bonds" or "social impact bonds," which fund projects that promote such societal benefits as clean water or reduced prisoner recidivism.

**THE FINANCIAL IMPACT OF SOCIALLY RESPONSIBLE INVESTING** But couldn't excluding investments in companies you disagree with philosophically lead to poorer investment performance? Not necessarily. A 2012 meta-analysis of more than 100 academic studies of SRI found that companies with high environmental, social and corporate governance (ESG) ratings had higher credit ratings and lower cost of capital. Eighty-nine percent of the studies found companies with high ESG ratings exhibited market-based outperformance, and 85% showed these companies exhibited greater profitability relative to the broader market.

While the demand for socially responsible investing has been concentrated among institutional investors, there is increasing interest among today's retail investors, particularly millennials and women. According to the U.S. SIF Foundation, currently more than $1 of every $6 in investable assets under professional management is in socially responsible investment products. If the prospect of aligning your portfolio with your values interests you, your Baird Financial Advisor can discuss socially responsible investments with you in greater detail. D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