Quarterly Newsletter

Roth FINANCIAL PARTNERS

Q2

July 2021

Depth

By: Eric Johnson
Financial Advisor

It is summertime in Texas… and it is hot. As the unlucky recipient of an overactive sweat gene (self-diagnosed!) I tend to dread the summer heat. I, for one, think that the walk from the parking lot to the front door of our building each day should not require contemplating whether I should have brought an extra shirt to the office!

However, for many of us, the season brings about more opportunities to enjoy that summertime staple: the swimming pool. This summer is a big one for my family, as it is the first one in which our son Abe (almost 18 months) will potentially be able to enjoy floating around in the pool on his own accord (with floatation devices, of course.) As the years go by, Abe will learn plenty about swimming and the dimensions of the various pools in which he swims. Once he is old enough and the "floaties" are no longer necessary, he will have to learn about his comfort level with handling the dichotomy that occurs in most pools: the shallow end and the deep end. I am sure that watching him learn the difference on his own will be both entertaining as well as slightly worrisome for his mother and me (as we try not to be helicopter parents!)

The concept of shallow vs. deep connects well to a main notion that we discuss often with our clients: risk in their investment portfolios. Popularized in Dr. William Bernstein's *Deep Risk: How History Informs Portfolio Design*, the difference between shallow and deep risk is an important one to note.

700 Rockmead Dr., Suite 158
Kingwood, TX 77339
Phone: 281-973-8816
Fax: 281-973-8716
www.rothfinancialpartners.com

The Shallow End

Shallow risk is best defined as volatility, which shows how large an investment's prices move up and down around an average. Volatility is not necessarily a bad thing – it is how you react to volatility that is dangerous. If the volatility in your portfolio makes you consider what may be investing's "most dangerous game" of trying to time the market, then you are more likely than not in a portfolio allocation that is not best suited for you.

The best way to manage shallow risk is to have your short-to-medium term needs held in conservative investments, such as cash and short-term fixed income. Having these highly liquid and mostly "safe" reserves give you the ability to do three important things, per Bernstein:

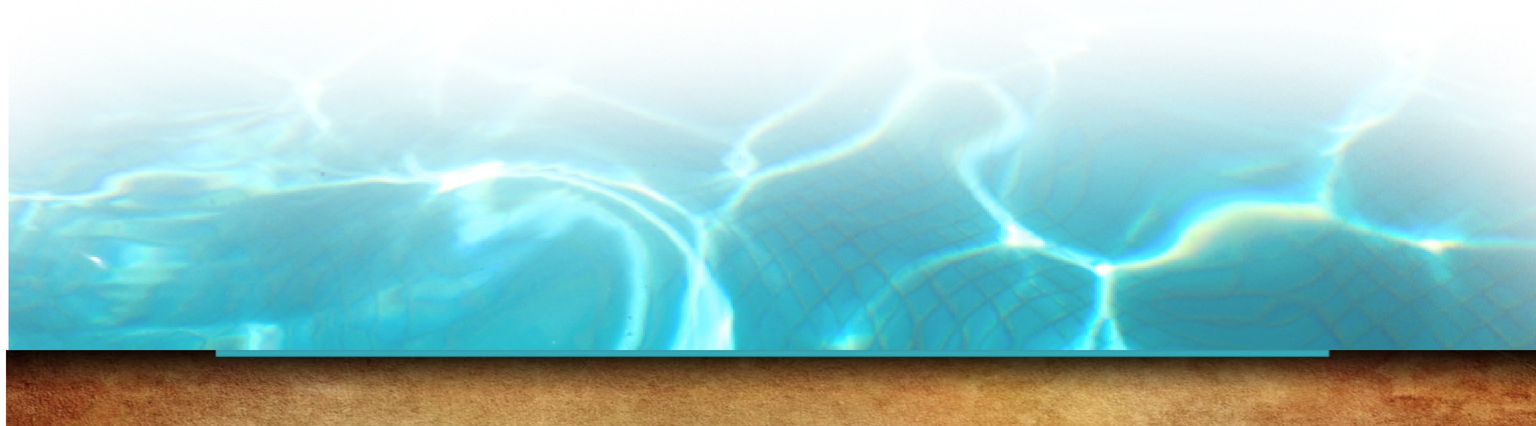
1. Keep your courage to be fully invested when you need it most.
2. Purchase stocks at lower prices.
3. If still working, weather potential employment setbacks that come from down markets.

