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Anniversaries and Reflections

As luck would have it, this 30th anniversary issue of the *Quarterly* coincides with the 10th anniversary of a landmark low for the U.S. stock market. On March 9, 2009, the Standard & Poor's 500 Index closed at 677, the Dow Industrial Average at 6,547, and the Nasdaq Composite at 1,269. On March 8, 2019, those benchmarks closed at 2,743, 25,450, and 7,408, respectively.

The Investment Performance Review accompanying this article translates that run into annualized returns for widely held categories of mutual funds. Obviously, those who gathered the nerve to maintain significant equity exposure realized a huge performance premium over bonds and cash equivalents.

Those ten-year performance numbers for U.S. stock funds represent more than a quadrupling of capital. But one did not have to be heroically aggressive to do reasonably well. The average Conservative Allocation fund managed 8.5% annualized, or better than a double. Those funds keep stock allocations to between 30% and 50%. Even that might have required a bit of courage in late 2008 and early '09, but it was hardly a death-defying leap of faith.

High yield bonds demonstrated their equity-like nature on the upside. Note that their performance was just as equity-like during the downdraft of the exigent credit crisis and economic calamity.

Specialty Real Estate funds produced the biggest ten-year bounce. Real estate investment trusts generally are not thought of as particularly aggressive, but like much of the Review, they demonstrate the dynamic potential for any mainstream asset class that gets deeply oversold. ■

Some folks' taxes went *up*. Who knew?

According to recent news reports, many taxpayers filing their first returns under 2017's Tax Cuts and Jobs Act are "shocked" at smaller refunds than they expected or additional taxes due for 2018. The size of your tax refund or remaining amount due is not a reliable measure of your overall tax burden compared to prior years. It simply reflects how accurately your withholding and/or estimated payments matched your ultimate tax obligation.

Analysts suggest that about two-thirds of taxpayers did see tax savings: an average of about $1,260, other factors being equal. Early last year the Internal Revenue Service gave employers new withholding schedules, so most people realized the savings paycheck by paycheck over the balance of the year. However, many taxpayers and most media seemed to have missed the likely impact on a much smaller set of upper income households.

A year ago, the *Quarterly* offered a point-by-point overview of the new law, noting specific changes that might call for a timely review of tax planning strategies as well as withholding and estimated payments. A point of emphasis was the trade-off between a higher standard deduction and new limits on itemized deductions for state and local taxes as well as mortgage interest.

As noted then, those provisions incentivize a strategy of "bundling deductible expenses into one year, then taking the standard deduction the next." However, that kind of tax planning cannot wait until the wan-

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Investment Performance Review	**TOTAL RETURN *** (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	**--- Annualized through March 8, 2019 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Blend)	1.0 %	11.8 %	8.3 %	16.0 %
Mid-Cap Stocks (Blend)	- 2.1	10.5	5.7	16.2
Small-Cap Stocks (Blend) †	- 3.1	11.4	5.1	16.6
Foreign Stocks (Large Blend) †	- 8.1	7.0	1.6	9.7
Diversified Emerging Markets †	-12.8	10.0	2.5	10.2
Specialty Natural Resources †	- 9.5	8.8	- 2.0	9.0
Specialty Real Estate †	14.3	7.0	7.7	18.7
Cons. Allocation (30-50% Equity)	0.6	5.7	3.3	8.5
Long-Term Bond	3.4	4.1	5.0	7.5
World Bond †	- 0.2	2.5	1.0	4.2
High Yield Taxable Bond †	2.8	7.1	3.3	9.9
Long-Term Municipal Bond	3.9	2.4	3.8	5.0

* Source: Morningstar. **Past performance is NOT indicative of future results.**

† Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

U.S. Energy Renaissance Cuts Many Ways

Through the 1970s, '80s, and '90s, Americans were conditioned to see energy as our Achilles heel. We felt unalterably at the mercy of the Organization of Petroleum Exporting Countries (OPEC), a cartel with few U.S. allies and several avowed adversaries. We saw higher oil and gas prices as a definitive threat to our economy and national security, while lower prices were seen as unalloyed good news on both fronts.

As chronicled in past *Quarterlies*, times have changed. Over the past decade, the fracking revolution has pushed U.S. oil and gas production to global supremacy. As recently as 2009, we produced less than half our energy needs and imported the rest. Today we fill 90% of our needs domestically, and U.S. oil and gas *exports* are surging.

Not surprisingly, oil prices are hovering near their lowest levels in 10 years, and gas is similarly inexpensive on a historical basis. However, America's renaissance as an energy producer makes lower prices a two-edged sword: still a boon for consumers but a challenge for domestic energy producers who now cut a higher economic profile and must constantly strive to locate, develop, and transport those resources more cost-effectively.

