Wenzel
Analytics
Inc

October 6, 2017

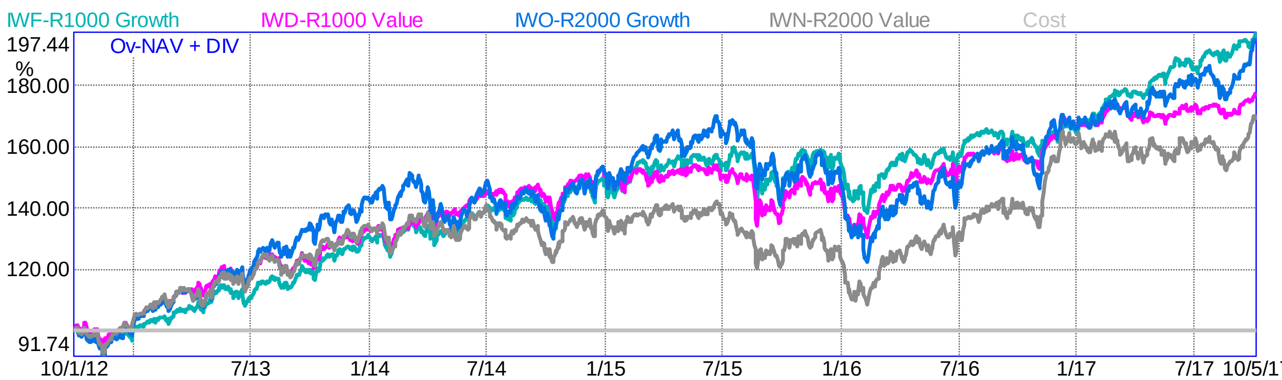
Clients,

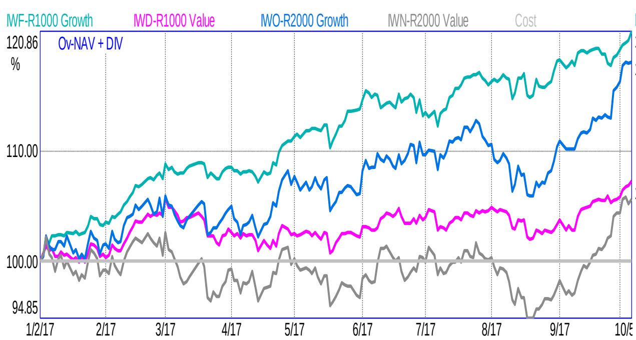
Markets

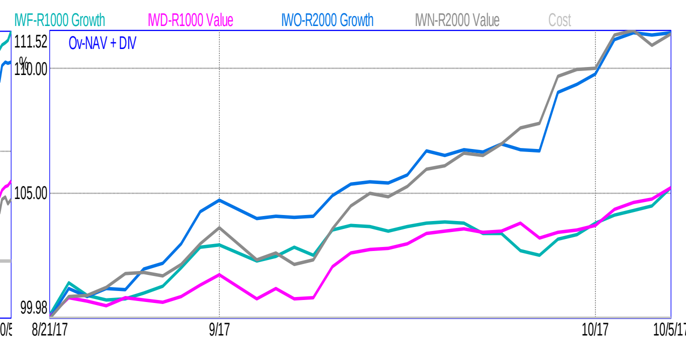
The major markets have been moving up nicely, and your returns are also moving up nicely even if you are positioned defensively with fixed income preferred stocks, gold/silver, and the Defense portfolio selected from stock characteristics that do well in down markets.

However, the composition of which stocks are moving up is changing. Until recently the large tech and Internet-scaled stocks were accounting for most of the gains. Small cap growth has done consistently well. Recently the strength has shifted to the small cap stocks, both value and growth.

The charts below show the last five years, year-to-date and the last six weeks for large cap growth (IWF), large cap value (IWD), small cap growth (IWO) and small cap value (IWN).







Most of the stocks which meet my criteria tend to be smaller stocks. And most of your positions are about the same size, regardless of the stock. This is in contrast to market indexes such as the Russell 3000 which is cap-weighted, meaning they are based on dollars rather than each stock counting the same in the index.

What always amazes me is that while some stocks and classifications of stocks move up or down more than others, usually to a minor degree, they tend to all move in the same direction or are highly correlated. This happens second by second, day by day and month by month, and no one seems concerned about how to explain the phenomenon. I think the answer lies with indexed and benchmarked trading. I'm having initial success in buying from the few stocks that are not correlated with other stocks.

An alternative to mutual funds.

Lee Wenzel
(952) 944-2699
Lee@WenzelAnalytics.com
www.WenzelAnalytics.com

Wenzel Analytics, Inc.
Registered Investment Advisor
8666 Westwind Circle
Eden Prairie, MN 55344

Planning the Future of Your Money

I've been reading some good books on estate planning. I'm struck by how the individual issues and possible actions can become very complex. Because of geometric progression for both assets and debts, most of us with white hair either don't have enough money to last us a lifetime, or have more money than we will probably need. What should happen to the money that might outlive us? Decisions are based on concepts of rights, needs or gifts.