Let us use three main assets to put a rough order of which assets have the least/most shallow risk (using standard deviation (SD) as the statistical measure), over various time horizons (5, 10, and 30 years ending 12/31/2020, using annual returns):

Asset Class	Proxy	5 Yr SD	10 Yr SD	30 Yr SD
Cash	3-Month Treasury Bills	0.7%	0.7%	2.0%
Fixed Income	10-Year Treasury Bonds	4.7%	6.9%	8.7%
Equities	S&P 500 (dividends reinvested)	11.8%	11.6%	16.8%

Data: NYU

As you can easily see, from a shallow risk perspective, stocks take the cake, with at least two-times more volatility than intermediate-term fixed income (as represented by 10-year bonds) and many multiples more than ultra-short bills/cash. This is the risk you see when CNBC flashes a red "MARKET SELL-OFF" or "MARKETS IN TURMOIL" – the roller coaster of the daily interactions between investors and traders coming to the marketplace, trying to find the "right" price for a security based on their individual situations.



The Deep End

So, if shallow risk is volatility, what is deep risk? **Deep risk relates to a permanent loss of capital.** Dr. Bernstein provides three ways capital is permanently lost:

1. Catastrophic personal loss (solution: buy appropriate amounts of insurance).
2. Loss of investment discipline (solution: determine the correct asset allocation for you).
3. Macro/political reasons (inflation/deflation/confiscation/devastation).

The reason above that is front of mind seems to be inflation, but mostly because television networks, newspapers, and blogs are hoping to rile you up about it for their own purposes (worries/anxieties/anger leads to more viewers/readers.) Though most of its current discussion is hyperbolic in nature, it is still a real phenomenon that must be taken into account when considering financial plans and the investments that work towards the goals instilled in said plans.

The reason you save in the first place is to use for future consumption, whether your own or your families'. Therefore, we should look at "real," or after-inflation, rates of return on these asset classes to determine the level of deep risk found in investing in them.

Asset Class	Proxy	5 Yr Real Return	10 Yr Real Return	30 Yr Real Return
Cash	3-Month Treasury Bills	-0.9%	-1.2%	0.1%
Fixed Income	10-Year Treasury Bonds	2.9%	2.6%	3.7%
Equities	S&P 500 (dividends reinvested)	12.9%	11.8%	8.1%

Data: NYU

Based on the above, we have flipped the script. The asset class with the least amount of shallow risk (cash) barely squeaked out a real return over the past thirty years and was under water for at least the past ten. If deep risk is a permanent loss of capital, especially over long periods of time, then cash is the most prone to deep risk. Fixed income has had a positive real return over the periods reviewed, but was also in a declining interest rate market, which we are not likely to see in the next 5-, 10-, or 30-year period (at least, that is not what is projected.)

We agree with Corey Hoffstein, a manager at Newfound Research, when he says, "Risk is not destroyed, only transformed." The decision that must be made for you and your family is how to balance the shallow and deep risks for your individual situation. We are thankful that you allow us to walk through those decisions with you.

Cryptocurrencies

A brief word on an emerging asset class which most likely has the highest amount of shallow risk in markets today and is being touted by its believers as the antidote for deep risk: cryptocurrencies.

We have added two whitepapers from Raymond James to our website providing a high-level review of cryptocurrencies as well as blockchain technology, which are two separate ideas that may very well have two different growth trajectories. The former has much more to do with economics than the latter, which may be useful where any data is stored/distributed.