Energy efficiency is another mixed bag of blessings and challenges. While dramatically expanding production, the U.S. has trimmed its energy *use* relative to the size of the economy. U.S. energy *intensity* – the amount used per dollar of gross domestic product (GDP) – is at the lowest level in 50 years. The Energy Information Administration (EIA) estimates our use at 5,420 BTUs per dollar of GDP compared to more than 13,000 BTUs in the 1970s and 7,500 as recently as 2000.

This reflects a global trend with broad promise for greener economic growth, but clear concerns for energy producers. The EIA expects U.S. energy intensity to fall to 3,329 BTUs by 2050 with other countries following suit to varying degrees. Again, this does not imply less energy use on an absolute basis, just more economic bang for the energy buck. The trend's key drivers include the shift from manufacturing to services, the digital revolution, more efficient home appliances, better insulation, etc.

Sustained improvement in automobile fuel efficiency is emblematic. Much has been made of American consumers' preference for larger cars and trucks that are not as fuel efficient as small and mid-size cars. Rarely mentioned is the fact that the percentage improvement in mileage over the past 35 years has actually been a bit greater for light trucks than for passenger cars. Also, we are driving several hundred fewer miles per year, per vehicle, than the peak levels of 15 years ago.

Any energy discussion raises the issue of emissions, especially carbon dioxide (CO_2). That debate will be part of political battles to come. However, since 2005, CO_2 emissions for the U.S. have actually fallen 14% despite 48% growth of GDP. About 60% of that drop is attributable to the switch to natural gas for power generation, another result of the fracking revolution.

This trend also echoes across other regions. The most apt comparable may be the European Union which realized a slightly larger percentage reduction in emissions over the same period but only managed to grow its economy 20%.

Geopolitics is yet another arena of reordered realities. This includes changed policy prerogatives in the Middle East, counter-leverage to Russia's energy-based influence in Europe, and the acute pressure on oil-rich Venezuela and its primary regional ally, Cuba.

Just as OPEC's domination was destined to change, today's new energy realities are bound to sow seeds of further disruption. Energy is an intricately networked, foundational component of the world's economy, constantly reshaped by the relentless quest for efficiency and a revolutionary realignment of global production. Expect the unexpected. ■

Who is IRMAA and why should I care?

Six months ago, the *Quarterly* discussed some of the ways in which Social Security benefits are means-tested. Last quarter we also touched on the means testing that applies to Medicare premiums.

Medicare's high-income premium surcharge is officially called the Income-Related Monthly Adjustment Amount, or "IRMAA." It kicks in for Medicare recipients whose modified adjusted gross income (plus tax-exempt interest) is above $85,000 for singles or $170,000 for married couples.

Just above those levels, IRMAA adds $54 to the Medicare Part B base monthly premium. At higher incomes, it can add as much as $325 a month. Similar percentage surcharges apply to Part D prescription drug coverage. These add-ons apply to *both* members of a Medicare couple, so they easily can total several thousand dollars annually.

Medicare looks to the income reported on your last-filed tax return. For 2019 premiums, the relevant return is for tax year 2017. If your income has dropped significantly since then, you can ask to have the surcharge based on more recent information. However, this generally applies only if the drop was due to such life-changing events as marriage, divorce, death of a spouse, retirement, or loss of income property due to a disaster or some other event beyond your control.

If you may be eligible for an adjustment, you can find Form SSA-44 posted at *www.SSA.gov*. You might first review that site's discussion of *Medicare Premiums: Rules for Higher-Income Beneficiaries*. It may clarify whether it is worth your while to complete the form, and it lists toll-free numbers if you want to talk to a Medicare representative.

If none of those life-changing situations would apply, but your 2018 income was meaningfully lower, IRMAA should automatically adjust for 2020. Just make sure to check on that early next year. ■

Even our best laid plans run into real life.

We plan for the future not because of what we know, but because of what we don't know. A recent study by the Center for Retirement Research at Boston College amplifies the point. Researchers looked at the impact on early retirement of unexpected changes in health, employment, family, and finances.

Using data compiled by the Employee Benefits Research Institute, the study found that the percentage of workers planning to work *past* the age of 65 rose from just 16% in 1991 to 48% in 2018. However, the University of Michigan's Health and Retirement Study indicated that 37% of workers actually end up accelerating their retirement.

Data collected between 1992 and 2012 identified health shocks as the leading factor prompting people to retire earlier than they had planned. Involuntary loss of a job and changes within a worker's family were the next most prevalent factors. On the other hand, those who switched jobs voluntarily were about 7% *less* likely to retire early.

Changes in one's family situation, such as a spouse's retirement or having a parent move in, also appear to raise the odds of early retirement. Rather surprisingly, financial shocks did not play much of a role, although each of the events mentioned above would be expected to have some financial implications.

Before deciding that your own planning has fully considered all of these factors plus others, we should note that the event categories listed above only explained about a quarter of earlier-than-planned retirements. As long-time investors can attest, stuff happens. ■

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Some folks' taxes went up...

ing days of December. So, why were some taxpayers caught off guard?

