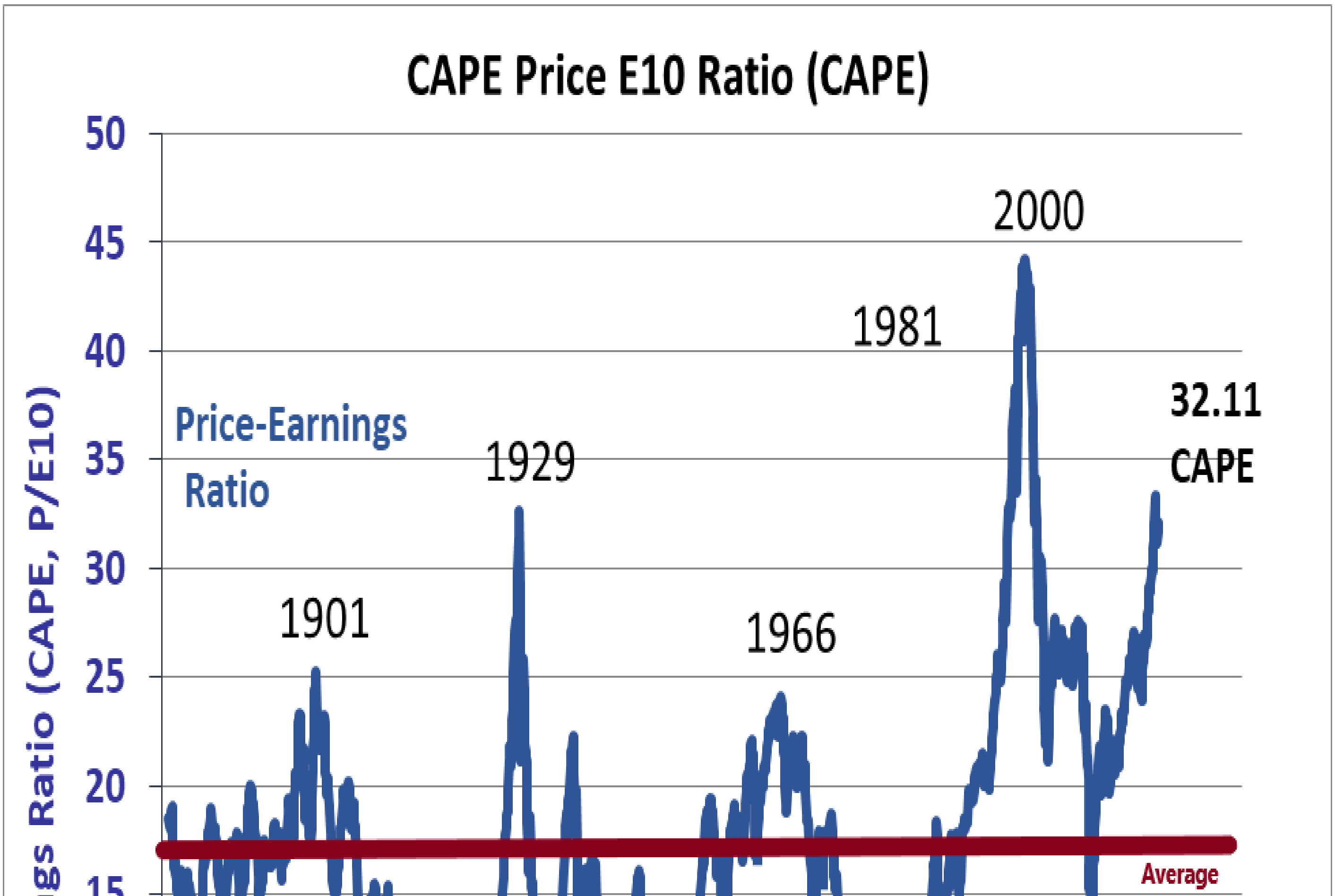
How an advisor should talk to clients and what rhetoric leads to big sales are often at odds. It can be death to an advisory business if the advisor is negative. Clients tend to want reassurance from an optimistic advisor. That?s why economist Andrew Smithers refers to broker happy talk as ?*stockbroker economics*.? **The two rules of stockbroker economics are:**