As a quick distinction, cryptocurrencies (such as bitcoin and ether) are digital currency units without a backing from a government authority. Transactions involving cryptocurrencies are found on a blockchain (such as Bitcoin – notice the capital letter! – and Ethereum.) Blockchains are databases that, instead of being housed with a single central authority, are instead distributed across multiple systems, which proponents state allows for more privacy and reliability.

Since it is such a young space, there are a lot of cool ideas about how to use blockchain technology to revolutionize certain industries. Some of these ideas may work out and many will most likely not – however, the uncertainty is so high with these ideas that those in need of stability to offset the uncertainty that comes from smaller income streams in retirement are better off with most of their portfolios being invested in liquid asset classes with a longer history upon which to plan.

For an asset class that (as of this writing) sums up to basically 1% of the combined global value of equities and fixed income, cryptocurrency currently receives way more than its fair share of media attention. Why does it receive so much attention? Because it used to be an even smaller percentage (meaning it has increased in value recently) and it moves around a lot! Like a dog watching a tennis match, we are much more interested when the ball/price is moving back and forth.

Updating our standard deviation chart above shows the astronomical shallow risk involved in investing in cryptocurrencies.

Asset Class	Proxy	5 Yr SD
Cash	3-Month Treasury Bills	0.7%
Fixed Income	10-Year Treasury Bonds	4.7%
Equities	S&P 500 (dividends reinvested)	11.8%
Cryptocurrency	bitcoin	86.4%

Data: NYU, Investing.com

As noted above, volatility is not a bad thing if you are able to control your emotions and there is an expected return on the asset. There is no expected return on cryptocurrencies (or on normal currencies), as they do not generate cash flows for those who hold them. That does not mean you cannot sell some for more than you purchased them – just that you cannot calculate a value based on underlying attributes like you can for fixed income and equities.

An emotional element makes cryptocurrency seem more like a collectible (which can be priced and have an aesthetic/emotional value, like a piece of art) as opposed to a currency (since it only has limited acceptance as a medium of exchange and causes a taxable event when using it as such.) For someone to own cryptocurrencies and expect to be able to sell them later for more than they purchased them, he or she must have a certain level of faith without historical backing. Maybe that backing will arrive someday, but it takes years and years of data to prove an asset class' worth.

Like many topics nowadays, the discussion of cryptocurrency is turning into two sides entrenched in their beliefs in what is most likely an unhealthy manner. Opinion runs rampant, which makes it hard for me to discuss, as I would rather focus on the data (which requires less emotion.) The fervent proponents of cryptocurrency often use language to make those who do not have a familiarity with the subject come down. Hence why we continue to focus on maintaining a long-term perspective as it pertains to your financial plan. We are thankful for the confidence and trust you place in us. We sincerely hope you enjoy you and your families enjoy the rest of your summer, and we look forward to our next conversation with you.

**As a note, we are not able to directly purchase cryptocurrencies on your behalf if requested, as all cryptocurrency-related securities cannot be purchased or deposited in accounts in which Raymond James is the custodian.*

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Please Note: IF you are a RFP client, **Please advise us** if you have not been receiving account statements (at least quarterly) from the account custodian.

Cybersecurity

By: Jimmy Roth
Financial Advisor

In recent years, stories surrounding cybersecurity threats and identity theft have become more and more prominent. People continue to find ways to access information, which is why it is important to review your security settings and update them regularly in an effort to protect yourself.

Earlier this Spring, I was the victim of identity theft. A person was able to somehow print a counterfeit copy of my driver's license, but with his face on it. He then attempted to apply for a luxury high rise apartment and rent a car out of state in my name. Thankfully, I was able to halt the damage and retroactively clear everything up, however it was very time consuming and proved to be a big headache. All things being equal, the situation could have been even worse had I not had proper security settings enabled for my accounts. With that, I want to offer a few cybersecurity suggestions that may help you prevent someone from gaining unauthorized access to your information.

