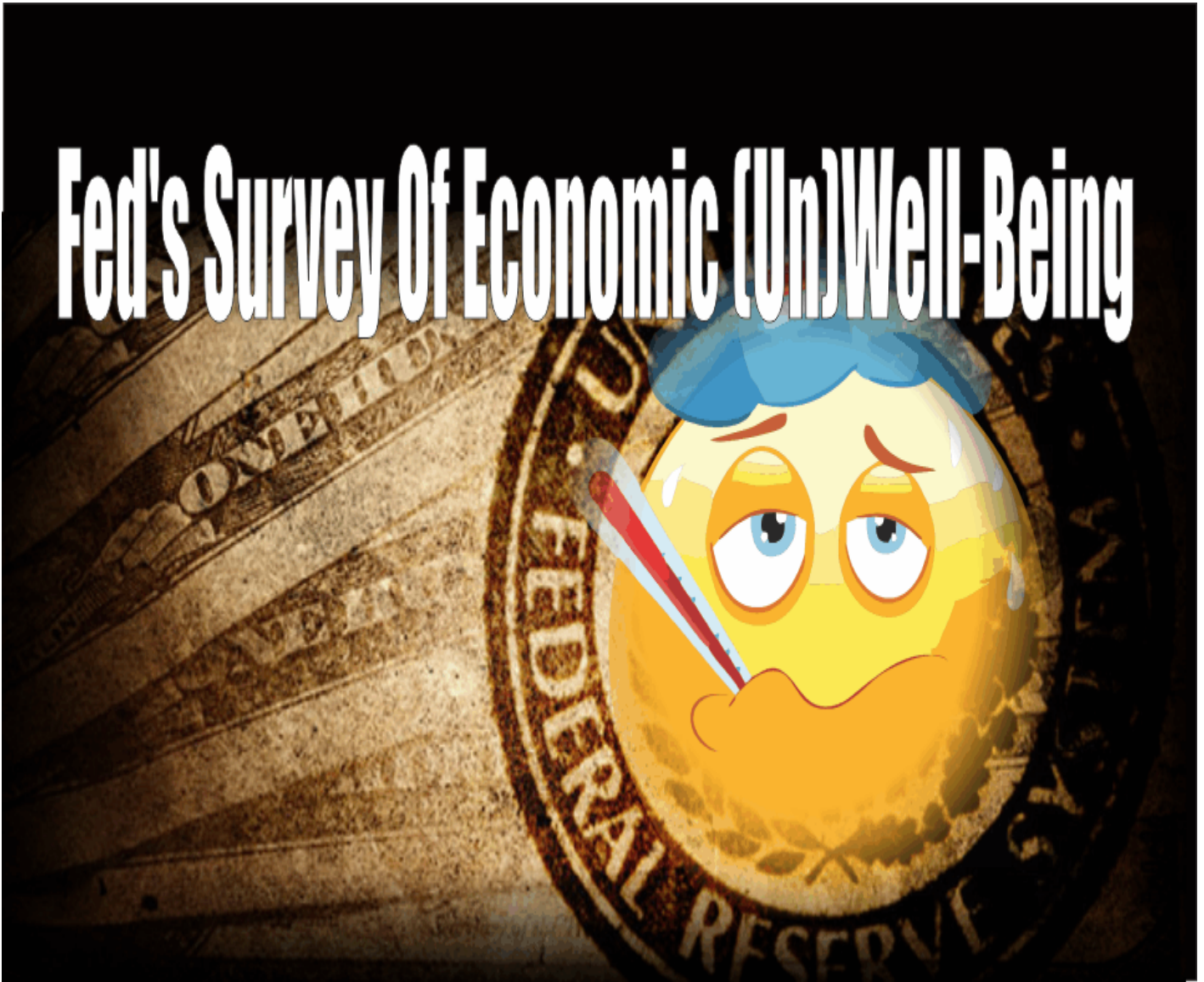


Fed's Survey Of Economic (Un)Well-Being



The Federal Reserve Report on the [Economic Well-Being of U.S. Households in 2017](#) was recently released. The Federal Reserve Board's Division of Consumer Affairs 5th annual Survey of Household Economics and Decisionmaking is designed to gain understanding of how adults in the U.S. feel about the state of their finances. A sample of 12,000 received the survey in late 2017. What's unique about the study in my opinion, is that it tackles subjective well-being from a financial perspective and emerging issues that may be formidable obstacles in the future. For example, this year for the first time the study included questions related to opioids. Overall, respondents feel better about their overall financial situation as the economy has improved since the genesis of the survey. However, the continued rapid growth in wealth disparity threads throughout the analysis. Also, the disappointing state of retirement preparation and the cancerous effects of financial illiteracy remain chronic for the Americans surveyed. **Direct-from-the-survey positive highlights:**

- *When asked about their finances, **74 percent of adults said they were either doing okay or living comfortably in 2017**?over 10 percentage points more than in the first survey in 2013.*