Most contentious inheritance issues are based on judgments of what is fair or unfair. These are essentially rights-based or entitlement perceptions. We grow up in families and are entitled to the costs of care. Many adults still think they are entitled to the family assets. Are they? If one child has one grandchild and another child has four grandchildren, are the grandchildren entitled to equal inheritances, or is each child entitled to an equal amount and the grandchildren then eventually inherit disproportionately?

Needs-based decisions involve differentiating inheritances based on the special needs of a child, or on dramatically different economic needs between children. Decisions about how to balance between what goes to heirs and what goes to larger causes to benefit humanity are essentially needs-based decisions. In this country the public retirement program is rights-based (Social Security), while aid to dependent children and their low-income parents are generally needs-based. Often the rights-based get money while the needs-based get scorn. The rights-based elderly get more than the needs-based children. Estate planning based on needs needs more work.

A third option is to consider an inheritance as a gift. Gifts can be declined but not demanded. Gifts are a form of communication and it's often more about what is being communicated than the gift itself. In estate planning, there are fewer complications in giving before death than after.

A main thrust of what I've been reading is the importance of family conferences to bring together transparent and realistic expectations. If we want children to be skilled philanthropists with our money or theirs, it is good to have family "board" meetings to develop the relevant skills and values.

Institutional Incentives to not be Response-able

I will close with a final rant about how we live in a society with an increasing belief that the world is uncontrollable and that one cannot improve one's condition, one's health or our institutions. I will give institutional examples.

Many believe we should not aspire to good government because government is the problem. There is a denial of the legitimate functions of government. Therefore we should throw up our hands and be libertarian. There is an economic nihilism that denies the value of saving for the future. Why worry about retirement? I may not live that long. This is true at the individual level and at a societal level in terms of infrastructure repair and development.

This attitude is increasingly true in terms of corporate capital expenditures, which are down. Most growth and stock appreciation is coming from innovation, network effects, large company access to foreign markets, and the reflexivity of cap-weighted indexes disproportionately rewarding large cap stocks in a rising market. Return on assets is on its way to becoming meaningless for many companies and much of investing.

Future catastrophes are always hard to imagine. We live in a society with a pervasive denial of the real possibility that the earth will not be habitable for our grandchildren when they would otherwise reach our age. The required changes are inconceivable. A world without burning fossil fuels is dismissed, even if survival depends on it, because it is unimaginable to not capriciously fly hither and yon or drive cars and trucks with internal combustion engines. We live amidst profound cynical skepticism about facing obvious challenges.

Medical insurance presumes that we have no control over our health and therefore need to insure against the financial costs of random catastrophes. Insurance is always to cover a loss, never to achieve a goal such as health. Insurance sets the stage for us to be passive patients expecting the medical system to fix us. Against such a premise, why would we invest in medical research or why would anyone endeavor to improve their health? Insurance sets the context for being cynical about managing one's health. That insurance is for unmanageable events cannot be tweaked or changed. It is an essential aspect of insurance, just as how the number three performs in a decimal system is not subject to alteration. Very few thought leaders are advocating for other systems of economic exchange that would introduce very different incentives, such as procurement, contracting for outcomes, charity, theft (think uncollectables), entitlements or even investing in health. Even the principles of gambling take the probabilistic laws of large numbers used in insurance and direct them towards decision-making to achieve goals.

There is an increasing cynical presumption that one should invest in indexed products because one cannot tell a good company, investment, strategy or management from one that is mediocre or poor. Wall Street is supposedly a random walk. However, we know that markets are not random or Gaussian with a normal distribution described by standard deviations. Markets have a keratosis or extremes of both good and bad swings beyond what would be predicted by a normal distribution. Chaos theory and fractals is a more accurate way to explain market or price behaviors, although that doesn't make it simple or readily predictable.

Indexed products create a self-fulfilling prophesy that stock prices are not dependent upon the merits of the individual company. The market as a whole explains more of the variation in individual stock prices than any other variable. The stock options designed to provide incentives for management correlate with the overall market more than the merits of an individual company or its management. Public companies don't have a choice about being heavily included in indexes, yet their stock price (and executive options) are largely determined by the indexed products indiscriminately buying or selling their stock in the same bundle as every other company.

We will see how passive the passive investors are when the market takes a correction. I see investors holding indexed products, even if balanced by style, as holding more downside risk than I would want to carry.

So I summarize that we live with prevalent attitudes of cynicism and institutional support for not thinking and acting to create a better or even viable future.

Comments, perhaps over a lunch?

Sincerely,

Lee