1. **Use strong passwords and use a password management tool.** It is a good habit to consider using longer passwords (at least 8 characters) with a mixture of upper-case letters, numbers, and even symbols. And while it is easy and convenient to use the same password for nearly everything, that habit can come back and bite you should someone get ahold of that singular password. It is a good idea to use different passwords for different accounts. (This is also where a password management tool can help you keep track of your different logins).

2. **Use Two Factor Authentication on everything** – your email account, bank account(s), social media, etc. In case you are unfamiliar with Two Factor Authentication, it is an extra layer of security on top of your username and password. You will be prompted to enter one additional authentication method (such as a passcode that gets texted to your cell phone) after entering your username and password. Yes, it can be a little annoying having to do this each time you log in, but it can help prevent outsiders from accessing your login information or even changing your password unless they have your phone. This leads me to my next suggestion:

3. **Use a passcode on your phone.** The benefits here are rather obvious – having a passcode helps prevent another person from unlocking and accessing the contents of your phone such as photos, documents, or even your email (which they can use to access and reset passwords to other accounts). Make sure you keep this passcode written down somewhere safe, and most importantly, ensure that your spouse and/ or another trusted family member has this code. This is very important. In the event something ever happens to you, it can be a real headache for surviving family members if they are unable to verify your two-factor authentication on your phone and/or reset passwords if needed.

4. **Be diligent and cautious of phishing scams.** We live in a day and age where spam calls seem to take up the lion's share of missed calls. And if that were not enough, we now must deal with spam text messages that claim to be from a banking institution requesting that you click on a link or enter your information. If you are ever unsure of the source, do not reply to a text and consider hanging up the phone from the caller. Instead, make an outbound call to the official institution and talk to a representative. Bottom line, be very wary of text/ emails/ calls from unknown senders.

5. **Check your credit report.** You can receive a free annual credit report from each of the three main credit bureaus (Experian, Equifax, and Transunion). These reports will give you a comprehensive list of your outstanding credit (including any debt that another person may have opened in your name). And, in a worst-case scenario, if someone else *has* opened new debt in your name, it is important to contact all three credit bureaus and have your credit frozen.

Individuals will only continue to get more and more creative as time progresses, which is why it is important to utilize the appropriate security measures moving forward. If you have questions about anything listed above, or would like to chat, please do not hesitate to reach out to us.
I hope you find these suggestions helpful and remain free from cybersecurity attacks and identity theft!

Around The Office Updates

Everybody Dance Now!

It seems that Kaylee (3 ¾) and Maggie (almost 1 ½) do not want to do anything other than dance these days. Kaylee recently performed in her annual dance recital (she crushed it!), and Maggie has been busy jamming to her favorite songs from the hit Australian children's music group, *The Wiggles!* (We listen to them so much that their songs are permanently etched into our brains). Their dance moves put all of us to shame.

Hole in One!

Abe (almost 1 ½) has been very busy this summer. He recently spent a week at Lake Travis with the whole family and made the most of every moment. While there, Abe spent lots of time floating in the pool, going out on the boat, eating delicious food, taking some afternoon naps, sinking lots of puts on the green, and cruising around in the golf cart! It is easy to see why everyone was vying to be Abe's golfing partner.

Thumbs up!

You may be wondering why Pete's thumb is currently in a splint. Last month, while building some new cabinets in his workshop, Pete's thumb made an unauthorized visit with his table saw – ouch! 10 stitches later, we are happy to report that his thumb is on the mend. In the meantime, Pete has decided to buy a new table saw that can detect fingers and instantaneously turning off. It is called a "Saw-Stop" and is one of the neatest inventions out there!

Looking Into Q3

Copies of Tax Returns

If we have not already received a copy of your 2020 tax return, we would like to get a copy from you at your convenience.

This allows us to maintain updated information as it relates to your financial plan.

Our Phone Line

As a quick reminder, our phone number (281) 973-8816 is a landline. As such, we cannot receive text messages on this line. If you are looking to get in touch with us and cannot make an outbound phone call, please send us an email.