> ***1. All news is good news, and; 2. It?s always a good time to buy stocks.***

On the role of news, a strong economy fills clients will all the optimism and willingness to buy that they need. **A weak economy simply prompts a broker to say that falling interest rates and future rising profits are good for stocks, never mind that profits and prices had only moved in tandem 54% of the time when Smithers wrote his 2006 article.** On the second rule, nothing has succeeded as well as what Smithers calls the *?bond yield ratio,?* another name for which is the *?Fed Model.?* That model compares bond yields to the earnings yield of the stock market *(the* *reciprocal of the P/E ratio or E/P).* This ratio worked from 1977 to 1997, but didn?t from 1948 to 1968. Using the full dataset **shows no relationship between bond yields and earnings yields,** according to Smithers. Other forms of nonsense used to support the second rule include using a current P/E ratio to appraise stocks. Of course, a current P/E ratio has little ability to forecast long-term returns. It sometimes shows stocks are expensive when they are actually cheap, and *vice versa*. **A third piece of nonsense that Smithers doesn?t mention is the assertion that all forecasting is bunk.**•While forecasting next year?s returns might be bunk, metrics like the Shiller PE and Tobin?s Q have strong records in forecasting future long-term returns. Even if the Shiller PE has been elevated for the past 25 years, **the S&P 500 Index has delivered tepid returns *(5.4% annualized)* from 2000 through 2017 with the entirety of that return occurring only in the last 5-years.** All of this means the first rule for investors judging their advisors is **whether their advisors engage in too much happy talk ? especially about future returns.** If an advisor says a balanced portfolio should deliver a 7% annualized return for the next decade with starting 10-year U.S. Treasury yields at 3% and stocks at a 32 CAPE, be wary. Second, investors should avoid advisors who avoid making forecasts to the point where they disparage anyone who does. That?s because it?s not hard to make a bond forecasts. With high-quality bonds, yield-to-maturity will get you close to the total return. Although stocks are harder, the Shiller PE can help. And, the more it?s stretched by historical standards, the more accurate it gets. No advisor should be dogmatic about pinpointing future returns; anyone who thinks they can be precise is crazy. But it?s also outlandish to expect long term historical returns from the stock market when valuations are as stretched as they are today. **Stock market forecasts are hard, but don?t let your advisor squirm out of them completely.** Making a forecast is also necessary for constructing a financial plan. And, while it?s true that an accurate forecast doesn?t have to be available just because advisors and clients need one, decade-long projections are easier, if imperfect, than guessing what next year?s market move might be. When the Shiller PE stretches to more extreme levels, low future returns become more likely. **So, when you hear an advisor making fun of something, that should raise warning flags.** We think advisors with integrity aren?t afraid to tell clients stocks are expensive even when it might hurt the advisor?s business. An advisor constructing a financial plan owes you an honest assessment of future returns. Currently, the Shiller PE is at 32. And while nothing is impossible, it?s very unlikely that stocks will deliver more than a 2% real annualized return for the next decade.



Third, consider if your advisor goes beyond the risk questionnaire he gives you. Nearly every financial advisory firm has a risk questionnaire that it gives to prospects and clients. The questionnaire often has many questions about how much risk the investors think they can handle and what portion of their assets they?d like to put at risk in exchange for possibly getting a higher return than a low risk investment will deliver. **But risk questionnaires ask about percentages, and most people don?t think in percentages.** Consider if your advisor asks you how you might feel if you opened up your statement and your account was down by a certain dollar amount. That?s more meaningful than a percentage question. Consider it a positive thing if your advisor pursues this line of questioning a bit, including asking you how you felt and how you reacted to the market plunge in 2008. **Risk often boils down to how much of a portfolio decline a client can tolerate before selling out, and everyone has a point at which they sell.•**This is important because it shows how investors do themselves damage. The tendency should be to buy stocks when they get cheaper, not sell them. But investors rarely think of buying when the prices of their holdings are declining. Advisors have other ways of trying to train clients about how to treat price declines in their portfolios. Many advisors focus on long--term asset class returns, trying to persuade investors that they can overcome declines if they have the willpower to stay the course and not be discouraged. Other advisors do the opposite, focusing on how severe declines can be and trying hard to get clients into allocations that they can live with at the outset and to prepare them for the difficulty that lies ahead in the inevitable downturns. The advisors who emphasize long term returns often come close to shaming clients into owning stocks. In my experience, such has made some clients feel inadequate for not wanting to assume more risk ? or have encouraged clients to take more risk than they would have for fear of being deemed inadequate in the eyes of the advisor. **Make sure your advisor isn?t shaming you into owning more stocks than you can handle.** At Clarity Financial, we focus on the growth of savings and on the minimization of emotional duress that can lead to poor investment decision-making.