- Individuals of **all education levels have shared in the improvement** over the past five years, though the more educated still report greater well-being than those less educated.
- **Less than one-fifth of non-retired adults are pessimistic about their future employment opportunities**, although pessimism is greater among those looking for work or working part time for economic reasons.
- **Slightly over 7 in 10 adults keep track of their spending** and over half follow a budget or spending plan.
- **The 7 percent of adults in 2017 who find it difficult to get by financially is about half of what was seen in 2013.** This decline in financial hardship is consistent with the decline in the national unemployment rate over this period.
- **Nearly three-quarters of adults say they are either living comfortably** (33 percent) or doing okay (40 percent), when asked to describe how they are managing financially. The share who are at least managing okay has risen consistently over the past five years and is over 10 percentage points higher than in 2013 when this survey began.

Areas of concern or importance:

- **About one-fifth of adults (and one-quarter of white adults) personally know someone who has been addicted to opioids.** Exposure to opioid addiction was much more common among whites?at all education levels?than minorities. Those who have been exposed to addiction have somewhat less favorable assessments of economic conditions than those who have not been exposed.
- **Three in 10 adults participated in the gig economy in 2017.** This is up slightly from 2016 due to an increase in gig activities that are not computer or internet-based, such as child care or house cleaning.
- **Four in 10 adults, if faced with an unexpected expense of \$400, would either not be able to cover it or would cover it by selling something or borrowing money.** This is an improvement from half of adults in 2013 being ill-prepared for such an expense.
- **Over one-fourth of adults skipped necessary medical care in 2017 due to being unable to afford the cost.**
- **Less than two-fifths of non-retired adults think that their retirement savings are on track**, and one fourth have no retirement savings or pension whatsoever.
- **Older adults are more likely to have retirement savings and to view their savings as on track than younger adults.** Nevertheless, even among non-retirees in their 50s and 60s, one in eight lacks any retirement savings and less than half think their retirement savings are on track.
- **Three-fifths of non-retirees with self-directed retirement savings accounts, such as a 401(k) or IRA, have little or no comfort in managing their investments.**
- **Many adults are struggling to save for retirement**, and less than two-fifths feel that they are on track with their savings. While preparedness for retirement increases with age, concerns about inadequate savings are still common for those near retirement age.
- **On average, people answer fewer than three out of five basic financial literacy questions correctly**, with lower scores among those who are less comfortable managing their retirement savings.

For example, one question ? ?Housing prices in the United States can never go down? (True or False),? was answered: Correct ? 60%, Incorrect ? 19%, Don?t know or no answer ? 22%. After a devastating housing crisis, I was surprised by the survey respondents? inability to answer or get this question incorrect. Another ? ?Buying a single company?s stock usually provides a safer return than a stock mutual fund? (True or False).? Correct ? 46%, Incorrect ? 19%, Don?t know or no answer ? a surprising 50%. In addition to being disheartened by the Fed to attach the words ?safer return & stocks?, (stocks in any form are never safe regardless of time - not by a long shot), there exists a greater probability to lose capital with concentrated ownership of the stock of one

company. I've e-mailed feedback to the Consumer and Community Development Research team at the Fed suggesting a re-word of the query - *"Buying a single company's stock may be riskier than a stock mutual fund?"* is a truthful representation.

- **Approximately 1 in 10 adults receive some form of financial support from someone living outside of their home.** Nearly one-quarter of young adults received such support during 2017. Among young adults with incomes under \$40,000, over one third receive some support from outside their home. Conversely, older adults are more likely to provide financial support to individuals outside their home? peaking at 23 percent of adults in their 50s.
- **One-fifth of those with education debt were behind on their payments.** Individuals who did not complete their degree or who attended a for-profit institution are more likely to struggle with repayment than those who took on large amounts of debt but completed a degree from a public or not-for-profit institution.
- **Women of all education levels and less-educated men are less comfortable managing their retirement investments.**

So, what lessons should RIA readers take away from the highlights of the latest survey?

1. **The financial industry has done a horrible job at educating consumers about the true nature of stocks and personal finance in general.** I mean, not even the Fed can't get it right when it comes to understanding the long-term inherent risk of the stock market. Bless their hearts. The entire industry pushes the myth that stocks are safe in the long run and the Federal Reserve supports it.

Unlike the pervasive, cancerous dogma communicated by money managers like Ken Fisher who boldly states that in the long-run, stocks are safer than cash, stocks are not less risky the longer they're held. Unfortunately, academic research that contradicts the Wall Street machine rarely filters down to retail investors. One such analysis is entitled [*"On The Risk Of Stocks In The Long Run,"*](#) by prolific author [Zvi Bodie](#), the Norman and Adele Barron Professor of Management at Boston University. In the study, he busts the conventional wisdom that riskiness of stocks diminishes with the length of one's time horizon. The basis of Wall Street's counter-argument is the observation that the longer the time horizon, the smaller the probability of a shortfall. Therefore, stocks are less risky the longer they're held. In Ken Fisher's opinion, stocks are less risky than the risk-free rate of interest (or cash) in the long run. Well, then it should be plausible for the cost of insuring against earning less than the risk-free rate of interest to *decline as the length of the investment horizon increases*. Dr. Bodie contends the probability of a shortfall is a flawed measure of risk because it completely ignores *how large the potential shortfall might be*. Sound familiar? It should. We write of this dilemma frequently here on the blog. Using the probability of a shortfall as the measure of risk, no distinction is made between a loss of 20% or a loss of 99%.