For starters, there was the oft-repeated claim that the law was a "giveaway to the rich." Top marginal rates did drop by a couple percentage points, but they are still up around 40%, counting the 3.8% surtax on investment income. At that level, every $1,000 of income exposed to tax by way of reduced deductions offsets the savings from a 3% lower marginal rate on more than $13,000 of income.

Whatever the political sophistication and biases of media pundits, they appear to struggle with that kind of basic math. The law's changes turned out to be more nuanced and multi-faceted than either side's political talking points.

For corporate taxes, the focus was on making it fundamentally more attractive for businesses to invest and book profits in the U.S. For the last fiscal year under the old law (2017), corporate *income* tax collections totaled less than $300 billion, while the *employer* contribution to *payroll* taxes was nearly $600 billion. Like those whispers from the corn in *Field of Dreams*, the law's strategy regarding corporations is *build it here, and you will hire*.

On personal income taxes, the law probably made the system a bit more progressive, delivering incremental savings to a broad swath of lower- and middle-income households while pinching a small number – maybe 6-8% – of taxpayers at the high end of the income scale.

Many commentators may have been too wedded to preconceived notions of "Republican" tax reform to notice and more effectively parse the law's actual provisions. Now the predictable results are playing out across all those 1040s.

Through the current tax season and beyond, politicians will look to score points regarding the relative merits of the law. Those efforts often betray an assumption that Americans are poor students of the system by which we tax ourselves. Knowledge is power, and it's always there for the asking. ■

Are we getting *dumber*? And if so, how will we know?

Now *here's* something to worry about. In a recent Special Report, the economists at BCA Research cited extensive evidence that IQ scores have been slipping throughout the world's developed economies. They see it as a reversal of "the most important trend in the world" with no ready explanation.

Some might question the validity of IQ testing itself, but the scores have shown predictive power with respect to educational attainment, job performance, income level, health, criminality, and fertility choices. Slipping IQ scores have paralleled a drop in math and science proficiency noted by the Programme for International Student Assessment (PISA), which looks at 15-year-olds across many countries.

IQ is believed to be highly heritable, but studies also indicate that environment plays a role. At some point in the grand sweep of history, the development of more sophisticated tools, higher-level problem solving, better health, expanding education, and other factors reinforced one another in a virtuous cycle and quickening pace of human progress.

Reversal of that very long trend of rising IQ appears to have come on too quickly to be the result of the slower-moving hereditary process. Humans are still accomplishing remarkable things, but some wonder if the long, complementary relationship between technological advance, mental stimulation, and rising intelligence is breaking down.

Nobody can yet define what the key environmental factors might be. Does GPS blunt our development of visuospatial skill? Have computers and calculators let us sidestep the mental discipline of learning to spell or run the multiplication tables? Are multi-tasking and ubiquitous mobile devices eroding our ability to focus on intellectually demanding topics and longer-form content?

It is hardly controversial to

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Consider the plight of the poor billionaire.

If you happen to be a billionaire, your ears must be burning. It seems like everybody's talking about you, and not always in a nice way.

Yes, it can be lonely at the top, and last year it got a little lonelier. China's Hurun Institute reports that the ranks of the world's billionaires thinned to 2,470 in 2018. New entrants numbered 206, while 430 fell off the B-list. Key factors included a strong dollar and the poor performance of global equity markets.

The U.S. and China account for about half the world's billionaires. Since 2016, China has minted them at a faster pace, a remarkable factoid for anyone old enough to remember the Cultural Revolution. This past year welcomed 210 new Chinese billionaires, but market struggles helped knock 161 off the list.

Greater China (including Taiwan and Hong Kong) boasts 658 billionaires. However, the U.S.'s 584 include six of the world's ten richest. China's richest person ranks 22nd.

With billionaires getting all this attention, we might note that there are now nearly 20 million American *millionaires*. For the most part, those folks are more diversified, as the wealth of your "typical" billionaire is often tied up in one business or a lot of real estate. Even those who are relatively liquid can find it challenging to spend *billions* just on themselves. In fact, being a billionaire is often more like running a large, semi-public trust, and that can attract a rather harsh spotlight. ■

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Are we getting dumber?

suggest that a broad decline or even sustained stagnation in human intelligence would present a distinct challenge to future productivity, progress, and living standards. For what it's worth, the data suggest that the decline in scores appears to have started with those born *after* 1971. If that assessment is essentially correct, we are talking about a very large percentage of the working population today and for some decades to come.

On the other hand, figuring out how to head off or, ideally, reverse a decline in intelligence is likely to be loaded with controversy. It may be that traditional approaches to measuring intelligence simply are not yet up to the task of gauging the kind of mental acuity and creativity that will prove most useful, adaptable, and pivotal in a brave new world of artificial intelligence, robotics, and virtual reality. The issue of declining IQ may even parallel the challenge of defining and measuring productivity itself in the new economy.

Observing something is but a starting point to understanding it, and those time lags can be long indeed. ■

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