If it were true that stocks are less risky in the long run, it should portend to a lower cost to insure against that risk the longer the holding period. The opposite is true. Dr. Bodie uses modern option pricing methodology i.e., put options to validate the truth.

Using a simplified form of the Black-Scholes formula, he outlines how the cost of insurance rises with time. For a one-year horizon, the cost is 8% of the investment. For a 10-year horizon it is 25%, for a 50-year time frame, the cost is 52%. As the length of horizon increases without limit, the cost of insuring against loss approaches 100% of the investment. The longer you hold stocks the greater a chance of encountering tail risk. That's the bottom line (or your bottom is eventually on the line). Not only that, from this survey readers understand consumers are generally poor at managing their retirement plans. However, nothing stops the undying love for defined contribution plans. Unfortunately, small businesses can't afford to establish an administratively burdensome structure therefore many small business employees do without. According to Pew Research, thirty-

five percent of private sector workers 22 and older do not work for an employer that offers a defined contribution plan or a traditional defined benefit plan. Financial firms provide wholesale guidance like "max out your 401(k) before all else," without understanding the impact of these actions to the distribution phase of retirement when a retiree has zero tax diversification and every distribution taken is taxed as ordinary income. Roth in most situations, is a smarter choice. A 2017 Harvard Business School Study for the [Journal of Public Economics](#) suggests that most investors will have more money or retirement consumption dollars if they use a Roth 401(k) instead of a traditional choice. Roth accounts do not require mandatory retirement distributions at 70 and qualified distributions including earnings are tax free. As Lance Roberts and I have lamented numerous times in print and on our podcast

"The 401(k) is one of the worst financial creations that exists today." Read: [6 Reasons Why You Should Unfriend Your 401\(k\) Plan.](#)

The loss of pensions has been a major if not the paramount reason behind why many Americans are failing to meet retirement goals. The Department of Labor is in the process of proposing a rule that would allow small businesses to band together to offer 401(k) plans to employees. President Trump signed an executive order to reduce regulatory barriers that keep small businesses from providing access to retirement plans for their employees. If defined contribution plans are all workers are going to have access to (bye-bye pensions), then at the least, the financial industry, hopefully fiduciary advisers at the forefront, should understand investor accumulation and distribution cycles to formulate tax-efficient retirement strategies for plan participants.

2. Financial vulnerability remains a factor for many U.S. households. Our culture of spending is hazardous especially now as borrowing costs increase.

Most metrics of economic health are based on consumption; personal consumption comprises 70% of America's Gross Domestic Product. Through the 60s and 70s, the U.S. personal saving rate rarely fell below 10%. Our ensemble culture or the culture overall has become obsessed with owning more, status through the acquisition of goods and services. In your household, it must be different. I have a feeling in most RIA reader households, it is (and that's a very good thing). The movement must be grassroots, the individual one by one, must take action to shore up their personal and family household balance sheets. Think GPP or "Gross Personal Product", not GDP. Let's face it: Nobody is going to bail you out when the economy cycles in reverse. As a matter of fact, when our economy falls into the abyss, it's we as taxpayers who bear the brunt of the costly, ineffective patchwork that fiscally duct-tapes systems back together.

3. Households must establish financial boundaries and learn how to say "no," more often to family and friends who require financial support.

Clarity's Financial Guardrail Rule #3 is: **Never allow others to cross your personal financial boundaries.** It's a tough lesson for some, but once learned, never forgotten. There's nothing inappropriate about maintaining boundaries and saying "no" to obligations that may place your personal financial security in jeopardy. For example, we witness parents who extend themselves to co-sign for children. We know of those who lend to friends and family members only to be disappointed when loan obligations are not met. It's acceptable to establish in a household budget, charitable intentions and gifts; it's honorable to help people you love who are in need. However, it's best to understand upfront what the financial impact to your personal situation is going to be. Know your boundaries and adhere to them. If you say "no" enough, others will respect them, too. The Fed Survey outlines strong improvement especially for higher-educated, high-income households. Unfortunately, financial vulnerability still plagues a majority of middle-class households and financial literacy remains downright embarrassing. The growing dependency on opioids is a known issue that requires attention. Overall, the Federal Reserve gets a bad rap. Nonetheless,

factions of the institution conduct relevant consumer research. This report on economic well-being is one of my favorites.